Social Security Considerations for Government Employees

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When I spoke about Social Security planning at the NTSAA 403(b) Advisor Summit in Las Vegas last month, much of the discussion centered on the Government Pension Offset (GPO) and Windfall Elimination Provision (WEP) in Social Security. If you're an advisor who works with teachers, police officers, firefighters, government employees or the spouses of those workers, you need to be aware of these provisions and how they affect your clients.

While the GPO and WEP differ in who they affect and how they impact benefits, both are aimed at reducing Social Security benefits for people who receive a pension from work in which they did not pay into the Social Security system.

Government Pension Offset Explained

The GPO reduces a government employee's Social Security spousal and survivor benefits by two-thirds of their government pension. Normally, the Social Security spousal benefit is equal up to 50% of the retired or disabled worker's benefit and up to 100% of the deceased worker's benefit. GPO reduces the spousal and survivor benefit for spouses who also qualify for a government pension by two-thirds of the pension amount. If the pension from non-covered work is sufficiently large in comparison to the Social Security spousal benefit, GPO may eliminate the entire spousal or survivor benefit.

For example, Cindy worked in non-covered jobs her entire career and has a $3,000 a month pension. Her husband Bruce worked enough in Social Security-covered employment and is eligible for a $2,500 per month Social Security Benefit if he elects at age 66. Cindy is, therefore, eligible for a spousal benefit of up to $1,250 under Bruce's work history. However, under GPO Cindy's spousal benefit is reduced to $0 because two-thirds of her pension ($2,000) is greater than her spousal benefit ($1,250).

Upon Bruce's death, she would still get a survivor's benefit, but it would be only $500, rather than the $2,500 (at her full retirement age) she would get if the GPO did not apply.

GPO Example	Bruce	Cindy
Social Security Worker Benefit	$2,500	$0
Monthly Pension amount	$0	$3,000
Maximum Spousal Benefit	$0	$1,250
GPO Reduction ($3,000 x .66)	$0	$2,000
Actual Spousal Benefit ($2,000 - $1,250 = $0)	$0	$0
Survivor Benefit (What Cindy gets if Bruce Dies)	$0	$500

Windfall Elimination Provision Explained

The WEP reduces the Social Security benefits of people who qualify both a Social Security benefit *and* a government pension based on their own earnings. In order to understand how WEP affects benefits, you first need to understand the basics of how Social Security benefits are calculated. In general, a worker's monthly Social Security benefit is based on his or her 35 highest-paid years in Social Security-covered employment. The worker's earnings are indexed to wage growth to bring earlier years up to a current basis, then divided by 35 years, and divided again by 12 months per year to determine the Average Indexed Monthly Earnings (AIME). Once a worker's AIME is established, the Social Security Benefit Formula is applied to arrive at their Primary Insurance Amount (PIA).

Social Security Benefit Formula	
Factor	**Average Indexed Monthly Earnings (AIME)**
90%	Of the first $767
32%	Of earnings over 767 and through 4,624 plus
15%	Of earnings over $4,624

As you can see, the formula is progressive, which means workers with low average lifetime earnings will receive a larger proportion of their earnings as a Social Security benefit.

For someone who worked in the private sector for 10 years then changed careers to become a public employee who didn't pay Social Security taxes, their AIME would be relatively low because their 10 years of income would be averaged over 35 years. Therefore, the benefit formula would replace more of their earnings at 90% than someone who spent his or her full 35-year carrier in covered employment. This is known as a windfall. Under the WEP, instead of 90% of their first $767, this worker would only get 40%. Let's look at an example of someone with an AIME of $1,500.

Regular Benefit Formula		**Windfall Elimination Formula**	
90% of first $761	$684.90	40% of first $761	$304.40
32% of earnings over $761 and through $4,586	$236.48	32% of earnings over $761 and through $4,586	$236.48
15% over $4,586	$0.00	15% over $4,586	$0.00
Total PIA	**$921.38**	**Total PIA**	**$540.88**

The WEP reduced this worker's earnings by $380.50 per month. A worker's WEP reduction cannot exceed more than half of his or her pension. And workers who have 30 or more years of Social-Security-covered employment are exempt from WEP.

For each year over 20 of “Substantial Earnings” a worker receives a 5% addition to the percentage in the first bend point. For example, a worker with 22 years of Substantial Earnings would have a 50% factor, rather than 40% of the first $767.

How Many are Affected?

According to the Social Security Administration[1], GPO and WEP affect a relatively small portion of the population. In December 2009, the SSA reported that nearly 522,000 Social Security beneficiaries, or about 1.6% of all retired worker beneficiaries, had spousal benefits reduced by the GPO and 1.2 million Social Security beneficiaries were affected by the WEP (about 3.3% of retired workers). Of those 1.2 million, only 8% were spouses and children of affected workers. I would propose that the numbers are actually considerably larger (particularly spouses and children). If spouses were aware of the “restricted application” and it was a more common technique, a considerably larger portion would end up subjected to the WEP.

Take the example of Jim and Susan. Susan was a teacher who did tutoring on the side throughout her career. Jim was the higher earner. Under normal circumstances, which is all the SSA’s numbers above account for, Susan would be affected by WEP and Jim would fall into the 92% of spouses that SSA claims are unaffected. However, Jim and Susan’s advisor runs their numbers through Social Security Timing® and the software recommends that Jim file a restricted application, i.e. file for a spousal benefit under Susan’s record at age 66, then switch to his own benefit at age 70. In this scenario, which the above stats do not account for, Jim’s spousal benefit would be impacted because Susan’s total benefit has been reduced by WEP.

What’s at Stake?

The point of all this is to raise awareness of two issues: First, GPO and WEP affect a lot more people than even the government realizes. Second, there are ways to get more benefits for your clients by understanding these results and having a process like Social Security Timing® in place to identify optimal claiming strategies.

Let’s go back to the first example outlined in the explanation of the Government Pension offset explanation. Cindy’s entire spousal benefit was eliminated by GPO and after Bruce’s death she would only have received about $300 as a survivor benefit. A simple analysis by their advisor would have revealed that if Bruce were to delay his benefit to 70, the survivor benefit to Cindy would be $1,300. That could easily make the difference between whether Bruce should elect at full retirement age or delay. In short, we are happy to now be able to provide a process that incorporates both the WEP and GPO.

As an advisor who works with government employees, you need to not only be aware of how these provisions work and who they affect, you also need to understand that your clients are beginning to expect this kind of advice when it comes to Social Security. According to research conducted in 2011[2], 57% of married couples age 60-66 now expect Social Security advice from their financial planner. Another 56% said they would actually look for a new advisor if their current one didn't offer this kind of advice. In other words, when it comes to Social Security planning, your clients aren't the only ones who have something at stake.

[1]Social Security Administration, Office of Research, Evaluation and Statistics, January 2010
[2]Social Security Timing, *Social Security Planning: A Cornerstone of Your Financial Practice?,* 2011