

# Basis and Background of the Retirement Test

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*President Eisenhower's proposal to liberalize the retirement test for receipt of old-age and survivors insurance benefits has aroused new interest in this question. The philosophy on which the test is based, its history, earlier proposals for change, and similar provisions in effect in private and other public plans are examined in the following pages.*

SO that only those older men and women who have actually retired from employment covered by old-age and survivors insurance will receive benefits under the program, the Social Security Act provides a test of retirement. The test is applicable for both retirement and survivor benefits when the beneficiary is under age 75. If the beneficiary, or the person on whose earnings the benefit is based, has substantial earnings in covered employment (including self-employment), the law requires that his benefit be withheld.<sup>1</sup>

The test has been the subject of discussion ever since the enactment of the Social Security Act. Current interest in it was stimulated when, on January 14, 1954, in his social security message,<sup>2</sup> President Eisenhower asked Congress to enact certain changes in the test. It should, he said, "be liberalized and its discrimination against the wage earner should be removed."

The President pointed out that by "depriving an OASI beneficiary of his benefit payment for any month in which he earns wages of more than \$75, present law imposes an undue restraint on enterprise and initiative. Retired persons should be encouraged to continue their contributions to the productive needs of the nation. I am convinced that the great majority of our able-bodied older citizens are happier and better off when they continue in some productive work after reaching retirement age. Moreover, the Nation's economy will derive large benefits from the wisdom and experi-

ence of older citizens who remain employed in jobs commensurate with their strength.

"I recommend, therefore, that the first \$1,000 of a beneficiary's annual earnings be exempted under the retirement test, and that for amounts earned above \$1,000 only one month's benefit be deducted for each additional \$80 earned.

"To illustrate the effect of these changes: a beneficiary could take a \$200-a-month job for five months without losing any benefits, whereas under present law he would lose five months' benefits. He could work throughout the year at \$90 a month and lose only one month's benefit, whereas under present law he would lose all twelve.

"Approval of this recommendation will also remove the discriminatory treatment of wage earners under the retirement test. Self-employed persons already have the advantage of an exemption on an annual basis, with the right to average their earnings over the full year. The amendment I have proposed would afford this advantage, without discrimination, to all beneficiaries."

## Philosophy of Test

Probably the major reason for the retirement test is that the old-age and survivors insurance program was designed to provide social insurance against presumed loss of earnings due to retirement from employment rather than, like private insurance, to provide annuities at a prescribed, fixed age.

Closely related to this reason is the cost element. If benefits were payable automatically on attainment of age 65 rather than only on retirement at age 65 or later, the increased cost would be close to 1 percent of taxable payroll now and somewhat more

later. Accordingly, if there were no retirement test, one of two alternatives would be necessary. Either the contribution income would have to be raised or the general benefit level would have to be lowered. Neither alternative seems desirable.

In addition, there is no social necessity for paying benefits to individuals who are in full-time employment, although there may be reasons for paying partial or full benefits to those in part-time or low-paid employment. It is here that the real problem exists.

Still another argument in favor of the retirement test has been presented in the past. Under certain economic conditions, payment of benefits automatically, without a retirement test, might depress wage scales because beneficiaries might be willing to take lower wages if they also had their benefits.

In theory, the retirement test should be applicable to all earnings from gainful employment, and proposals embodying this theory have recently been made. In practice, however, because of administrative reasons, the test has been applied only to earnings in covered employment. When it is restricted to earnings in covered employment, the regular wage and self-employment income reports made to the Bureau of Old-Age and Survivors Insurance can be used as a check on the retirement. Of course, if the coverage of old-age and survivors insurance were extended to all employment, there would be no difference between the actual practice and theory. Even if coverage were not universal but the excluded area of employment were greatly reduced, it might be possible to have the retirement test apply to all earnings, since the administrative problems would then be much smaller than they are at present.

## History

A test of retirement was implicit in the original Social Security Act. The law stated that, for any month in which the individual received cov-

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<sup>1</sup> For detailed data and analysis of the operation of the retirement test, see Robert J. Myers, "Old-Age and Survivors Insurance: Retirement Test Experience," *Social Security Bulletin*, November 1953.

<sup>2</sup> H. Doc. 295, 83rd Congress, 2d session.

ered wages from "regular employment," monthly old-age benefits would not be paid. Regular employment was not specifically defined, however.

The 1939 amendments permitted payment of benefits if the beneficiary had earnings in covered employment of no more than \$14.99 a month.<sup>3</sup> The test was on an "all-or-none" basis; earnings of \$14.99 or less did not affect payment of the full benefit, but earnings of even slightly more than this amount meant that the entire benefit for the month was lost.

The amount of earnings permitted by the retirement test was still set at \$14.99 a month when the 1947 Senate Advisory Council on Social Security was considering the general subject of old-age and survivors insurance.<sup>4</sup> Because of changes since 1939 in the wage level and other factors, it was generally agreed that this amount was too low. Furthermore, there was the important question of working out a more equitable basis for the test than the all-or-none basis and one that would also be reasonably simple to administer. The Advisory Council stated that modification was necessary so that beneficiaries should not have their total income reduced because of work.

One possibility considered was the general principle of a "one-for-one" reduction. Full benefits would be paid if earnings were a specified amount or less, while if earnings were larger the benefits would be reduced by the amount of the difference. Operation on this principle would permit a smooth transition between part-time employment and full-time employment. Individuals earning more than the amount permitted for payment of full benefits would thus, within a certain range, maintain their total income from benefits and earnings

<sup>3</sup> In determining earnings from covered employment for purposes of the retirement test, the effect of the maximum on taxable and creditable wages (\$3,000 a year until 1951 and then \$3,600) is disregarded. Thus, if an individual earns the maximum amount in the first 6 months of a calendar year, any subsequent earnings in that year would nevertheless be counted in applying the retirement test.

<sup>4</sup> The earlier Senate Advisory Council (1937) had made no recommendation about the retirement test.

combined, instead of having a reduction in total income as under the all-or-none retirement test. The Council recognized, also, that minor modifications would be necessary to facilitate administration to some extent, since month-by-month adjustments and calculations would be costly to make, and it recommended quarterly adjustments.

Specifically, the Advisory Council recommended setting the exempt amount in the retirement test at \$35 a month. Just as under the all-or-none test, benefits would be paid for any month in which earnings were \$35 or less and would be suspended for any month in which earnings exceeded \$35. For beneficiaries who had one or more benefits suspended in a given quarter, the following procedure would be used to determine the amount of the quarterly adjustment. The beneficiary would furnish a statement showing his earnings in each of the 3 months of the quarter. Then, when the employer's quarterly tax return was received, the beneficiary's statement would be checked against it. If there were reasonable agreement, for each month that benefit suspension occurred the adjustment amount would be computed. This amount would consist of any difference between his benefits (including any supplements for dependents) and his actual earnings in excess of the exempt amount of \$35. The adjustment amounts for the 3 months of the quarter would then be payable in a lump sum.

As an example of how the Advisory Council proposal would operate, consider the case of an individual with a total monthly benefit of \$60 who has wages of \$50, \$25, and \$100 for the 3 months of a given calendar quarter. In the first and third months, the benefit check would have been withheld because earnings were in excess of \$35. The amount of the adjusted benefit for the first month would be \$45—the \$60 benefit minus \$15, the amount by which his \$50 earnings exceeded the \$35 exempt amount. There would be no adjusted benefit for the third month, since the earnings of \$100 exceeded the exempt amount of earnings by more than the amount of the benefit.

The Advisory Council recognized

that some modifications would have to be made for the self-employed since their earnings would be reported annually. No specific proposals, however, were presented for this group.

Another recommendation made by the Advisory Council was that the retirement test should not apply to beneficiaries aged 70 and over. It was recognized that this provision would involve some significant increase in cost but not nearly so much, of course, as if the test were completely eliminated. In essence then, the proposal was a compromise with those persons who held that the test was a restriction on their activity and who considered the benefits as something that they had paid for and that therefore should be payable automatically as an annuity, at age 65. Furthermore, the elimination of the test for persons aged 70 or over would be attractive particularly to farmers and the professional self-employed (for whom the Advisory Council recommended coverage), since it had been argued that generally these groups "never retire."

The 1950 amendments raised from \$14.99 to \$50.00 a month the amount of earnings permitted under the retirement test, with no restrictions for workers aged 75 or over. The test remained on an all-or-none basis for wage earners. For the self-employed, who were brought into coverage by the 1950 amendments and who report their earnings annually, a "unit-reduction" procedure was adopted. Benefits were not withheld if the covered self-employment earnings reported for the year were \$600 or less, but 1 month's benefit was withheld for each \$50 (or remaining fraction thereof) of the amount in excess of \$600.

### *General Basis of Present Test*

The 1952 amendments to the Social Security Act continue the payment of benefits at age 65 to persons who have insured status if they are substantially retired. At age 75 and thereafter, benefits are paid regardless of retirement.

The test of substantial retirement is applied differently for wage earners and the self-employed, but for both it relates only to earnings in

covered employment.<sup>5</sup> If a worker earns covered wages of more than \$75 in a month, his benefits and those of his dependents are suspended for that month. A month-by-month suspension of benefits is not feasible for self-employed persons, who are generally able to determine their net earnings only on a taxable-year basis. Self-employed persons are therefore considered retired if, throughout the year, their covered self-employment earnings are not more than \$900 (12 times \$75). For each unit of \$75 or fraction thereof that is in excess of this amount, the beneficiary loses 1 month's benefit for himself and his dependents. When an individual eligible for benefits for all 12 months of a year has self-employment earnings of \$901-975, for example, only 11 months' benefits are paid; when such earnings are \$976-1,050, only 10 months' benefits are paid; and so on until, when earnings are \$1,651-1,725, only 1 month's benefit is paid. The number of the monthly benefit deductions may never, however, exceed the number of months during which the person was substantially self-employed.<sup>6</sup> In addition, withholding of benefits for wages and for self-employment earnings does not take place concurrently. A person with self-employment earnings of \$950 in a year and wages of more than \$75 in one particular month would have 2 months' benefits withheld unless he engaged in substantial self-employment only in the month in which he earned the wages.

The present test has a "double-exemption" feature in that it applies separately to wages and to self-employment earnings for persons who have both. An individual with self-employment earnings of \$900 in a

year and with wages of \$75 or less in several, or even all, months would not have any benefits withheld.

When an individual continues working beyond age 65, his eventual retirement benefit may be increased by such employment. This increase will result if his average wage is raised because his earnings were higher after he reached age 65 than they were before.<sup>7</sup> If earnings after age 65 are lower, the benefit is based on the average wage earned up to that age, assuming that the individual is then fully insured.

### *Illustrative Problems*

Under old-age and survivors insurance, the retired wage earner who makes more than \$75 a month, but not as much as \$75 plus his benefit amount, has a particular problem under the present retirement test provisions. If, for example, a man's primary insurance amount is \$60, and he has a wife aged 65 or over, the benefit for the couple will be \$90. In the month that this beneficiary has earnings of \$75, he will have available total income of \$165. If he earns \$80, he loses his own benefit and his wife's benefit and has only the \$80 from his work. The problem becomes less acute for him, of course, as his earnings approach the amount of his benefits plus \$75.

There is also a problem for the beneficiary who works only occasional months at wages that, while moderate, are more than \$75 and who loses benefits for such months. He is thus really substantially retired, certainly as much so as a \$75-a-month, 12-month worker, who perhaps has been able to adjust his wages downward.

The self-employed beneficiary does not have the same problem of a sharp "breaking point" that the retired wage earner has. He may earn more than \$75 in some months and less than \$75 in other months, but it is the cumulative total that governs, both in relation to the \$900 exempt amount and to the earnings above that amount. For example, a self-employed person who earns \$80 a month throughout the year loses only 1

month's benefits, while a similar wage earner does not receive any benefits. Again, a self-employed individual with earnings of \$900 in a year, making more than \$75 in some months and less than that in others, receives benefits for the entire year, but a wage earner with a similar history loses benefits for each of the months in which he earned more than \$75. Similarly, if a self-employed person has earnings of \$300 in 3 months, he loses no benefits; if he were an employee, benefits would not be paid for that period. The results are identical for both the wage earner and the self-employed person when large amounts of earnings are concentrated in a short period. If, for example, earnings of \$901 or more are obtained in 1 month and none in the rest of the year, 1 month's benefit is withheld for both the self-employed and the wage earner.

### *Current Criticism*

Much of the criticism of the retirement test is based on lack of understanding of its purpose and underlying philosophy and, in fact, of the nature of the program—that is, its intent to pay retirement benefits rather than strictly age annuities. Those who advocate a change point out, however, that individuals whose earnings either are on a part-time basis or are low (or moderately low) cannot easily adjust their earnings to make them the exact amount of the monthly retirement-test limitation (in which event, of course, both benefits and earnings could be received).

A criticism sometimes directed at the retirement-test provision is that it offers an inducement to older workers to retire. Benefit payments, however, are substantially lower than regular full-time wages, and there is no indication that many persons voluntarily<sup>8</sup> retire from full-time jobs in order to draw the benefits. The retirement test does not, on the other hand, permit older workers to "taper off" gradually from full-time employment to retirement, as would be desirable from a gerontological viewpoint. Many workers earning some-

<sup>5</sup> Since earnings received for employment outside the United States are "covered earnings" only when received for service on an American ship or airplane (in certain circumstances) or when received by an American citizen from an American employer, beneficiaries can engage in substantial employment of most kinds outside the country and not be affected by the retirement test. This situation would no longer exist under the terms of current proposals for amending the law.

<sup>6</sup> Regulations are prescribed for determining whether an individual has rendered substantial services.

<sup>7</sup> Benefits vary only with average wage and not with length of coverage, although absence from coverage will tend to reduce average wage and thus benefits.

<sup>8</sup> See Margaret L. Stecker, "Beneficiaries Prefer to Work," *Social Security Bulletin*, January 1951.

what more than the exempt amount are in a difficult position. Various proposals have been advanced to modify the provision to provide a more gradual transition in total income from earnings and from benefits as the individual gets older.

Any modification of the retirement test from the present all-or-none basis to a reduction basis, whether the unit, one-for-one, or some other type, would probably result in somewhat greater administrative problems. There would, of course, be greater problems if the one-for-one basis were used than if the unit basis were adopted. Any increased cost would be relatively minor contrasted with the increased benefit cost if the retirement test were completely eliminated.

### *Other Government Plans*

In the various retirement plans for State and local government employees, the general practice is to pay retirement pensions only after the individual has left the service of the particular government unit and to continue such payments thereafter regardless of whether the individual enters any other type of employment. Service beyond the minimum, or normal, retirement age is generally creditable toward producing larger pensions, though the amount is subject, of course, to the plan's maximum provisions.

Under the civil-service retirement system for Federal employees, an annuitant receives his benefit on retirement from Federal service even though he may be employed elsewhere. On return to Federal employment—regardless of whether the service is then covered by the system—the annuity is continued, but the salary is reduced by a corresponding amount,<sup>9</sup> and no further contributions to the system are collected. Service after the normal retirement age (62 with 5–29 years of service and 60 with 30 or more years) generally increases the annuity because of the additional length of service credited. Such service also

<sup>9</sup> An exception to this general rule is for annuitants who, before they attain age 60, return to Government service covered by the system, in which case the annuity is terminated. Upon subsequent retirement it is recomputed.

increases the annuity if it results in a higher average wage, which is based on the highest five consecutive years. The other retirement systems for Federal civilian employees have, in general, similar provisions; the pension system for the Armed Forces differs in that it suspends payments while the individual is employed in any type of Federal service for which pay is received.

Under the railroad retirement system, age retirement annuities are awarded only after termination of all employment, whether in or out of the railroad industry. Once awarded a retirement annuity, an individual can receive it even though he is later employed, as long as he does not work for a railroad or for the last nonrailroad employer for whom he worked before his retirement.<sup>10</sup> In any event, contributions are payable on all railroad employment after age 65. As a result of the 1951 amendments to the Railroad Retirement Act, all service after age 65 is used in computing the retirement annuity. Previously, under the 1946 amendments, service after the calendar year in which the worker attained age 65 could not be used in calculating the retirement benefit. Before the 1946 amendments, service after the month of attaining age 65 could be used to increase the average compensation, but not the length of service, on which the annuity is based.

Of interest historically is the provision in the original Railroad Retirement Act of 1934 for compulsory retirement at age 65, with permissive 1-year extensions up to age 70 upon joint agreement of employer and employee. The Railroad Retirement Act of 1935, which was enacted when the 1934 legislation was declared unconstitutional, did not provide for compulsory retirement but contained a provision reducing the annuity by 6½ percent for every year of continued service beyond age 65. The reduction, however, was not applicable to service

<sup>10</sup> In certain circumstances, nonrailroad employment after retirement under the railroad plan can reduce an annuity based at least in part on railroad service before 1937. If the individual engages in employment covered by old-age and survivors insurance, his railroad retirement annuity is reduced as soon as he meets the eligibility conditions for an old-age benefit, even though he may not receive such benefit because he is continuing at work.

before the worker attained age 70 under an agreement between the employer and employee or to service performed by officials of railroads or employer organizations. This unusual procedure reflected the depression philosophy of retiring older men to make jobs for younger men; in general, employment beyond the normal retirement age resulted not only in suspension of an annuity but even in reduction of the ultimate annuity payable upon retirement. The provision, however, was in actual operation for only a short period in 1936 and 1937, and the 1937 act superseded it.

### *Private Pension Plans*

Retirement plans established by private employers naturally stress the payment of benefits only upon retirement from employment. Generally, such pensions are payable after retirement from work for the particular employer, regardless of whether the individual is employed elsewhere. In some instances, payment of the pension is discretionary on the part of the employer if the former employee—particularly an executive or salaried employee—works for some other employer in the same line of business.

In noninsured private plans, the almost universal practice is to pay pensions only upon cessation of employment with the particular employer. In insured pension plans, where the insurance company necessarily determines the initial costs on the basis of the benefits being paid at a specific age, varying practices are followed, but in almost all plans the contributions cease at the normal retirement age. Under many insured plans, pension payments are not made to the employee for the period after the normal retirement age during which he continues in employment, and the withheld payments are credited to the employer's account to meet future costs of the plan. Another procedure is to pay the pension just as though the employee had retired but to reduce his salary by an equal amount, while under some plans the individual receives both the pension and his salary concurrently. In still other plans the pension is not paid currently but is accumulated and paid either in a lump sum on retirement or as an increased pension then.