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# AARO 2020 Advocacy Survey Results

## Article 11: My Social Security Was Reduced!

### It's called WEP

In Article No. 10, we addressed your difficulties with defined contribution retirement plans. In this article we conclude our focus on retirement, examining Social Security and the Windfall Elimination Provision (WEP).

Imagine the situation of Lois, an American who worked in the US for the first half of her career, moved overseas to finish her career, and now decides to retire in her country of residence. For the last several years she has received annual Statements from the US Social Security Administration (SSA), indicating how much she will get in Social Security (SS) at various retirement ages.

Lois planned the age of her retirement on that Statement. She calculated her projected total retirement income based on the SS benefit amount, adding to that her small US private pension and projected withdrawals from her small US defined contribution plan (see [Article 10](#)), to which she added the estimated retirement income from her overseas pension. She does not have a defined contribution plan in her country of residence (opening one was not worthwhile (see [Article 10](#))). She thought that she had a good idea of what her income would be in retirement, and SS benefits would have been a sizable part of it.

Lois signs up for SS and her overseas pension and, to her shock and dismay, finds out that her SS will be reduced by almost \$500/month because of the overseas pension.

Lois, welcome to WEP.

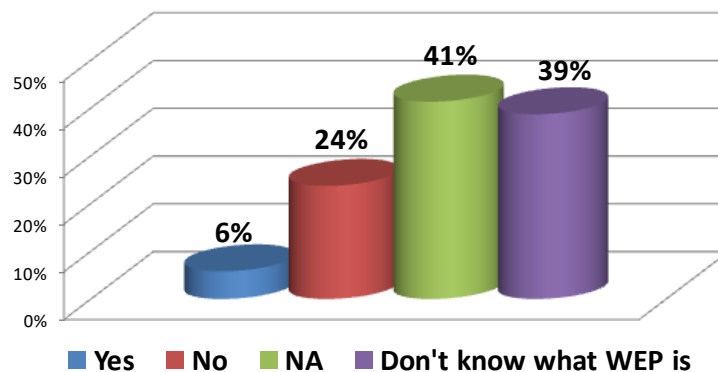
### What is WEP?

WEP is a formula by which the US reduces SS benefits to people who are also entitled to pension benefits from jobs not covered by the SS system (such as SS-like benefits earned by overseas Americans from foreign employment).

## Many don't know what WEP is

In the survey we asked you the question: “Have your Social Security benefits been reduced due to the Windfall Elimination Provision (WEP)?” and found that many of our respondents (39%) do not know what WEP is, as you can see by the chart below.

**Have your SS Benefits been Reduced due to WEP?**



This is unfortunate because knowing if one would be subject to WEP (we call this “to be WEPT”) would help one to plan better for retirement (save more or work longer). With proper planning, a few can even avoid being WEPT. We assume that some of the 41% who chose “Not Applicable” are not yet retired and may someday be confronted with WEP.

So, this article will focus on the ABC's of WEP.

## Social Security Benefits

Why does WEP exist? How much can one be WEPT? In order to understand that, one needs to first have a basic understanding of how SS benefits are calculated.

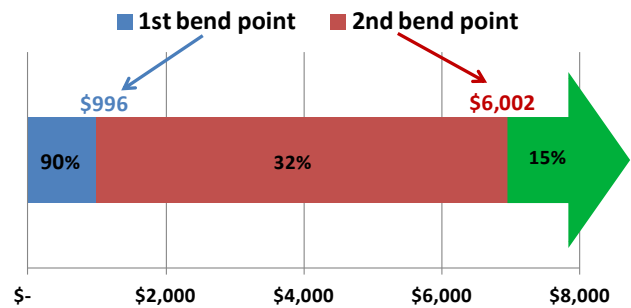
### That 6.2% withholding is my money for retirement, right?

Wrong. SS is not a defined contribution retirement plan, not like an IRA nor a 410(k). One does not receive back the amounts one has put in. You did not contribute 6.2% of your wages (12.4% for the self employed) in savings for your future; you were paying the benefits for someone who was already retired with the expectation that someone will do that for you when you retire. Basically, people who work support the people who have retired.

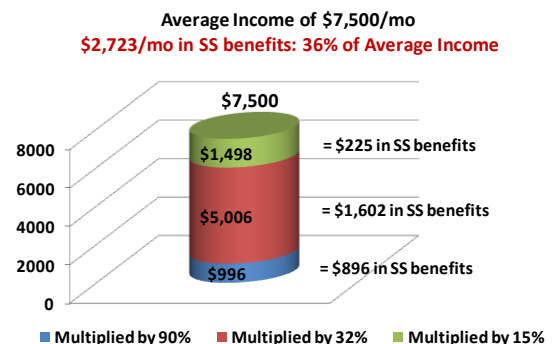
## Calculating SS benefits

The SS benefits formula is weighted to pay a proportionately greater amount to low-paid workers than to high-paid workers. Here is how it works:

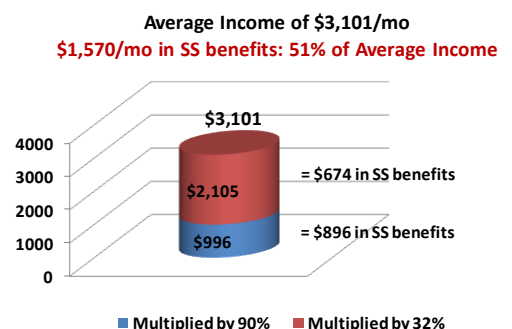
1. First, the SSA adjusts your historical annual earnings for wage inflation using its average wage index for the year in which you turn 60. This is a complicated calculation, not addressed here since overseas Americans are treated the same as US residents.
2. Then, the SSA adds up your 35 highest years of income and divides that sum by 420 (12 months x 35 years). The end result is your average indexed monthly earnings (Average Income).
3. The percentage of your Average Income returned in SS benefits is divided into 3 brackets: 90 %, 32% and 15%. These resemble tax brackets, but the SSA calls them “bend points” (i.e., monthly income thresholds). The SSA uses the bend points to calculate the amount you’ll receive from SS at full retirement age. In 2021, the 1<sup>st</sup> bend point occurs at \$996 and the 2<sup>nd</sup> occurs at \$6,002. See the chart above right. The bend points vary annually with wage inflation.
4. The SSA will give you SS benefits equal to (a) 90% of your Average Income up to \$996, (b) 32% of your Average Income over \$996 and through \$6,002, and (c) 15% for any Average Income above \$6,002.



Let’s compare the situations of Lois and Clark. Clark worked his entire career in the US and has Average Income of \$7,500/month. His calculation is shown in the chart at right: 90% of the first \$996 + 32% of the \$5,006 tranche up to the 2<sup>nd</sup> bend point + 15% of the remaining \$1,498 above the 2<sup>nd</sup> bend point = **\$2,723 in benefits. So, Clark’s monthly SS benefits at full retirement age would equal 36% of his Average Income.**



Lois earned the same as Clark until she moved overseas in mid career. Her Average Income is, mathematically, cut down to \$3,101 because her 35-year average contains 17 zeros for the last (higher earning) half of her career. See the chart at right. Her calculation is as follows: 90% of the first \$996 + 32% of the \$2,105 tranche above the 1<sup>st</sup> bend point = **\$1,570 in benefits. Although she earned the same as Clark the first half of her career, Lois would get more “bang for her buck,” 51% of Average Income, at full retirement age, plus whatever**



overseas pension she earned during her 17 1/2 years overseas.

SS benefits typically replace roughly 40%.of the average retiree's Average Income. The 90% bracket in the bend point formula weighs in favor of lower income workers so, for example, SS benefits approach a 50% return for someone with Average Income of \$3,000 per month, reaching 70% for those with Average Income of \$1,500. But the weighting of the formula has also favored Lois, who has another pension.

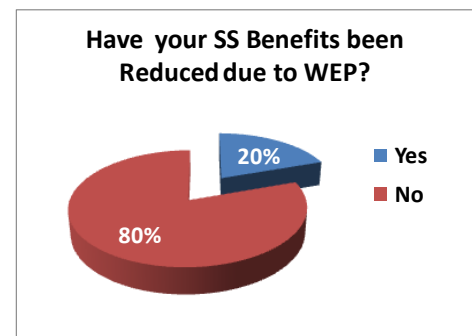
## How much can WEP cost me? Who are WEPT?

WEP reduces the % in the first bend point from 90% to 40%. Therefore, for 2021, the maximum one can be WEPT is \$498 (90% of \$996 minus 40% of \$996), but WEP is capped at 50% of the other pension. To put it another way: Maximum WEP is the smaller of \$498 and 50% of the other pension. The number \$498 changes every year along with the bend point adjustments.

Lois will be WEPT. Her SS of \$1,570 will be reduced by the maximum down to \$1,072 because her overseas pension is the dollar equivalent of \$1,000 per month. So, instead of having a combined \$2,570 from her pensions, as she had thought based on her SS Statements, she will instead have a much smaller aggregate of \$2,072.

WEP only applies to other public pensions; private retirement plans do not trigger WEP. WEPT persons can include US State and local governmental employees (who are covered by alternative pension plans), as well as overseas Americans who receive SS-type pensions abroad. According to the SSA, as of January 1, 2020, 81,137 retired overseas workers were WEPT (103,848, when you add the disabled, spouses and children), approximately 8.6% of retired overseas workers.

The answers to the WEP question in the survey, counting only those who knew what it was and for whom the question was applicable (presumably, those already taking SS) show that 20% of our respondents are WEPT. The significantly higher WEPT % of our survey respondents seems to indicate that they are more affected than, and not representative of, Americans abroad in general.



## Why does WEP exist?

The purpose of SS is to replace a portion of the income one had while working. Since some people will have had a lifetime of low earnings, the payment calculation is progressive, weighted so as to protect those people from penury when they retire. That is why people who have low Average Income all their life get a bigger SS payment, on a % basis, than someone who had earned more.

The benefit formula, however, does not distinguish between lifetime low income workers and persons who appear to have low Average Income because they worked for many years outside the SS system (such as Lois). This is because those years show up as zeros in their SS earnings records, which, when averaged, lower their earnings. Lois, for example, moved overseas after 17 1/2 years in SS-covered employment. Even though she did have a full career, she had a relatively short career in the eyes of the SSA, so Lois would have benefitted from the weighted formula.

According to the SSA, unreported earnings from another pension (such as foreign pensions earned by overseas Americans) distort a person's "true" economic status in the sense that that person's lifetime earnings and, therefore, income in retirement, are higher than shown in the SS system. So, according to the SSA, calculating such an SS benefit using the 90% bracket would be an unintended "windfall."

The WEP, meant to rectify this unintended "over-generosity," was part of the 1983 SS reform, a package needed to shore up the financing of the SS program. The SSA says that the WEP reduction in benefits is designed to put affected persons in approximately the same position they would have been had all their earnings been covered by SS. But, for overseas Americans, whether that is true depends on the amount of the overseas pension.

## Exceptions to WEP

WEP doesn't apply to:

1. Federal workers first hired after December 31, 1983
2. Employees of certain non-profit organizations
3. Railroad pensioners
4. Persons whose only work for which they didn't pay SS taxes was before 1957
5. Persons with 30 or more years of "substantial earnings"
6. Persons who receive foreign pensions after 1994 based on a totalization agreement with the US

We address below the 5<sup>th</sup> and 6<sup>th</sup> exceptions, as they are more likely to affect overseas Americans.

### Substantial earnings

The chart below shows the amount of earnings that count towards the exception.

- Those who have 30 years or more of substantial earnings avoid WEP entirely
- For those with 21-29 years of substantial earnings, WEP is reduced

- Those with 20 years or less of substantial earnings are fully WEPT

1980	\$5,100	1988	\$8,400	1996	\$11,625	2004	\$16,275	2014	\$21,750
1981	\$5,550	1989	\$8,925	1997	\$12,150	2005	\$16,725	2015	\$22,050
1982	\$6,075	1990	\$9,525	1998	\$12,675	2006	\$17,475	2016	\$22,050
1983	\$6,675	1991	\$9,900	1999	\$13,425	2007	\$18,150	2017	\$23,625
1984	\$7,050	1992	\$10,350	2000	\$14,175	2008	\$18,975	2018	\$23,850
1985	\$7,425	1993	\$10,725	2001	\$14,925	2009-2011	\$19,800	2019	\$24,675
1986	\$7,825	1994	\$11,250	2002	\$15,750	2012	\$20,475	2020	\$25,575
1987	\$8,175	1995	\$11,325	2003	\$16,125	2013	\$21,075	2021	\$26,550

## Totalization agreements

Exception No. 6 does not appear in SSA Publication No. 05-10045 (the official WEP publication), so many retirees are not aware of it. But it is essential for overseas Americans.

A bilateral intergovernmental agreement on social security is called a totalization agreement. These agreements coordinate the US SS program with social insurance programs of other countries, so as to provide benefit protection to workers who divide their careers between the US and another country. These agreements ease the access to a pension in that, if you have insufficient number of credits/years in either country (the US and/or the country of residence), you can use years of work from the other to create eligibility. This will not, however, increase the amount of benefits. The US has such agreements with approximately 25-30 countries.

Application of this exception is complicated: First, you need to have earned credits in a country with which the US has such an agreement. Second, you only avoid the WEP reduction if you needed and used the totalization agreement in the country of your other pension to establish entitlement to benefits in that country. If you didn't need the totalization agreement, you cannot use this exception and you could be WEPT.

Only pensions that are based on work trigger the WEP reduction. Some countries which have totalization agreements with the US grant pensions based upon non-work factors (such as residence). These pensions that do not trigger the WEP reduction are at right:

Australia	Social Security
Canada	Old-Age Security
Denmark	Folkepension
Finland	National Pension Scheme
Netherlands	National Insurance Scheme
Norway	Basic Pension Program
Sweden	Basic Pension Program

## What can I do?

If you are not yet overseas, and plan to move overseas to work for a US employer, consider the substantial earnings calculation. Maybe you can arrange with your employer to continue to pay a part of your salary in the US to optimize this exception (although, generally, one can only do this for up to 5 years).

Find out if your country of residence has a totalization agreement with the US and research whether you would need it to get the overseas pension. Like tax treaties, not all totalization agreements are the same.

If you think that you will be WEPT, go to the SSA website online calculator at [WEP Calculator](#) to calculate your WEP and plan your retirement savings accordingly.

If you will get a foreign pension based on a totalization agreement with the US, ensure that you receive a document (e.g., award notice or letter) issued by the foreign agency paying the pension indicating that the pension was based on this agreement. We call this the “magic language.”

France: There is a French/US totalization agreement, but the exception in this country is tricky: You can avoid WEP if you time the request for your French pension correctly, and you can be WEPT if you don't. Here, simplistically, is how it works:

- One is eligible for a French pension easily, needing only one quarter (*trimestre*) of employment, but getting the maximum percentage (*taux plein*) (50%) at the legal retirement age (generally, 62) is generally impossible for overseas Americans who have started their careers elsewhere, because one also needs to have earned a minimum number of *trimestres* and they will likely not have all the *trimestres* necessary for *taux plein* at this age. But, at an automatic maximum age (65- 67, according to year of birth), one gets the *taux plein* regardless of the number of *trimestres*. This means that:
  - If you file for French retirement before your automatic maximum age (65- 67), you will likely need to use the totalization agreement to get more *trimestres*, thereby avoiding WEP.
  - If you wait until you reach the automatic maximum age to file for French retirement, you are automatically deemed to be at *taux plein*; you will no longer need the totalization agreement for that purpose, so your SS benefits are likely subject to the WEP reduction.

The interplay between *taux plein* and WEP is complex; make sure you understand how this works in your situation prior to filing for French retirement benefits.

## AARO's advocacy

AARO's mission is to inform its members of the conditions for accessing SS. To that end, we have written this article. We hope that the SS calculation and the WEP issue are now clearer.

AARO believes that WEP is unfair because it substantially reduces a benefit that overseas Americans may have planned for and have included in their retirement plans. Also, the arbitrary 90% to 40% factor in the WEP formula is an imprecise way to determine the actual windfall when applied to individual cases. AARO has

supported recent legislation that would either eliminate WEP for some affected beneficiaries, including those with foreign pensions, or replace the current provision with a new proportional formula based on past earnings from both SS-covered and non-SS covered employment.

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The Association of Americans Resident Overseas (AARO) researches issues that significantly affect the lives of overseas Americans and keeps its members informed on these issues. Founded in 1973 and headquartered in Paris, AARO is an international, non-partisan association with members in 46 countries. For more information please email us at [contact@aaro.org](mailto:contact@aaro.org).

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