SOCIAL SECURITY RETIREMENT BENEFITS (OR NOT?)

When the nation's Social Security system was established in 1935, governmental units, such as cities and towns, were precluded from participation. Congress changed the rules over the years and states received permission to set up voluntary (and irrevocable) agreements with the Social Security Administration (SSA) to provide Social Security coverage to state and local government employees.

These agreements, called Section 218 Agreements, cover positions, not individual employees. According to SSA rules, a referendum must be held under the "majority vote" process or under a "divided vote" process to institute a Section 218 Agreement. Under the former, all current and future employees become Social Security covered if the majority of employees votes in favor of coverage; under the latter, only those employees who vote "yes" and *all* future employees become covered.

It is important for cities and towns to know whether or not they are operating under a Section 218 Agreement. Fran Reina, the Internal Revenue Service's (IRS) Vermont Federal, State and Local Government Specialist, is currently working with Cynthia Webster, the Social Security Administrator for the State of Vermont, to ascertain the Section 218 status of our member municipalities. Until they complete their work, VLCT is not able to advise members of their Section 218 status. However, a general workshop explaining Section 218 Agreements is planned for Town Fair on September 30, 2004.

The other scenario for a municipality is the lack of a Section 218 Agreement. In this case, employees covered under a government pension plan do not have Social Security taxes withheld. (It is important to note that even without a Section 218 Agreement, payment by employees and employers into the Social Security Medicare fund is *required* for all employees hired on or after April 1, 1986. Also, temporary or other employees, such as some part-timers, who are not eligible for the municipality's pension plan must have Social Security taxes withheld.)

Employees who have earned benefits elsewhere under the Social Security system (or who might in the future) need to understand the potential impact on their Social Security benefits of working for a municipality that does not have a Section 218 Agreement. Depending upon several factors, the negative impact on their eventual Social Security benefits can be substantial. It is thus ethically incumbent upon municipalities to educate their current employees, as well as those being recruited, about this situation. Further, under a bill signed into law earlier this year, government employers *will be required to notify non-covered employees hired January 1, 2005 or later in writing of the potential effect of non-covered work upon their Social Security benefits.* You should have these employees sign a statement indicating that they understand that by working for your municipality their Social Security benefits could be subject to penalties. Applicants can be provided, before or during the actual hiring process, with copies of fact sheets downloaded from the SSA's Web site (www.ssa.gov) to aid in their understanding of the possible impact.

How these penalties are applied is complicated. The following outline is intended only to alert employers and employees to their possible impacts. For more detailed information, please contact Cynthia Webster (Vermont's Social Security Administrator, tel. 802/828-2302), your town attorney or accountant. There are two forms of potential penalties to a Social Security benefit when an individual works for an employer that does not withhold Social Security retirement taxes:

• The **Windfall Elimination Provision (WEP)** affects those who have earned a government pension and have also worked (or may in the future work) at a job(s) where they paid Social Security taxes long enough (40 quarters or ten years) to qualify for Social Security retirement or disability benefits. An exception is the case where an individual has 30 years or more of "substantial earnings" in a Social Security covered position(s.) To qualify as "substantial," earnings must meet a specific dollar amount as set out by the SSA based on the year in which earned. (For example, for 1970 the substantial earnings figure is $1,950; for 1980 it is $5,100 and for 2004 it is $16,275.) Those with 30 or more years of substantial earnings in a covered position are unaffected by work they perform outside the system.

• The **Government Pension Offset (GPO)** applies to those who receive a government pension and are eligible for Social Security benefits as a spouse, widow or widower.

Under the **Windfall Elimination Provision**, a modified formula is used to calculate a person's benefit. As its name implies, the reasoning behind the modification is to prevent a windfall to those who might unfairly benefit from Social Security provisions that were established to assist low-income workers.

Generally, social security benefits are based on a worker's average monthly earnings adjusted for inflation and referred to as "substantial earnings." These dollar amounts are separated into three parts, each being multiplied by a different percentage factor. For example, for a person retiring at age 62 in 2004, the first $612 is multiplied by 90%, the next $3,077 by 32% and any remaining dollar amount is multiplied by 15%. Under the WEP, however, the factor of 90% is reduced to 40% if you have between 10 and 20 years of substantial earnings. (The 32% and 15% remain the same.) If a person has between 21 and 30 years of substantial earnings, the factor increases with each year so that with 21 years it is 45%; 22 years, 50%; 23 years, 55 %, and so on, until at 30 years it reaches the 90% level (i.e. no penalty.) In other words, if you have fewer years of earning Social Security benefits because you worked for a municipality that did not have a Section 218 Agreement, your Social Security benefit will be lessened on the assumption that you have access to your municipal pension plan instead.

The **Government Pension Offset** affects the benefits of spouses, widows and widowers. These are "dependent's" benefits that were initially created to compensate spouses who stayed home to raise families and were financially dependent upon their working spouses. When both spouses work the law has always required that a person's spousal benefit be offset dollar for dollar by the amount of his or her own non-government pension benefit. The GPO was put into place in order to treat government employees in a similar manner as those in the private sector.

Essentially, under the GPO a spouse, widow or widower's benefits are reduced by two-thirds of that of his or her spouse or deceased spouse's government pension. Keep in mind, however, that a person without a government pension has his or her social security benefit offset dollar for dollar (rather than just two-thirds) by his or her own social security benefit. So the GPO is actually somewhat more favorable to those with government pensions than to those with social security benefits.

Further details are available on the Social Security Administrations Web site at www.ssa.gov. Click on Federal, State, & Local Government Employees in the lower right hand corner. Included are fact sheets on both the WEP (including a chart of "substantial earnings" and a chart of the incremental changes to the "90% factor") and the GPO. There is also a WEP Online Calculator available to help employees who are subject to the WEP estimate their future benefits. If you lack access to the Internet you may call your local Social Security Administration office, tel. 800/772-1213, for information and copies of fact sheets.

- Jill Muhr, VLCT Human Resources Administrator

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