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Social Security Coverage for Employees of State and Local Governments

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In 2018, nearly all employees of private corporations in the United States, as well as U.S. nationals working for U.S. employers and certain subsidiaries of U.S. employers outside the U.S., are *mandatorily* covered by the U.S. Social Security program. In the vast majority of cases, neither the employees nor their employers have any choice in the matter. The law requires that they participate in the program and pay the mandatory payroll taxes. (Eligible employees are not required to apply for benefits, but nearly all do!) Mandatory Social Security coverage is also imposed on nearly all self-employed individuals who file U.S. income-tax returns and on Federal Government employees hired since Jan. 1, 1984.

Employees of state and local governments are different and follow their own special rules. Because of constitutional limitations on the Federal Government's ability to tax states (as employers, in the case of Social Security coverage), employees of state and local governments can be covered by Social Security in only two ways:

1. Mandatorily, for employees working in positions that are *not* covered by an employer-sponsored retirement plan considered to be "comparable" (as defined by IRS regulations) to the Social Security program, or

2. Voluntarily, for employees working in positions that are covered by a "comparable" employer-sponsored retirement plan.

Voluntary coverage of any state or local governmental employee group is effectuated by the group's employer, working through the appropriate state's Social Security Administrator, entering into an agreement with the Social Security Administration (SSA). These agreements became possible under the terms of Social Security Act section 218, which was first enacted into law back in 1950 and has been amended from time to time. Before 1950, state and local government employees simply could not be covered by Social Security.

Section 218 requires the employer desiring Social Security coverage for its employees to conduct a referendum among

employees in positions that would become covered by the proposed voluntary coverage agreement. If a majority of the employees vote in favor of being covered by Social Security, then the voluntary agreement goes into effect. In such cases, state and local governmental employees working in covered positions—and their employers—pay the same Social Security taxes as do private-sector employees and their employers. The employees become eligible to receive the same Social Security benefits under the same eligibility conditions as apply to private-sector employees.

In most states, the required referenda are all-or-nothing. In other words, if the affected employees vote yes, then all of them are covered, along with newly hired employees. But in 23 states listed in Social Security Act section 218(d)(6)(C), governmental employers can create so-called divided retirement systems. In those cases, coverage occurs only if a majority of affected employees votes yes, but the positions of employees who voted no can continue to be excluded from Social Security coverage. If a majority of existing employees vote yes in such a referendum, thereby approving it, then all **newly hired** employees are also covered by Social Security going forward.

At the current time, slightly more than 20 million people are employed by state and local governments across the U.S. Almost three-fourths of those employees are covered by Social Security, mostly under section 218 voluntary coverage agreements. The rest, about 5 to 6 million workers, do not have Social Security coverage in their current government jobs. Obviously, and importantly, many (even most) of these noncovered employees may have been or will be covered by Social Security in their previous, subsequent or even simultaneous other jobs, whether in the private sector or the public sector. Few people work their entire careers in noncovered employment.

The Social Security Act provides special benefit formulas for people receiving pensions based in whole, or in part, on employment that was not covered by Social Security. Fundamentally, the reasoning behind these special formulas is that people with employment histories split between covered and noncovered employment appear to the SSA (and to the Social Security program itself) to be poorer than they really are. In the absence of special rules, these not-really-poor people would be able to receive certain subsidies intended to go to lower-income workers and their families. The special formulas apply only to retirees **receiving pensions** based on noncovered employment because receipt of a pension represents a sort of threshold for determining whether the noncovered employment was substantial or not. People who worked for just a short time in noncovered employment generally have their benefits computed using the regular benefit formulas, without any adjustments.

The two special benefit formulas are as follows:

1. The government pension offset, or GPO, was first enacted into law in 1977 and significantly amended in 1983. That formula often prevents government retirees from receiving Social Security benefits as spouses or widow(er)s. The GPO does not affect the worker's **own** benefit (i.e., based on his or her own earnings record), just certain auxiliary benefits that the worker might otherwise be able to receive on a spouse's or former spouse's earnings record.

2. The windfall elimination provision, or WEP, was enacted into law in 1983 and provides a special benefit-computation formula for retired-worker benefits. The special formula removes some of the weighting in Social Security's usual benefit formula that gives higher replacement rates to low-income retirees. Most governmental retirees get much less of that weighting. The WEP, unlike the GPO, affects the worker's own benefit. Interestingly, the WEP does not affect the computation of benefits payable to the widow(er) of a worker whose benefit was computed using the WEP formula. After the worker's death, the WEP ceases to apply. Note that workers receiving governmental pensions that would normally trigger the WEP may be exempt if they have substantial enough covered employment.

This article has merely introduced, or scratched the surface, of some of the complex issues involved in providing Social Security coverage to employees of state and local governments and in computing the Social Security benefits of those who were not covered. These subjects will be covered in more detail in a series of articles planned for the next several issues of this newsletter. I hope that you look forward to learning more about this interesting subject.

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