Social Security, Retirement Benefits, and Divorce

November 2009

Social Security in the United States refers directly to a lesser known federal Old Age, Survivors and Disability Insurance program or OASDI. The program was originally rolled out in the 1930's in an attempt to limit what were seen as dangers to the American way of life such as increased life expectancy, poverty, and fatherless children. So the Social Security Act, signed in 1935, created social insurance programs to provide benefits to retirees, the unemployed, and as well as a lump sum benefit to the family at death. Many amendments have been made since the original Social Security Act of 1935. Most importantly; Medicare was added in 1965. The Social Security Act of 1965 also recognized for the first time that divorce was becoming a common cause for the end of marriages and added divorcees to the beneficiary list.

The largest component of benefits is retirement income. Throughout a person's working life the Social Security Administration keeps track of income and taxpayers fund the program via payroll taxes also known as FICA (Federal Insurance Contributions Act) taxes. The amount of the monthly benefit to which the worker is entitled depends upon the earnings record and upon the age at which the retiree chooses to begin receiving benefits. FICA taxes are 7.65% for employees and 15.3% for self employed individuals. The amount of taxes paid is not directly used to calculate an individual's benefit. The rate is broken down into two parts: Social Security and Medicare. The Social Security portion is 6.2% and is paid on a maximum of $106,800 of income for 2009. The income maximum is also known as a wage base. The Medicare portion is 1.45% on all earnings. These rates are set by law and haven't changed since 1990. The wage base for Social Security is indexed each year for inflation and Medicare has maintained an unlimited base since 1993. Self employed person's pay double the amount of tax because the employer is responsible for the other half of an employee's liability. A self employed individual is both employer and employee. There are wages not subject to FICA taxes including some state and local government employees who participate in alternative programs such as CalSTRS and CalPERS. Each state and local government unit with a pension plan decides whether to elect Social Security and Medicare coverage. Civilian federal employees are covered by Medicare but usually not Social Security.

The earliest age at which reduced benefits are payable is 62. The age at which full retirement benefits are available is dependent upon the taxpayers age. An increase of regular retirement age was enacted to reduce the amount of benefits payable. For those currently over age 70 the normal age was 65. Anyone born after will fall somewhere on increasing scale which climbs incrementally to age 67 depending upon birth date. Anyone born after 1960 must reach age 67 for normal retirement benefits. Delaying receipt of benefits will increase a taxpayer's benefit until age 70.

Benefits are paid from taxes collected from other tax-payers. This makes Social Security a pay as you go system and will eventually be directly responsible for the downfall of the program. At least as we know it today. In 2009, nearly 51 million Americans will receive $650 billion in Social Security Benefits. Economists project that payroll taxes will no longer be sufficient to fund benefits somewhere in the next 10 to 15 years. Once we can't cover the expense from cash flow, the program will begin drawing down the trust fund it has accumulated during times of surplus taxes. We can only speculate what happens when the trust fund runs out. This is the cause for concern often discussed in the news and other media. The fix for this problem is the subject of much political posturing including that witnessed in President Bush's 2005 State of the Union address.

The first reported Social Security payment was to Ernest Ackerman, who retired only one day after Social Security began. Five cents were withheld from his pay during that period, and he received a lump-sum payout of seventeen cents from Social Security. This might give you an indication of how Social Security handles business.

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A current spouse is eligible to receive survivor benefits equal to 100% of the deceased worker's benefit if they have reached normal retirement age.

Divorced spouses are eligible for benefits equal to one half of the worker's benefit if they were married for 10 years have not remarried and are at least 62 years old. This is called a derivative benefit. A spousal applicant must wait until the worker has reached retirement age, 62, in order to apply for benefits. The worker is not required to have applied for benefits in order for the ex-spouse to apply for spousal benefits. They are not entitled to increases for benefits taken after normal retirement age. If a worker has died and the ex-spouse has reached full retirement age they can receive 100% of the worker's benefit as survivor benefits.

If an applicant is between age 62 and their normal retirement age; the application for benefits will be based on the applicant's earnings record. If one half of an ex-spouse's benefit is greater than the applicant's benefit on their own record; the applicant can choose to take whichever is greater. If you wait until your normal retirement age and file for spousal benefits you can continue to accrue benefits and enhancements for delaying your own retirement up until your age 70.

An ex-spouse's receipt of derivative benefits on the worker's record does not reduce the worker's benefits. It is even possible for more than one ex-spouse to collect on the worker's derivative benefits. This could lead to as much as 500% of the original benefit being claimed by the five ex-spouses.

Windfall Elimination Provision and Government Pension Offset Provision
For those worker's who are covered by a pension based on their own earnings not covered by Social Security a different method of computing benefits applies. The alternative method is called the Windfall Elimination Provision (WEP) and was created to close a loophole that enabled worker's who earned benefits in covered and non-covered employment from being labeled a low-earning worker and receiving a disproportionately large Social Security benefit. The Social Security formula is weighted in favor of low earners because such a person is more dependent on Social Security. If the WEP is applicable it reduces a worker's Social Security benefit by 50% of the worker's pension benefit up to a maximum of $380.50 in 2010.

If you earned a pension based on work where you did not pay Social Security taxes, your Social Security spousal or derivative benefits may be reduced. The Government Pension Offset Provision (GPO) was enacted to treat retired government employees who had not contributed to Social Security similarly to retirees who had. The GPO reduces derivative benefits by two-thirds of other government pensions received. This can reduce Social Security benefits to zero.

The truly important ramification of the WEP and GPO on Social Security retirement benefits comes into play during divorce proceedings. Federal Law makes Social Security benefits the separate property of the party that earned them. They are not assignable or divisible in a family law court and not considered an asset of the community in California. Government and other pensions, on the other hand, are considered community property in the state of California to the extent benefits were earned during marriage. Derivative benefits under the Social Security program for ex-spouses would seem, at first glance to remedy the problem. The non-worker spouse get's half of the worker's retirement benefit via derivative benefit payments. Getting to the true ramifications of the WEP and GPO during divorce proceedings requires sound financial planning.

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Consider the following couple.
- Jim was a private employee covered by the Social Security system. He retired at age 66 with a monthly Social Security benefit of $2,014.
- Barbara has been employed as a teacher for 30 years covered by the California State Teacher's Retirement System. She retired this year at age 65 with 30 years of service under CalSTRS and a monthly benefit of $5,520 without having paid a single penny into Social Security.
- Barbara's CalSTRS benefits are considered community property in California having been earned entirely during marriage.
- Jim and Barbara are divorcing and her CalSTRS pension will be divided equally with each party receiving $2,760.
- Jim will continue to receive his $2,014 per month of Social Security.
- Barbara will be entitled to a derivative Social Security benefit equal to one half of Jim's benefit, $1,007, or the benefit she has earned on her own record. Barbara has not earned a benefit on her own record so she will choose to receive the derivative benefit on Jim's record.
- The Government Pension Offset will reduce Barbara's Social Security benefits by two thirds of her $2,760 pension benefit, or $1,839.82. The GPO leaves Barbara with $0 from the Social Security derivative benefit.
- Barbara will receive a total of $2,760 from her CalSTRS Pension and $0 from Jim's Social Security derivative benefit.
- Jim's Social Security benefits will not be affected by the GPO or WEP.
- Jim will receive $2,760 from Barbara's CalSTRS benefit and $2,014 from his Social Security retirement benefits for a total of $4,776.

What looks to the lay person to be an appropriately arranged method for completing an equal division of assets leads to a grossly in-equitable settlement that provides Jim with $4,776 per month and Barbara with $2,760 per month.

The California Federation of Teachers sponsored a rally on November 7th to urge Congress to pass SR 484 in the Senate and HR 235 in the House of Representatives to repeal the Government Pension Offset and Windfall Elimination Provision. This has been attempted numerous times before without success. Social Security is a monster of finances, public policy and entitlement. Making changes is not easy or quick.

Consulting with a qualified financial planner experienced in the nuances of divorce finances and retaining their services as a neutral expert or advisor will help divorcing individuals work with and around in-equities caused by the system.

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