Article from

In The Public Interest

July 2019
Issue 19

Voluntary Social Security Coverage of State and Local Government Employees

By Bruce D. Schobel

In 2019 nearly all employees of private-sector corporations in the United States, as well as U.S. nationals working for U.S. employers or certain foreign subsidiaries of U.S. employers, are mandatorily covered by the U.S. Social Security program. Almost none of these employees (or their employers) has any choice in the matter. The law requires that they participate in Social Security and pay the mandatory payroll taxes. (Eligible retirees are not required to apply for benefits, but nearly all do eventually!) Mandatory Social Security coverage is also imposed on nearly all self-employed individuals who file U.S. income-tax returns and have net earnings from self-employment exceeding a de minimis amount. Federal Government employees hired since Jan. 1, 1984, and a small number of very high-level employees (for example, members of Congress and Federal judges) hired before that date are mandatorily covered as well.

Employees of state and local governments are different and follow their own special rules. Because of constitutional concerns regarding 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 under present law:

1. Mandatorily for employees working in positions that are not covered by an employer-sponsored retirement plan deemed to be "comparable" to Social Security, or

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

The first situation, involving mandatory coverage of state and local government employees not covered by a retirement plan comparable to Social Security, was explained in the previous issue of *In the Public Interest* (January 2019). This article describes the second situation, voluntary coverage.

Governmental employees who are not covered by any employer-sponsored retirement plan, or who are covered by a plan that does not meet one of the Social Security comparability tests described in the previous issue, are mandatorily covered by Social Security. However, if such employees become covered by an employer-sponsored retirement plan that is comparable to Social Security, then mandatory coverage ceases. Depending on the governmental employer involved, they may then become covered under a voluntary-coverage agreement or remain non-covered by Social Security.

Voluntary coverage of any state or local governmental employee group must be effectuated, if at all, by the group's employer. Individual employees generally have no say in the matter, especially if they enter governmental service after a voluntary-coverage agreement has been put into effect. The employer, working through the employer's state Social Security Administrator (and every state has one), must enter into an agreement with the Social Security Administration (SSA) to cover certain positions—positions, not individuals—under Social Security. The employer agrees to withhold Social Security taxes from the affected individuals' wages and salaries, match those taxes with employer contributions (not technically taxes in this situation because they are voluntary), and remit those amounts to the Internal Revenue Service.

Voluntary Social Security coverage agreements for state and local government employees are allowed under the provisions of Social Security Act section 218, which was first enacted into law in 1950. Before then, state and local government employees simply could not be covered by Social Security under any circumstances.

Today, somewhat more than 20 million people are employed by state and local governments across the U.S. Almost three-quarters of those employees are covered by Social Security, mostly under section 218 voluntary-coverage agreements. A much smaller number, 2.4 million individuals, are covered mandatorily by Social Security under a provision enacted into law as section 11332 of the Omnibus Budget Reconciliation Act of 1990 (Public Law 101-508), effective on July 2, 1991. The relevant subsection of the Internal Revenue Code is 3121(b)(7)(F).
Social Security Act section 218 requires any governmental employer desiring Social Security coverage for some or all of its employees to conduct a referendum among employees working in positions that would become covered by the proposed voluntary-coverage agreement. If a majority of such employees votes in favor of being covered by Social Security, then the voluntary-coverage agreement goes into effect on a date specified by the agreement. In such cases, state and local governmental employees working in covered positions—and their employers—begin paying Social Security contributions at exactly the same rates as private-sector employees and their employers pay in Social Security taxes. Likewise, the governmental employees may become eligible to receive the same Social Security benefits under the same eligibility conditions (for example, age and coverage requirements) as apply to private-sector employees.

In most states, the required referenda to effectuate voluntary coverage for governmental groups are all-or-nothing. In other words, if a majority of the affected employees votes yes, then all of the employees are covered, including those who voted no, as well as all newly hired employees. But in 23 states listed in Social Security Act section 218(d)(6)(C),[1] 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 votes yes in such a referendum, thereby approving it, then all newly hired employees are also covered by Social Security going forward. Noncovered employees become a closed group that eventually disappears.

Before 1983, any governmental unit that had entered into a voluntary-coverage agreement under Social Security Act section 218 had an option under the law of terminating such agreement and becoming noncovered. Such terminations were fairly rare until the 1970s, when significant numbers of governmental employers began the process of withdrawing from coverage, for at least two reasons. First, they saw that Social Security was having serious financial problems at the time and began to question whether promised benefits would really be paid. Second, they believed that they could provide larger benefits to their employees by investing the amounts of Social Security contributions in the equity markets, instead. By 1980 or so, withdrawals of governmental employers from voluntary coverage began to have a noticeable financial effect on the Social Security program, exacerbating already severe financial problems that were caused by general economic conditions at the time. The sweeping Social Security Amendments of 1983 (Public Law 98-21, enacted into law on April 20, 1983) eliminated, going forward, the option of terminating voluntary Social Security coverage agreements. Effective upon enactment, governments that had entered into voluntary-coverage agreements could never terminate them, even though they had that right at the time the agreements went into effect. The constitutionality of the provision that terminated opting-out, as it was called, was upheld by the U.S. Supreme Court in *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986). Of course, any governmental unit entering into a voluntary-coverage agreement after the effective date of the Social Security Amendments of 1983 knew that such agreement would be irrevocable.

About six million state and local governmental employees do not have Social Security coverage in their current government jobs, either mandatorily or voluntarily. Such noncovered workers may, however, receive Social Security benefits when they reach Social Security's eligibility age, based on other employment. 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. Relatively few people work their entire careers in noncovered employment. And workers with 40 coverage credits—about 10 years of work in Social

About six million state and local governmental employees do not have Social Security coverage in their current government jobs.

Security–covered employment or self-employment—qualify for Social Security retired-worker benefits at age 62. That much covered employment is fairly easy to obtain, even for workers whose primary employment was noncovered. In 2019, workers with just $5,440 in Social Security–covered earnings receive four coverage credits for the year, without regard to how many days they actually worked during the year.

Workers with careers split between covered and noncovered employment (not necessarily at the same time) may not receive the same benefits that workers with only covered employment receive. The Social Security Act provides two special benefit formulas for people receiving pensions based in whole or in part on employment that was not covered by Social Security. Those special benefit–computation formulas will be described in the next article in this series. ■

Bruce D. Schobel, FSA, MAAA, is located in Winter Garden, Fla. He can be reached at *bdschobel@aol.com.*

ENDNOTE

1 Alaska, California, Connecticut, Florida, Georgia, Illinois, Kentucky, Louisiana, Massachusetts, Minnesota, Nevada, New Jersey, New Mexico, New York, North Dakota, Pennsylvania, Rhode Island, Tennessee, Texas, Vermont, Washington, Wisconsin, or Hawaii, or any political subdivision of any such state. Interestingly, Hawaii appears last (violating alphabetical order) because it was originally included in this list as a territory and subsequently became a state. This list of states allowing divided-retirement systems has changed over the years, but not recently.