Social Security and Government Employees

Part Two: Windfall Elimination Provision

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In Part One of this series of articles, we looked at certain types of government employees. These are people who have worked previously with a "non-covered" pension. That is, they worked at a job where they didn't have to pay Social Security (SS) withholding taxes (such as certain state and municipal employees), but still got a separate pension from the work they did.

The federal government has ways of adjusting any possible Social Security benefits to reflect this. Today we look at the Windfall Elimination Provision (WEP), which is used to reduce a worker's Social Security benefits to offset the perceived windfall.

How the WEP Works

The Primary Insurance Amount (PIA) is the basic Social Security monthly benefit at Full Retirement Age. The Windfall Elimination Provision produces a reduced PIA; for example, if Mr. Smith is subject to WEP, it means that a different formula will be used to calculate his PIA.

In effect, the WEP causes a portion of the retired or disabled worker's PIA to be reduced when the worker is covered under two separate retirement programs: one from non-Social Security covered employment and one from employment covered by Social Security (SS).

Assume Mr. Smith's retirement benefit from his years of ***non-SS covered employment*** is $900 per month. But during the last 15 years, he has worked in a job where both he and his new employer have paid Social Security taxes.

PIA Calculation

The standard PIA calculation favors the worker with lower earnings. As noted in the previous article (*Part One—The Basics,* Form 0013794), the PIA is based on a three-tiered calculation that provides a higher percentage (90 percent) of benefits for lower Social Security earnings (up to $926 Average Indexed Monthly Earnings for 2019).

Many workers have higher incomes that reach Tier 2 ($926 to $5,583 per month for 2019) and are calculated at 32 percent, or Tier 3 ($5,583 and above) which are calculated at 15 percent.

WEP Eliminates the "Windfall"

Because of his limited years of private sector employment, Mr. Smith's PIA will primarily be produced by the higher 90 percent first tier, even though his income during those years could have been substantial.

Remember that Social Security averages the highest 35 years, and when the number is less than 35, a zero is assumed for that year. Thus a high earner with a short history will get a relatively higher benefit. WEP is designed to reduce the benefit "windfall" derived from the higher percentage first-tier PIA benefit calculation.

An Example of the WEP

Let's assume that during Mr. Smith's 15 years of Social Security employment, he had sufficient Average Indexed Monthly Earnings (AIME) ($1,500) to generate a $1,017 "regular" PIA to supplement his $900 non-SS-covered pension.

But the non-covered pension changes things. Under normal circumstances, his Tier 1 benefit would be $833 (90% of $926). His Tier 2 benefit is $184 ($1,500 - $926 = $574 x 32%).

Thus, with an AIME of $1,500, the "regular" PIA would be $1,017 ($833 + $184). But under WEP, the 90 percent portion is replaced with 40 percent. The chart above shows how the revised PIA would be calculated.

Because of the WEP provision, his $1,017 full benefit is reduced by 46 percent to $554.

But this is a bit of an extreme case. Because of Mr. Smith's short history, the 90 percent Tier is reduced all the way to 40 percent. That is true for anyone with a Social Security-covered work history ("years of substantial earnings" in Social Security lingo) of 20 years or less. Remember, you need the equivalent of 10 years to qualify for a personal benefit at all.

On the other end, there is no WEP reduction if the worker has at least 30 years, regardless of any non-covered employment. For someone who had "substantial earnings" for more than 20 but less than 30 years, 5 percent is added for each year above 20.

Regular First-Tier Calculation		
90% of $926	=	$833
WEP First-Tier Reduced Calculation		
40% of $926	=	(370)
Reduction		$463
WEP Reduced PIA ($1,017 – $463)		$554

For example, if Mr. Smith had 25 years of substantial earnings, the 40 percent figure would be increased to 65 percent. By the way, the term "substantial earnings" is indexed. It is defined by the Social Security Administration as $24,675 or more in 2019.

Keep in mind that as bad as the WEP is, it can only go so far. There is a maximum amount that the PIA can be reduced. A worker's PIA will never be reduced by more than one half of the retirement benefits received from his or her non-covered employment. So the Social Security benefit will never go away completely.

The WEP and Spousal Benefits

Here's one interesting question: Does WEP affect Social Security *spousal* benefits? The answer is yes, but only indirectly.

Let's go back to our example. Assume Mrs. Smith qualifies for a spousal retirement benefit based on Mr. Smith's Social Security record. Her benefit will be derived from Mr. Smith's reduced $554 PIA—not his unreduced $1,017 PIA. So yes, the potential spousal benefit will be lower.

However, if Mrs. Smith qualifies for a ***surviving*** spouse's benefit, her benefit is based on his full unreduced $1,017 PIA. In other words, WEP does not affect survivor benefits.

Now for the scary part: A worker could be subject to WEP and not even know it. Worse yet, even Social Security may not realize it.

All Social Security sees is a few zeroes on the employment history. They have no way of knowing why that's the case. They even acknowledge this in the fine print of the Social Security statement. And they're not going to know, either, until Mr. Smith actually starts collecting the non-covered pension.

So in that situation, the Social Security statement itself can be wrong. Fortunately, the Security Mutual Life Social Security Evaluator includes a PIA calculator that can help evaluate your results in that situation.

In our next article we will look at Government Pension Offset (GPO). This is the provision that affects spousal and survivor benefits for this type of employee.

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