



**Retirement and Insurance Service
Benefits Administration Letter**

Number: 05-306

Date: October 20, 2005

Subject: CSRS Withholdings for CSRS-Offset Employees

In 2002, we issued several Benefits Administration Letters (BAL) pertaining to CSRS deductions for CSRS-Offset employees participating in Health Benefits Premium Conversion (HB-PC). Because we continue to get questions relating to CSRS deductions for CSRS-Offset employees - whether they are participating in HB-PC or not - we have reviewed our previous guidance and believe that we need to clarify how non-basic pay affects the CSRS-Offset deduction. Specifically, we want to clarify when payroll offices should revert from withholding deductions at the reduced CSRS rate (0.8 percent of basic pay for most CSRS-Offset employees) to withholding CSRS deduction at the full CSRS rate (7 percent of base pay for most CSRS employees) for CSRS-Offset employees whose annual earnings exceed the Social Security contribution and benefit base.

Principal Ideas Discussed in This BAL

- While the total withholdings from a CSRS-Offset employee's salary for CSRS deductions and Social Security Old Age, Survivors, and Disability Insurance (OASDI) should normally equal the "full" CSRS withholding rate (7, 7 ½, or 8 percent), the total withholdings sometimes may be less than the "full" CSRS withholding rate if the employee's total taxable wages (including non-basic pay wages) reach the contribution and benefit base before the employee's taxable basic pay wages.
- Payroll offices need to track two separate "contribution and benefit base" amounts for CSRS-Offset employees - one to determine when OASDI tax withholding should cease during a calendar year and one to determine when the reduced CSRS deduction rate should revert to the full CSRS deduction rate.
- The contribution and benefit base affecting the OASDI tax withholding should include basic pay wages (after applying pre-tax deductions such as HB-PC, flexible spending accounts (FSAs), and annuity offset for reemployed CSRS-Offset annuitants) and non-basic pay wages.

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Program*

- The contribution and benefit base affecting the CSRS deduction should only include basic pay wages (after applying pre-tax deductions such as HB-PC, FSAs, and annuity offset for reemployed CSRS-Offset annuitants).

Reduced CSRS Deduction Rate for CSRS-Offset Employee

When Congress defined the retirement deduction rate for CSRS-Offset employees in the Federal Employees' Retirement System Act of 1986 (FERSA), it established a reduced rate on basic pay wages subject to OASDI tax.

“With respect to Federal wages of an employee or Member (or that portion thereof) not exceeding the contribution and benefit base during the calendar year involved, the appropriate amount to be deducted and withheld under this subsection is the amount by which-

- (i) the total deduction for those wages (or for that portion) exceeds;*
- (ii) the OASDI contribution with respect to those wages (or that portion).”*
(5 U.S.C. 8334(k)(2)(A))

The contribution and benefit base referenced in the law defines the maximum amount of earnings in a calendar year that is subject to Social Security Old Age, Survivors, and Disability Insurance (OASDI) tax. When an employee's taxable wages reach the contribution and benefit base in a calendar year, the OASDI tax stops. Although basic pay wages and non-basic pay wages must be counted in determining when an employee's taxable wages reach the contribution and benefit base for OASDI tax purposes, FERSA specified that only basic pay wages be counted in determining when the employee's taxable wages reach the contribution and benefit base for retirement deduction purposes (see definition of OASDI contribution at 5 U.S.C. 8334(k)(2)(C)(iv)). Thus it is possible to have retirement deductions based on the reduced deduction rate even after the OASDI tax withholding stops in a calendar year. When we issued regulations implementing the CSRS-Offset deduction provisions, we specifically addressed this kind of situation at 5 CFR 831.1003(d):

“For any amount of Federal wages paid after reaching the contribution and benefit base calculated including all wages, but before reaching the contribution and benefit base calculated using only Federal wages, the amount withheld under this section is the difference between 7, 7 ½, or 8 percent, as appropriate, and the OASDI tax rate, even though the Federal wages in question are not subject to the OASDI tax.” (Note: the term “Federal wages” in the regulation means basic pay.)

Consequently, a payroll office may still have to withhold retirement deductions at the reduced CSRS rate even after it has stopped the OASDI tax withholding. When that happens, the total withholding from the CSRS-Offset employee's pay for retirement and OASDI tax, which usually equals the full CSRS deduction rate, will be less than the full CSRS deduction rate.

To illustrate this point, we've included a pay-period by pay-period break down of a CSRS-Offset

employee's earnings in calendar year 2004, when the contribution and benefit base was \$87,900. The employee earned a salary of \$105,900 a year (unchanged from 2003). She received \$10,000 of non-basic pay wages early in 2004. She did not participate in FEHB-PC.

2004 Earnings

Pay Period	Basic Pay Wages	OASDI Tax on Basic Pay	CSRS Deduction	Total OASDI Tax and CSRS Deduction	Non-Basic Pay Wages	Contribution and Benefit Base for OASDI Tax	Contribution and Benefit Base for CSRS Deductions
1	\$4,059.20	\$251.67	\$32.47	\$284.14 (7%)	----	\$4,059.20	\$4,059.20
2	\$4,059.20	\$251.67	\$32.47	\$284.14 (7%)	----	\$8,118.40	\$8,118.40
3	\$4,059.20	\$251.67	\$32.47	\$284.14 (7%)	\$5,000 (OASDI = \$310)	\$17,177.60	\$12,177.60
4	\$4,059.20	\$251.67	\$32.47	\$284.14 (7%)	----	\$21,236.80	\$16,236.80
↓	Pay during pay-periods 5-7 remained unchanged.						
8	\$4,059.20	\$251.67	\$32.47	\$284.14 (7%)	\$5,000 (OASDI = \$310)	\$42,473.60	\$32,473.60
9	\$4,059.20	\$251.67	\$32.47	\$284.14 (7%)	----	\$46,532.80	\$36,532.80
↓	Pay during pay-periods 10-18 remained unchanged.						
19	\$4,059.20	\$251.67	\$32.47	\$284.14 (7%)	----	\$87,124.80	\$77,124.80
20	\$4,059.20	\$48.06	\$32.47	\$80.53 (1.98%)	----	\$87,900	\$81,184.00
21	\$4,059.20	----	\$32.47	\$32.47 (0.8%)	----		\$85,243.20
22	\$4,059.20	----	\$119.42	\$119.42 (2.94%)	----		\$87,900
23-26	\$4,059.20	----	\$284.14	\$284.14 (7%)	----		
Totals	\$105,539.20	\$4,829.79	\$1,937.85	\$6,767.64	\$10,000 (OASDI = \$620)		

For the first 19 pay-periods in 2004, the total withholdings for CSRS deductions and OASDI tax equaled 7 percent of the employee's basic pay wages. (Additional OASDI taxes were withheld from the non-basic pay in the pay-periods that included the non-basic pay.) But in pay-period 20, the total withholdings for CSRS deductions and OASDI tax dropped to 1.98 percent of the

employee's basic pay wages. It was during that pay-period that the employee's total wages (basic pay and non-basic pay) reached the contribution and benefit base (\$87,900) causing the OASDI tax withholding to be reduced to \$48.06. The CSRS deduction, however, did not change because the employee's total basic pay wages through pay-period 20 continued to be less than the contribution and benefit base. The CSRS deduction continued to be calculated as though the full \$251.67 OASDI tax withholding still applied. In pay-period 21, with no OASDI tax withholding, the CSRS deduction continued to be \$32.47 (0.8 percent of basic pay) because the employee's total basic pay wages were still less than the contribution and benefits base. In pay-period 22, \$2,656.80 of the employee's basic pay wages were needed to reach the contribution and benefit base affecting retirement deductions. The CSRS-Offset deduction on that amount, \$21.25, was based on the reduced retirement deduction rate. The remaining basic pay wages earned during that pay-period, \$1,402.40, were subject to the full CSRS deduction rate of 7 percent. The total deductions for pay-period 22, \$119.42, equaled 2.94 percent of the basic pay wages. Finally, in pay-period 23, the CSRS deduction was \$284.14, or 7 percent of the employee's basic pay wages, and it remained that amount for the rest of the year.

This example shows that non-basic pay wages have no effect on the amount of a CSRS-Offset employee's retirement deductions. The total retirement deductions for this employee would be the exact same amount had this employee not received non-basic pay wages in 2004. By establishing that only basic pay wages influence when the reduced CSRS deduction reverts to the full CSRS deduction, FERSA ensured that CSRS-Offset employees with similar basic pay wages would be treated similarly. CSRS Offset employees with the identical basic pay wages will have identical CSRS deduction amounts even if some of the employees earned additional non-basic pay wages. Non-basic pay wages play no part in determining the amount of a CSRS-Offset employee's retirement benefit, and it follows that non-basic pay wages should have no part in determining the amount of the CSRS retirement deduction.

Pre-tax Deductions – HB-PC and FSA

Pre-tax deductions from a CSRS-Offset employee's basic pay add a wrinkle in determining the correct retirement deduction amount. Pre-tax deductions, such as those that now exist for Health Benefit Premium Conversion (HB-PC) and Flexible Spending Accounts (FSA), exempt a portion of a CSRS-Offset employee's basic pay from OASDI tax.

When Congress defined the rules for CSRS-Offset employees' retirement deduction rates in 1986, pre-tax deductions did not exist. Back then, all of an employee's basic pay wages earned before reaching the contribution and benefit base were subject to OASDI tax and all of the basic pay wages earned after reaching the contribution and benefit base were not subject to OASDI tax. Consequently, when Congress provided that the reduced deduction rate reverts to the full CSRS deduction rate when the basic pay wages exceed the contribution and benefit base (5 U.S.C. 8334(k)(2)(B)), Congress was saying, in essence, that the reduced deduction rate should revert to the full deduction rate when the basic pay wages are no longer subject to OASDI tax disregarding non-basic pay wages).

With pre-tax deductions, a CSRS-Offset employee's total basic pay wages may now reach the

contribution and benefit base before the taxable basic pay wages reach the contribution and benefit base. While a literal reading of 5 U.S.C. 8334(k)(2)(B) would require that the reduced deduction rate to revert to the full CSRS deduction rate as soon as total basic pay wages reach the contribution and benefit base, we find nothing in the legislative history that would suggest Congress ever intended for CSRS-Offset employees to pay full CSRS deductions on basic pay wages that were still subject to OASDI tax. Instead, we believe 5 U.S.C. 8334(k)(2)(B) must be read in the context of the time when it was written (when pre-tax deductions did not exist) for its essential meaning – the reduced deduction rate should revert to the full CSRS deduction rate when the basic pay wages are no longer subject to OASDI tax (disregarding non-basic pay wages).

For CSRS-Offset employees with pre-tax deductions, the non-taxable portion of the basic pay wages will always be subject to the full CSRS deduction rate. The taxable portion of the basic pay wages will be subject to the reduced deduction rate until the total taxable portion of basic pay wages reaches the contribution and benefit base. Once the taxable portion of the basic pay wages exceed the contribution and benefit base (determined without considering non-basic pay wages), the reduced deduction rate should revert to the full CSRS deduction rate.

To illustrate how CSRS deduction should be calculated for CSRS-Offset employees with pre-tax deductions and with non-basic pay wages, we’ve provided a pay-period by pay-period break down of a CSRS-Offset employee whose salary in 2004 was \$105,900 a year (unchanged from 2003), whose total pre-tax deductions each pay period equaled \$250.00, and who received non-basic pay wages of \$10,000 early in 2004.

2004 Earnings

A Pay Period	B Basic Pay Wages	C Pre-Tax Deduc- tions	D Basic Pay Wages Subject to OASDI Tax	E CSRS Deductions		F OASDI Tax on Basic Pay Wages	G Non- Basic Pay Wages	H Contribution and Benefit Base for OASDI Tax	I Contribution and Benefit Base for CSRS Deductions
				Full Rate (7%)	Reduce d Rate (0.8%)				
1	\$4,059.20	\$250	\$3,809.20	\$17.50	\$30.47	\$236.17	-----	\$3,809.20	\$3,809.20
2	\$4,059.20	\$250	\$3,809.20	\$17.50	\$30.47	\$236.17	-----	\$7,618.40	\$7,618.40
3	\$4,059.20	\$250	\$3,809.20	\$17.50	\$30.47	\$236.17	\$5,000 (OASDI = \$310)	\$16,427.60	\$11,427.60
4	\$4,059.20	\$250	\$3,809.20	\$17.50	\$30.47	\$236.17	-----	\$20,236.80	\$15,236.80
↓	Pay During Pay Periods 5-7 Remained Unchanged								
8	\$4,059.20	\$250	\$3,809.20	\$17.50	\$30.47	\$236.17	\$5,000 (OASDI = \$310)	\$40,473.60	\$30,473.60
9	\$4,059.20	\$250	\$3,809.20	\$17.50	\$30.47	\$236.17	-----	\$44,282.80	\$34,282.80
↓	Pay During Pay Periods 10-19 Remained Unchanged								
20	\$4,059.20	\$250	\$3,809.20	\$17.50	\$30.47	\$236.17	-----	\$86,184.00	\$76,184.00
21	\$4,059.20	\$250	\$3,809.20	\$17.50	\$30.47	\$106.39	----	\$87,900	\$79,993.20

A Pay Period	B Basic Pay Wages	C Pre-Tax Deduc- tions	D Basic Pay Wages Subject to OASDI Tax	E CSRS Deductions		F OASDI Tax on Basic Pay Wages	G Non- Basic Pay Wages	H Contribution and Benefit Base for OASDI Tax	I Contribution and Benefit Base for CSRS Deductions
				Full Rate (7%)	Reduce d Rate (0.8%)				
22	\$4,059.20	\$250	\$3,809.20	\$17.50	\$30.47	----	----		\$83,802.40
23	\$4,059.20	\$250	\$3,809.20	\$17.50	\$30.47	----	----		\$87,611.60
24	\$4,059.20	\$250	\$288.40	\$263.96	\$2.31	----	----		\$87,900
25	\$4,059.20	\$250	----	\$284.14	----	----	----		
26	\$4,059.20	\$250	----	\$284.14	----	----	----		
Totals	\$105,549. 20	\$6,500	\$87,900	\$1,234. 74	\$703.12	\$4,829. 79	\$10,000 (OASDI = \$620)	\$87,900	\$87,900
				\$1,937.86					

In each of the first 20 pay-periods in 2004, \$250 of this CSRS-Offset employee's basic pay wages were excluded from OASDI tax under the pre-tax deduction provisions. The retirement deductions on that non-taxable portion of basic pay wages were based on the full CSRS deduction rate. The remaining basic pay wages were not excluded from OASDI tax. The retirement deductions on those remaining basic pay wages were based on the reduced CSRS deduction rate. The total withholdings for retirement deductions (both full CSRS deductions and reduced deductions) and OASDI tax in each of the first 20 pay-periods in 2004 equaled 7 percent of the employee's basic pay wages. (Additional OASDI taxes were withheld from the non-basic pay in the pay-periods that included the non-basic pay.)

In pay-period 21, the OASDI tax withholding fell to \$106.39 because the employee's total earnings subject to OASDI tax (including basic pay and non-basic pay wages – column H of the chart) reached the contribution and benefit base in that pay-period. But the retirement deductions did not change in pay-period 21 because the basic pay wages subject to OASDI tax (column I of the chart) remained below the contribution and benefit base. The total withholdings for retirement deductions (both full CSRS deductions and reduced deductions) and OASDI tax in pay-period 21 equaled 3.8 percent of the employee's basic pay wages.

The retirement deductions in pay-periods 22 and 23 remained unchanged even though the OASDI tax had stopped because the total basic pay wages subject to OASDI tax remained below the contribution and benefit base through pay-period 23. The total withholdings for retirement deductions (full deductions and reduced deductions) and OASDI tax equaled 1.18 percent of the employee's basic pay wages.

In pay-period 24, \$288.40 of the employee's taxable basic pay wages were needed to reach the contribution and benefit base affecting retirement deductions. The CSRS-Offset deduction on that amount, \$2.31, was based on the reduced retirement deduction rate. The remaining basic pay wages earned during that pay-period, \$3,770.80, were excluded from OASDI tax and subject to the full CSRS deduction rate of 7 percent. The total deductions for pay-period 24, \$266.27, equaled 6.56 percent of the employee's basic pay wages.

Finally, in pay-period 25, all of the employee’s basic pay wages were excluded from OASDI tax. The CSRS deduction was \$284.14, or 7 percent of the employee’s basic pay wages, and it remained that amount for the rest of the year.

Reemployed Annuitants Subject to CSRS-Offset Coverage

The salary of a reemployed annuitant covered under CSRS-Offset is reduced by the amount of annuity attributable to the period of reemployment. This reduction, like pretax deductions for HB-PC and FSAs, reduces the taxable portion of the reemployed annuitant’s salary. OASDI tax should be withheld on the reemployed annuitant’s basic pay wages after the reduction for the annuity (and after any applicable pre-tax deductions). If the reemployed annuitant elects to have retirement deductions withheld from his pay, the reduced deduction rate should apply to the portion of the basic pay wages subject to OASDI tax and the full CSRS deduction rate should apply to the portion of basic pay wages not subject to OASDI taxes.

Example

- CSRS-Offset Monthly Annuity = \$1,600 per month (which equals \$19,200 per year and \$9.20 per hour)
- Salary Rate During Reemployment: \$50,000 (or \$23.96 per hour)
- FEHB Enrollment Maintained by Employing Agency During Reemployment
- Annuitant worked 80 hours per pay-period

A Pay Period	B Basic Pay Before Adjust- ments	C Annuity Offset Amount	D FEHB- Premium	E Retirement Deduction		F OASDI Tax	G Contribution and Benefit Base for OASDI Tax	H Contribution and Benefit Base for CSRS Deductions
				Full Rate (7%)	Reduced Rate (0.8%)			
1	\$1,916.80	\$736.00	\$100.00	\$58.52	\$8.65	\$67.00	\$1,080.80	\$1,080.80
2	\$1,916.80	\$736.00	\$100.00	\$58.52	\$8.65	\$67.00	\$2,161.60	\$2,161.60
↓	Pay During Pay Periods 3-25 Remained Unchanged							
26	\$1,916.80	\$736.00	\$100.00	\$58.52	\$8.65	\$67.00	\$28,100.80	\$28,100.80
Totals:	\$49,836.80	\$19,136	\$2,600	\$1,521.52	\$224.90	\$1,742	\$28,100.80	\$28,100.80

During each pay-period, the reemployed annuitant’s basic pay wages excluded from OASDI tax equaled \$836.00 (the sum of columns C and D). The basic pay wages subject to OASDI tax equaled \$1,080.80 (\$1,916.80 minus \$836). Because the reemployed annuitant elected to have retirement deductions withheld from his salary, full CSRS deductions were withheld on the \$836 of basic pay wages excluded from OASDI tax and reduced deductions were withheld on the \$1,080.80 of basic pay wages not excluded from OASDI tax. The OASDI tax was based on the \$1,080.80 of basic pay wages not excluded from OASDI tax. The contribution and benefit base for OASDI tax and the contribution and benefit base for CSRS deductions were identical in this

example because the employee did not receive any non-basic pay wages during the year.

Documenting the Individual Retirement Record

BAL 02-318, dated October 16, 2002, provided instructions on how to document retirement deductions for CSRS-Offset employees participating in HB-PC. Payroll offices must clearly show the amount of retirement deductions withheld at the reduced rate and the amount of retirement deductions withheld at the full CSRS rate. Those instructions apply not only to CSRS-Offset employees participating in HB-PC, but to any CSRS-Offset employee whose retirement deductions in any given year are based on more than one deduction rate, including reemployed annuitants covered under CSRS-Offset who elect to have retirement deductions withheld from their salary.

If a reemployed annuitant covered under CSRS-Offset elects not to have retirement deductions withheld from basic pay wages, payroll offices must still establish an Individual Retirement Record (IRR) documenting the employee’s service and salary history while reemployed. Although there will be no retirement deductions to document on the Fiscal Record side of the IRR, payroll offices must certify in the remarks column (column 8) the total amount of pre-tax deductions that affected the reemployed annuitant’s basic pay wages for each calendar year. Payroll offices can either show how the pre-tax deductions break down each year (showing the amounts for each pre-tax deduction separately) or they can simply show the total of all pre-tax deductions for a calendar year.

Example 1 – Show each pre-tax deduction amount separately – reemployed annuitant waits until 2006 to elect to have deductions withheld. (Pre-tax deductions posted in 2006 reflect pre-tax deductions before retirement deductions began.)

Fiscal Record			
Year	Calendar Year Salary Deductions	Accumulative Total Salary Deductions	Remarks
(5)	(6)	(7)	(8)
2004	0.00	0.00	HB: \$1,874.08
			FSA: \$2,000.00
			Annty: 19,136.00
2005	0.00	0.00	HB: \$2,068.30
			FSA: \$2,000.00
			Annty: \$19,427.20
2006	0.00	0.00	HB: \$1,034.15
			FSA: \$1,000
			Annty: \$9,869.60
			RET DED. BEG. 7/03/06

Fiscal Record			
Year	Calendar Year Salary Deductions	Accumulative Total Salary Deductions	Remarks
(5)	(6)	(7)	(8)
2006	\$1,055.00	\$1,055.00	\$130.00 @ 0.8%
			\$925.00@ 7%
2007	\$1,904.21	\$2,959.21	\$141.12@ 0.8%
			\$1,763.09@ 7%

Example 2– Show pre-tax deductions as one cumulative amount– reemployed annuitant waits until 2006 to elect to have deductions withheld. (Pre-tax deductions posted in 2006 reflect pre-tax deductions before retirement deductions began.)

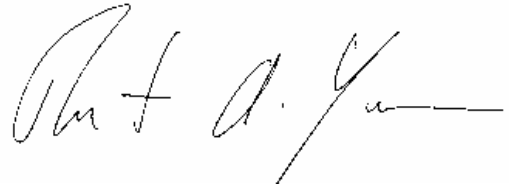
Fiscal Record			
Year	Calendar Year Salary Deductions	Accumulative Total Salary Deductions	Remarks
(5)	(6)	(7)	(8)
2004	0.00	0.00	Pre-tax ded: \$23,010.08
2005	0.00	0.00	Pre-tax ded: \$23,495.50
2006	0.00	0.00	Pre-tax ded: \$11,903.75
			Ret. Ded. Beg: 7/3/06
2006	\$1,055.00	\$1,055.00	\$130.00 @ 0.8%
			\$925.00@ 7%
2007	\$1,904.21	\$2,959.21	\$141.12@ 0.8%
			\$1,763.09@ 7%

Making Corrections

Payroll offices that have been changing the retirement deduction withholding from the reduced CSRS rate to the full CSRS rate prematurely (that is as soon as a CSRS-Offset employee's total wages, including non-basic pay wages, exceed the contribution and benefit base but before the taxable basic pay wages reach the contribution and benefit base) are underpaying their CSRS-

Offset employees. Those payroll offices must revise their withholding procedures to conform to the guidance in this BAL and must make whatever retroactive adjustments are necessary to resolve the salary underpayment and fix the Individual Retirement Record.

If you have any questions about this letter, we would prefer that you email us at finance@opm.gov, so that we may have a record of them. You may also phone us on (202) 606-0606.

A handwritten signature in black ink, appearing to read "Robert A. Yuran", with a horizontal line extending from the end of the signature.

Robert A. Yuran, Manager
Financial Reporting and Policy Group
Center for Financial Services