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Public Sector Workers Not Covered by Social Security

Implications for their Retirement Security

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This paper was drafted by members of the Social Security Committee & Public Plans Committee

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Executive Summary

Public sector entities seeking exemption from Social Security must demonstrate that they comply with the requirement that they sponsor a pension plan whose benefits are "comparable" to Social Security.

The most common method of demonstrating compliance is to show that the plan benefits are equal to or greater than a safe harbor that was established in 1991. But does the safe harbor truly ensure that benefits are comparable? This policy paper will attempt to answer that question. For career employees, the initial safe harbor benefit will typically be larger than the corresponding Social Security benefit at all but the lower salary levels. However, this may not be true in the long run because the safe harbor does not require cost of living adjustments, as does Social Security.

Introduction

State and local government employees were excluded from Social Security coverage under the original version of the Social Security Act because of unresolved legal issues regarding the ability of the federal government to impose a tax on state and local governments.

Beginning in 1951, states were able to opt into Social Security coverage via so-called "Section 218 Agreements." According to the Federal State Reference Guide (IRS Publication 963 – 5/2025 Revision), as of 2014, 28.1% of the state and local government workforce, or 6.4 million state and local government employees, were not covered by Social Security.[1] In particular, less than half of state and local government employees are covered by Social Security in Alaska, California, Colorado, Louisiana, Massachusetts, Nevada, Ohio, and Texas. The most significant portion of non-covered government employees work at the local level. Most non-covered local government public employees are police officers, firefighters, or teachers.

Beginning July 2, 1991, state and local government employees became subject to mandatory Social Security and Medicare coverage, unless they were (1) members of a "qualifying public retirement system," also called a Social Security Replacement Plan (SSRP) or (2) already covered under a Section 218 Agreement. Treas. Reg. section 31.3121(b)(7)-2 provides minimum requirements that public retirement systems must meet to be "qualifying." Revenue Procedure 91-40[2] sets forth rules for the minimum requirements prescribed under Treas. Reg. section 31.3121(b)(7)-2 and provides a safe harbor for defined benefit plans that has become the norm for compliance testing.

This policy paper reviews the minimum benefit requirements for qualifying public retirement systems. Although it addresses some of the requirements of Section 31.3121(b)(7) of the Employment Tax Regulations, the primary focus of this policy paper is the Revenue Procedure 91-40 safe harbor, which expands on the Employment Tax Regulations. The safe harbor sets forth a minimum level of benefits that defined benefit plans must provide to be exempt from Social Security. While plans meeting the safe harbor requirement are presumed to provide benefits "comparable to those provided in the Old-Age portion of the Old-Age, Survivor, Disability Insurance program under Social Security," it is not clear whether the plans' safe harbor benefits are, in fact, "comparable" to the current Social Security benefit. This policy paper analyzes the current safe harbor benefit to estimate the extent to which it is or is not "comparable" to the current Social Security benefit.

1 Federal-State Reference Guide; Internal Revenue Service.
2 Revenue Procedure 91-4; Internal Revenue Service.

Differences between Social Security and Social Security Replacement Plans

Social Security Replacement Plans (SSRPs) and Social Security also differ in a range of areas, including ancillary benefits, early retirement rules, cost-of-living-adjustments (COLAs), survivorship benefits, benefit formulas, normal retirement ages (NRAs), and portability. Social Security was created as a near-universal plan to provide a limited degree of lifetime income security with anti-poverty features. For example, current benefits at the lowest pre-retirement income levels are as much as 90% of average indexed career earnings. They are approximately three times greater than those for the highest covered income levels as a percentage of covered income. Social Security also provides disability, survivorship, and other family benefits.

Defined benefit formulas in SSRPs are typically based on late-career salary averages, times years of service, times a multiplier. Initially, many such plans included separate family benefits that covered dependent children or parents, similar to those provided by Social Security. More recently, particularly since the global financial crisis of 2008, there has been a trend toward curtailing or even eliminating such benefits. In addition, a few SSRPs offer defined contribution or cash balance arrangements in lieu of a traditional defined benefit plan. Comparing such plans to Social Security can be challenging because they do not provide protection from risk in the same manner as Social Security; nevertheless, the regulations permit them to qualify.

Social Security benefits are fully portable. While 40 quarters of coverage are required to qualify for a Social Security retirement benefit, not all of them need to be from the same employer. Public retirement systems provide varying degrees of portability; however, it is possible for a person to work a succession of jobs for different public employers and never qualify for a retirement benefit from any of them. Also, although Social Security replacement plan provisions vary widely from plan to plan, there is one Social Security plan formula that affects all covered workers and beneficiaries. Finally, public sector plan provisions may be subject to negotiations between multiple parties, sometimes as part of collective bargaining and sometimes via a process specific to the involved entity. By contrast, Social Security benefits are determined solely by federal law.

Purpose of the Safe Harbor

Demonstrating comparability between an SSRP and Social Security on a case-by-case basis would be demanding and subject to differing interpretations of the regulations. The purpose of the safe harbor is to provide a simple yet definitive measure of compliance with statutory and regulatory requirements for public sector entities that offer their own plan in place of Social Security. Plans that meet the safe harbor are presumed to be at least comparable to Social Security benefits. While the safe harbor is not the only means of complying with the statute and regulations, its definitive nature makes it the preferred approach for measuring such compliance.

Description of the Safe Harbor

The Omnibus Budget Reconciliation Act of 1990 (OBRA 1990) added 26 CFR § 31.3121(b)(7)(F) to the Internal Revenue Code. This section requires that state and local government employees be covered by Social Security unless they are members of a retirement system sponsored by the employer. The retirement system must satisfy the rules of 26 CFR § 31.3121(b)(7)-2. The rules generally treat an employee as a member of a retirement system if they participate in a system that provides an accrued benefit or an allocation under the system that is "comparable" to the benefits that Social Security would have provided. For part-time, seasonal, and temporary employees, the minimum retirement benefit is required to be nonforfeitable.

Specifically, in the case of a defined benefit plan, the regulation (as distinct from the safe harbor) requires that the employee has an accrued benefit under the system that entitles the employee to an annual benefit commencing on or before their Social Security NRA that is at least equal to the annual Primary Insurance Amount the employee would have under Social Security. For this purpose, the Primary Insurance Amount an individual would have under Social Security (SSPIA) is determined as it would be under the Social Security Act if the employee had been covered under Social Security for all periods of service with the employer, had never performed service for any other employer, and had been fully insured within the meaning of section 214(a) of the Social Security Act (i.e., had 40 quarters of coverage). In the case of a defined contribution plan, the regulation requires that the allocations to the employee's account (not including earnings) must be at least 7.5 percent of the employee's compensation. "Compensation" must include, at a minimum, the employee's base wage, but need not include compensation above the Social Security Taxable Wage Base (TWB).

Further, the employee's account must either be credited with earnings at a rate that is reasonable under all the facts and circumstances, or the employees' accounts must be held in a separate trust that is subject to general fiduciary standards and is credited with actual earnings from the trust fund.

To meet the safe harbor rule, a highest or final average pay defined benefit plan must provide a benefit payable no later than age 65 (regardless of the individual's actual Social Security NRA) at least as great as the following:

If the average compensation period is	Benefit factor must be at least
36 months or less	1.50%
37-48 months	1.55%
49-60 months	1.60%
61-120 months	1.75%
Over 120 months	2.00%

The safe harbor does not require that the plan provide any type of COLA, survivor benefit, death-in-service benefit, or disability benefit. While those benefits could have significant value depending on the circumstances, neither the regulations nor the safe harbor considers the presence or absence of such benefits. Later in this policy paper, we will use the term "3-year safe harbor" to refer to the 1.50% formula with a 36-month average compensation period. Similarly, we will use "10-year safe harbor" to refer to the 2.00% benefit formula with 120-month average compensation.

As specified in the regulations, compensation must include, at a minimum, the employee's base pay, and need not include compensation above the TWB.

If compensation under the plan is limited to an amount less than the TWB, the benefit factor applicable to the plan may have to be adjusted to account for the shortfall in compensation. The adjustment factor is the ratio of total actual compensation up to the TWB to the total compensation the plan covers. Similarly, if benefit service is only provided for, say, 25 years, the applicable benefit factor may have to be increased by the ratio of 30 to 25.

Revenue Procedure 91-40 also covers special situations, including, but not limited to, plans using a fractional accrual rule and treatment of part-time employees. In particular, the safe harbor rule does not permit so-called "double proration" of benefits for part-time employees. Further description of double proration is provided in Appendix 4.

If a plan fails the safe harbor test, the plan has at least three choices at the plan level, including:

1. Demonstrate by another means that the plan's benefit formula is comparable to Social Security without relying directly on the safe harbor. In doing so, the plan might consider its benefits other than those specifically mentioned in the safe harbor formula to demonstrate comparability. For example, a plan that provides a benefit of 1.4% times three-year average annual compensation, times the number of years of service would not meet the safe harbor requirement. But if it also provides an automatic 2% COLA or unreduced benefits at age 60, it could be argued that the plan benefits exceed the safe harbor requirement. There is no guarantee that such arguments will prevail, and the authors are not aware that this approach has ever been tried.
2. Modify the plan's benefit formula to meet the safe harbor requirement. To do this, the plan could be modified to include, for example, 1.5% of the three-year average final compensation benefit payable at age 65 as a floor to the existing benefit formula.
3. Commence participation in Social Security. This would require entering into a Section 218 agreement with the Social Security Administration. Presumably, such participation would be prospective. If the plan did not provide comparable benefits for some prior years, a plan modification might still be required, or some type of catch-up contributions to Social Security would be required. Employers electing to participate in Social Security (and their employees) will be required to contribute to Social Security in addition to their employer plan. It may be necessary to modify the employer plan to limit the effect on total costs.

The plan may also test at the individual level. A plan meets the minimum benefit for an employee if the employee's accrued benefit is at least as great as the accrued benefit under the three-year final average compensation safe harbor of 1.5%.

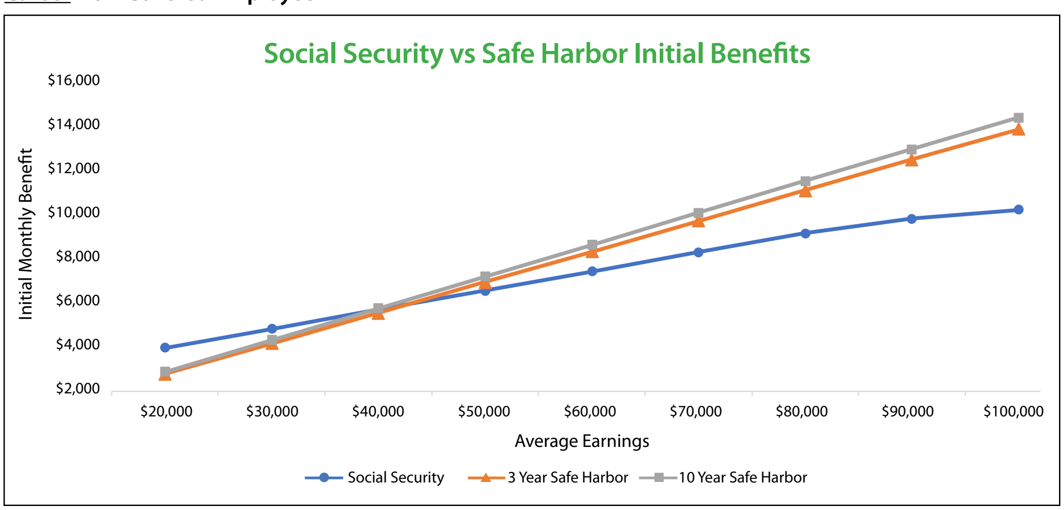
Assessing the Comparability of the 91-40 Safe Harbor Benefit Provisions to Social Security

The intent of the safe harbor is to ensure that non-covered employees receive pension benefits comparable to those they would have received through Social Security if they had been covered. The safe harbor used to measure equivalency is more than three decades old, and there have been significant economic and workforce changes in the U.S. during that time. Also, the Social Security NRA has increased from 65 to 67.

There are at least two ways to assess the comparability of the safe harbor to Social Security. One way is to evaluate whether a safe harbor monthly benefit is at least as great as the SSPIA for a worker with a long-term career earnings record.

Graph 1 compares safe harbor examples and SSPIA for workers hired at age 30 and retiring at age 65. The safe harbor example assumes benefits commence at age 65, while SSPIA is assumed to begin at age 67. If the Social Security benefit begins at age 65, the amount is reduced by 13⅓ percent, although the safe harbor does not reflect the increase in the Social Security NRA to age 67. These calculations are based on a salary history that assumes annual increases based on the historical AWI, using the intermediate cost assumptions in the 2024 Social Security Trustees Report.[3] Social Security ancillary benefits are not considered within the safe harbor.

Graph 1: **Comparison of Initial Benefits, Safe Harbor Defined Benefit versus SSPIA, Career Non-Covered Employee**

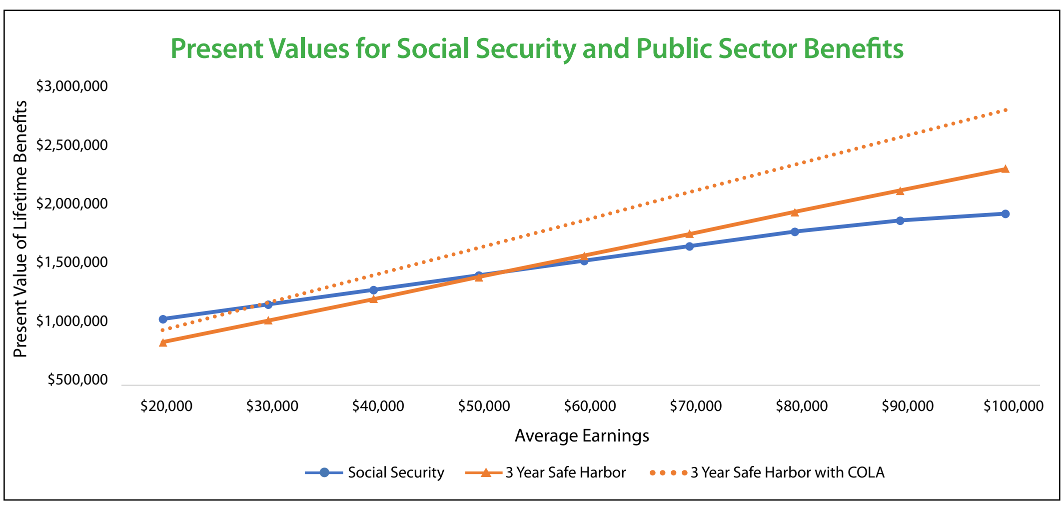


3 Note that the use of the 2025 Trustees Report does not produce materially different findings.

Graph 1 compares only the initial benefit and does not consider the lifetime benefits provided under each scenario. As noted above, Social Security provides relatively higher benefits for low-paid workers. Consequently, a plan that minimally complies with safe harbor 91-40 appears more likely to result in pensions that are less than Social Security at lower incomes than at higher incomes. This is because the safe harbor does not grade down as lifetime income increases, while the Social Security benefit formula grades down at a couple of bend points.

Another way to measure the comparability of the safe harbor is to compare the present value of individual lifetime benefits at retirement. This approach will consider the impact of COLAs, a core component of Social Security, but not included in the safe harbor guidelines. Graph 2 is an illustration that compares the present value of benefits for the same career employees as in Graph 1, assuming no COLA and the 2.4% COLA long-term assumption from the 2024 Social Security Trustees Report. The calculation of present values also uses the long-term-assumptions from the 2024 Social Security Trustees Report for career earnings growth, investment returns (and hence discount rates), and mortality rates (long-term intermediate).[4] Finally, sensitivity tests based on Social Security's high-cost and low-cost scenarios are shown in Appendix 3.

Graph 2: **Comparison of Lifetime Benefits, Safe Harbor Defined Benefit versus SSPIA, Career Non-Covered Employee**

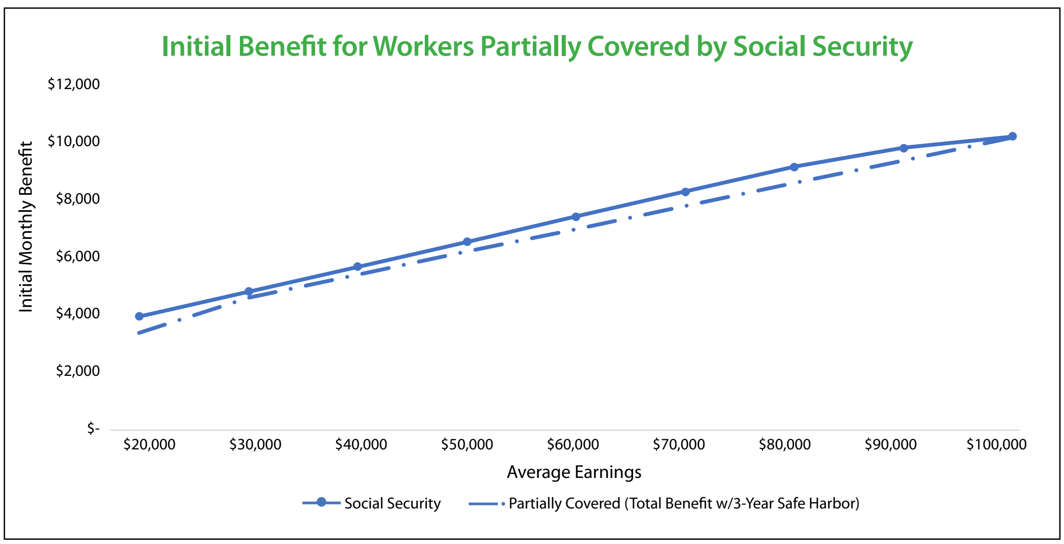


4 Assumptions are outlined in the Appendix 1.

As shown in Graph 2, the COLA significantly affects the comparison of present values for Social Security and SSRPs, which just comply with the 91-40 safe harbor. Without a COLA, the safe harbor plan is less favorable than Social Security for a greater number of workers than is true with the COLA. For the graph, the COLA for Social Security and the safe harbor example are assumed to be the same.

The safe harbor rules do not account for mid-career job changes, such as the widespread use of adjunct positions in academia. This presents an additional issue: some employees may spend time in both covered and non-covered service over the course of their working lifetimes. Therefore, it is possible for a public plan to comply with the safe harbor and yet have employees whose benefits at retirement are less than the corresponding SSPIA. This is especially the case when an employee spends the first part of their career in non-covered public sector plans and the rest of their career in covered plans. Graph 3 shows benefit comparisons for such an employee covered by a plan that averages the highest three years of earnings at retirement and where the worker spent the first 15 years in non-covered plans, followed by 20 years in covered plans.

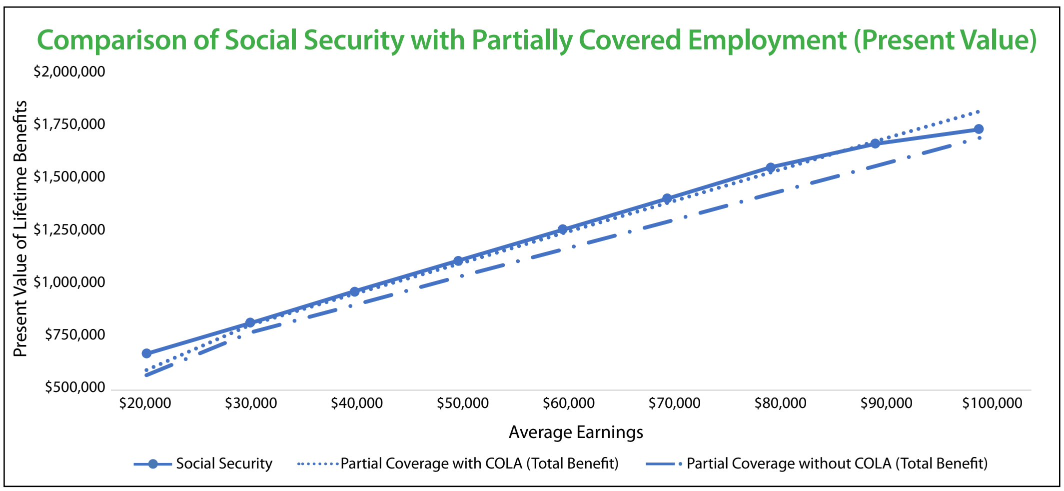
Graph 3: **Comparison of Initial Benefits, Safe Harbor Defined Benefit versus SSPIA, <u>Partial</u> Career Covered Employee**



The initial total benefit (Social Security + 3-Year Safe Harbor) for a partially covered employee is fairly close to the benefit that a similarly situated person with full coverage under Social Security would receive. This is because Social Security benefits represent most of the benefits paid and because a greater part of the reduced Average Indexed Monthly Earnings (AIME) from Social Security is in the 90% bracket and at larger sizes in the 32% bracket than is true if the worker had spent their entire career in covered plans.

Graph 4 compares the present value of benefits for participants who spent their entire career in Social Security to that of workers who spent parts of their careers in covered and non-covered plans.

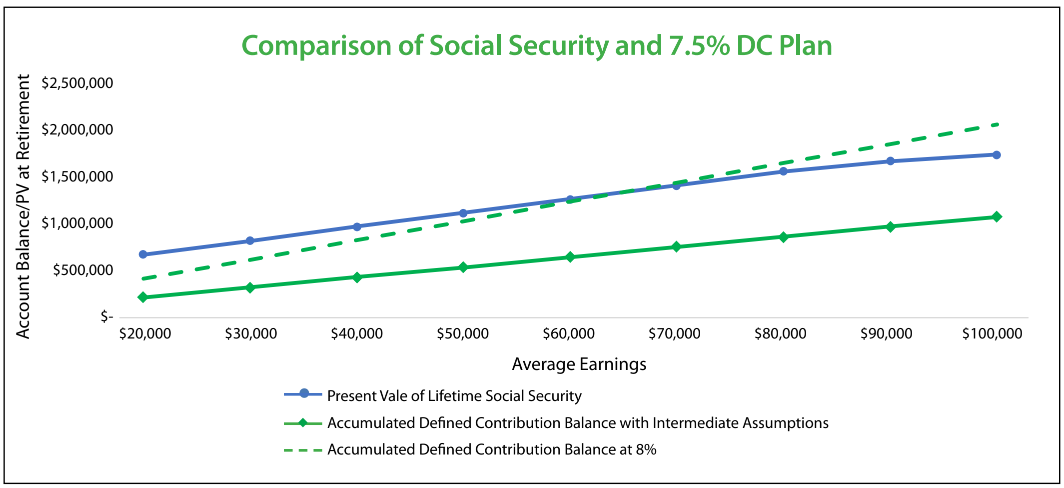
Graph 4: **Comparison of Present Value of Benefits, Safe Harbor Defined Benefit versus SSPIA, Partial Career Covered Employee**



Graph 4 shows that the shortfall for partially covered workers is nearly eliminated when a COLA is added to the non-covered plan. The three-year safe harbor formula is used in each partial coverage scenario above.

Under Section 31.3121(b)(7) of the Employment Tax Regulations, employer allocations to an employee's account in a defined contribution arrangement are required to be at least 7.5% of the employee's base compensation up to the TWB. For reference, the current allocation of payroll to the Social Security Old Age Survivors Insurance (OASI) program is estimated to be about 10%[5] of Social Security wages. It may need to be increased significantly to maintain the current benefit structure following the depletion of the Social Security Trust Fund. Note that an investment return higher than the Social Security assumption of 4.7% (8% in Graph 5) would result in higher-income people earning amounts more comparable to Social Security, but there will still be shortfalls at lesser income levels. Finally, whether or not a 7.5% defined contribution plan would have monthly benefits comparable to Social Security will depend on annuity purchase rates at the time of retirement, investment returns, and inflation rates prior to retirement.

Graph 5: **Comparison of Accumulated Value of 7.5% Defined Contribution versus Present Value of Benefits for SSPIA, Career Non-Covered Employee**



5 Total employee and employer OASDI payroll taxes, excluding amounts allocated to disability insurance.

Repeal of the Windfall Elimination Provision and the Government Pension Offset

Congress passed the Windfall Elimination Provision (WEP) in 1983 and repealed it in 2025. The WEP was intended to prevent workers who receive non-covered pensions from receiving Social Security benefits as if they were long-time, low-wage earners when they may not have been low-wage earners. Because the Social Security benefit formula is progressive, the Social Security benefits of such people are now higher as a percentage of covered earnings than they would be if Social Security had covered all their earnings.

Congress passed the Governmental Pension Offset Provision (GPO) in 1977 and repealed it in 2025. The GPO affected the benefits of spouses and widow(er)s of covered workers who also receive a pension from non-covered employment. The GPO reduced the spousal or widow(er) benefit by two-thirds of the monthly non-covered pension. The idea behind this was that if the spouse or widow(er) had been covered by Social Security, the spouse/widow(er) benefit would have been reduced by 100% of the spouse or widow(er)'s own Social Security benefits. Since the non-covered pension replaced Social Security, it was felt that some offset was justified.

Conclusions

The 91-40 safe harbor calculations are intended to ensure a comparable retirement benefit for individuals in public plans not covered by Social Security for at least part of their career. The safe harbor appears to provide reasonably comparable benefits to those provided by Social Security at retirement (depending on income level), but it does not provide insurance against inflation risk as does Social Security. It also does not provide greater benefits to lower-paid individuals than Social Security. The safe harbor focuses on retirement benefits, and other ancillary benefits are not considered. This could be viewed as unfair, because some systems that struggle to meet the safe harbor provisions provide significant automatic survivor benefits that are not considered in the safe harbor test.

Appendix 1: Assumptions Used in the Tables

Economic Assumptions are from the long-term Intermediate Assumptions of the 2024 Social Security Trustees Report. Appendix 3 also includes calculations based on the long-term Low-Cost and long-term High-Cost Assumptions in the 2024 Trustees Report.

Entry Age = 30
Entry Date = 1/1/2023
Retirement Date = 1/1/2058
Benefit Commencement Age for Pension Plan = 65
Benefit Commencement Age for Social Security = 67
Economic Assumptions

Assumption	Low-Cost	Intermediate	High-Cost
CPI-W Annual Increase	1.80%	2.40%	3.00%
AWI Annual Increase	3.54%	3.54%	3.54%
Nominal Rate on New Investments	5.80%	4.70%	3.60%

A worker's benefit at age 67, called the primary insurance amount (PIA), is based on the average worker's wage up to the taxable wage base (TWB) in the 35 highest-earning years. For this purpose, wages earned before age 60 are adjusted by the average wage index (AWI), that is, the ratio of the national average wage (NAW) in the year of attaining age 60 to the NAW in the year earned. The resulting average, divided by 12, is called the Average Indexed Monthly Earnings (AIME). The PIA is then calculated by the formula: 90 percent of the AIME up to the first bend point, plus 32 percent of the AIME from the first to the second bend point, plus 15 percent of the AIME above the second bend point.

Appendix 2: Sample Data Used in Graphs

Table 1: **Comparison of Initial and Lifetime Benefits, Safe Harbor Defined Benefit versus SSPIA, Career Non-Covered Employee (Corresponds to Graphs 1 and 2)**

	Safe Harbor 1.50% of 3-year Final Average Pay	Safe Harbor 1.75% of 10-year Final Average Pay	Social Security PIA
Age, Service at Retirement	65, 35	65, 35	67, 35
Initial Monthly Benefit	$4,139	$4,294	$4,800
Present Value of Lifetime Benefit[1]	$657,328	$682,089	$820,634
Safe Harbor vs. PIA PV	80%	83%	N/A

[1]The 91-40 safe harbor does not require a COLA; hence, it was not included in the present value calculation. Social Security does have a COLA.

Annual earnings in all three examples are assumed to be $30,000, increasing at the assumed AWI rate of 3.54% per year. Since earnings are assumed to increase by the change in the AWI each year, the actual annual earnings would be projected to be $30,000 for age 30, $30,000 x 1.0354 for age 31, and so on. For the three-year safe harbor, the monthly benefit would equal the average annual compensation for ages 62 through 64, times 35 years of service, times the safe harbor factor of 1.5%, divided by 12, or $4,139.

For Social Security, the AIME in this example would be $7,173. The Social Security NRA for individuals born in 1960 or later is age 67, the benefit commencement age used in this illustration. The actual illustration assumes that the monthly benefit (also referred to as the primary insurance amount or PIA) would equal 90% of the first $3,394, plus 32% of the next $17,066 and 15% of the remaining AIME up to the Social Security maximum. These bend points are equal to the 2023 Social Security bend points increased by the change in the AWI of 3.54% to the age of 60.

One final note is that using a different starting point with proportional increases to the AIME and the AWI would not change the shape of the graphic; rather, it would just cause the relationships to shift by the proportional increases in the AIME.

Table 2: **Comparison of Initial and Lifetime Benefits, Safe Harbor versus SSPIA, Career Non-Covered Employee with COLA (Corresponds to Graph 2)**

	Safe Harbor 1.50% of 3-year Final Average Pay	Safe Harbor 2.00% of 10-year Final Average Pay	Social Security PIA
Age, Service at Retirement	65, 35	65, 35	67, 35
Initial Monthly Benefit	$4,139	$4,294	$4,800
Present Value of Lifetime Benefit[1]	$837,146	$868,681	$820,634
Safe Harbor vs. PIA	102%	106%	N/A

This illustration is identical to Table 1, except that a COLA is included in the calculation.

Table 3: **Comparison of Initial Benefits, Safe Harbor Defined Benefit versus SSPIA, Partial Career Covered Employee (corresponds to Graph 3)**

	Safe Harbor 1.50% of 3-year Final Average Pay	Safe Harbor 2.00% of 10-year Final Average Pay	Social Security PIA
Age, Service at Retirement	65, 35	65, 35	67, 35
Years of Covered Employment	20	20	20
Monthly Benefit	$4,589	$4,622	$4,800
Safe Harbor vs. PIA	96%	96%	N/A

This illustration assumes that a worker was employed from age 30 to age 45 in a covered plan, and from age 45 to 65 in a non-covered plan. Scenarios where a worker spends the first part of their career in non-covered plans, and the remainder in covered plans are more likely than other scenarios to result in earnings that are less than amounts derived for an individual who spends their entire career in covered plans, insofar as covered plans are indexed for changes in wages and non-covered plans typically are not indexed.

As in Graph 1, compensation is determined assuming a constant rate of wage increase of 3.54%.

Table 4: **Comparison of Initial Benefits, 7.5% Defined Contribution plan versus SSPIA, Career Non-Covered Employee (Corresponds to Graph 4)**

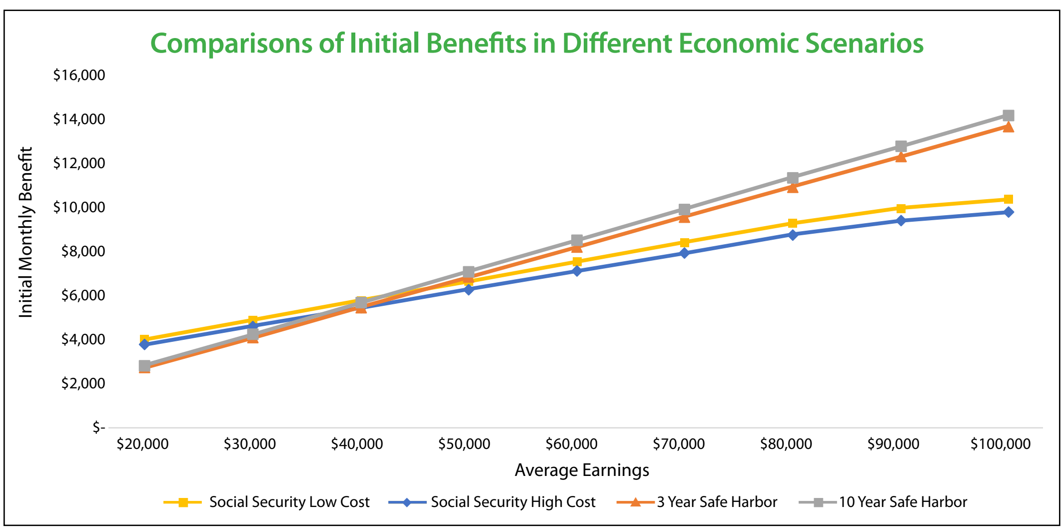
	Defined Contribution Employer Contributions	Social Security PIA
Age, Service at Retirement	65, 35	67, 35
Estimated Account Balance at Retirement	$322,776	$820,634
Monthly Benefit at Retirement	$1,626 (Actuarial Equivalent with COLA)	$4,800
Defined Contribution vs. PIA	34%	N/A

This illustration compares Social Security with a defined contribution plan in which contributions are 7.5% of payroll. One key assumption is that the defined contribution plan is assumed to grow at the Social Security long-term investment assumption of 4.7%.

Appendix 3: Sensitivity Tests of the Calculations in Graphs

One feature of the sensitivity assumptions is that the initial non-covered payments will not vary by scenario. This is because the Social Security sensitivity tests vary CPI and investment rates, but do not vary the AWI used in the scenario calculations to project salaries. As a result, only Social Security amounts vary by scenario due to the use of CPI to project compensation after age 62.

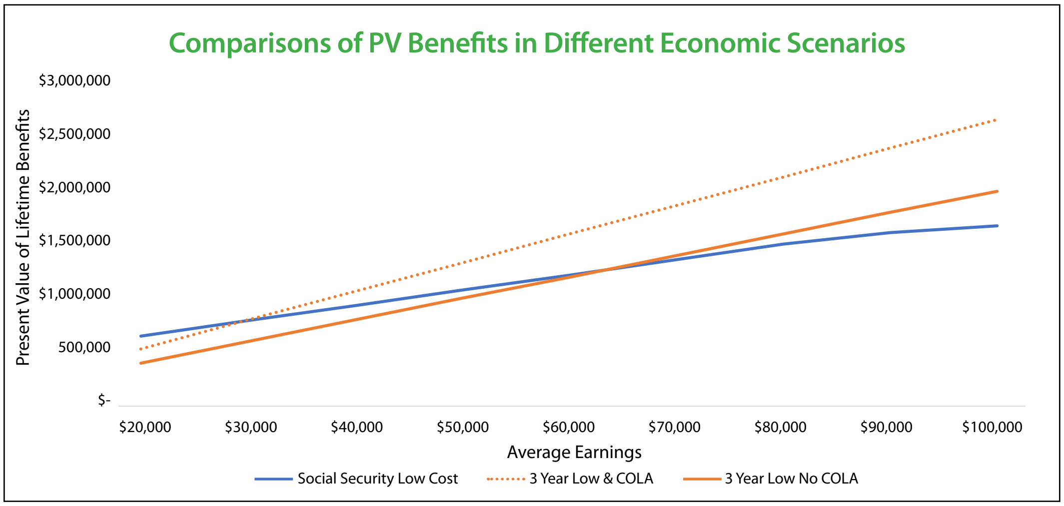
Graph 6: **Comparison of Initial Benefits, Safe Harbor Defined Benefit versus SSPIA, Career Non-Covered Employee (Corresponds to Graph 1)**



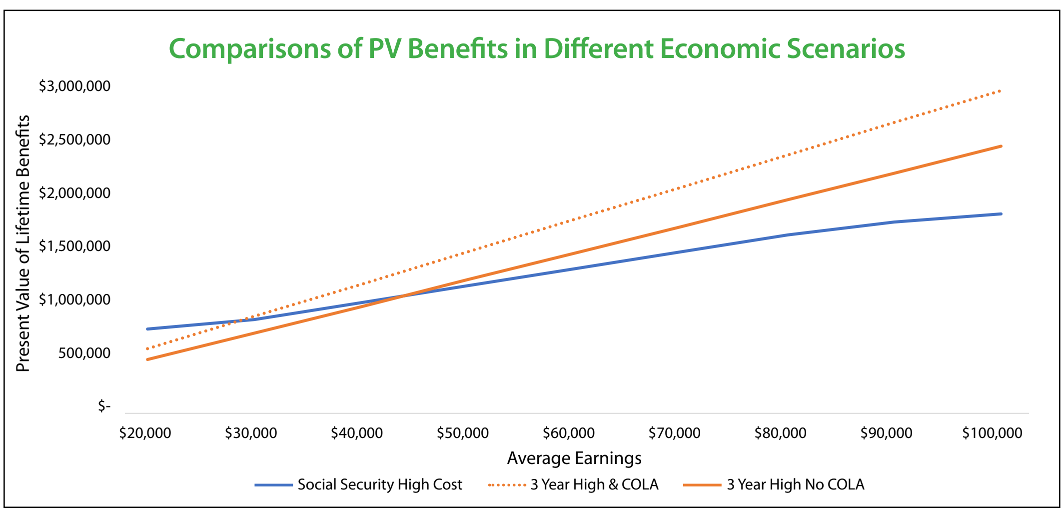
Because of the progressive nature of the Social Security benefit formula, initial benefits are fairly close to the safe harbor for lower income levels. At upper-income levels, the disparity becomes even wider.

Although initial non-covered benefits do not vary by scenario, the present value of benefits does vary, particularly when comparing plans with and without COLAs.

Graph 7: **Comparison of Lifetime Benefits, Safe Harbor Defined Benefit versus SSPIA, Career Non-Covered Employee (Corresponds to Graph 2), Low-Cost Assumptions**



Graph 8: **Comparison of Lifetime Benefits, Safe Harbor Defined Benefit versus SSPIA, Career Non-Covered Employee (Corresponds to Graph 2), High-Cost Assumptions**



The present values in each scenario are closest at the lower income levels. If there is no COLA, the present value of the three-year safe harbor is below that of Social Security except at higher income levels. This is more pronounced under the Low-Cost Assumptions, as shown in Graph 7. Under the High-Cost Assumptions shown in Graph 8, the safe harbor without COLA exceeds the Social Security benefit at most income levels.

The impact on initial benefits for partially covered workers is relatively independent of economic assumptions, with comparisons similar to what is shown in Graph 3.

Another sensitivity test involves comparing initial benefits and the present value of benefits after WEP. The comparison of initial benefits is relatively straightforward, once public sector benefits reach their maximum ($558 in 2024).

Appendix 4: Double Proration

The safe harbor rule does not permit "double proration" of benefits for part-time employees.

Double proration occurs, for example, if both the service credit and the compensation recorded for benefit accrual purposes are reduced due to part-time employment. A simplified example best illustrates this. Suppose a public defined benefit plan whose participants are not covered by Social Security provides a benefit of 1.50% times the number of years of service, times three-year average final compensation. John is covered by this plan and has worked half-time for 30 years in a job that has always been compensated at an annual rate of $50,000. The safe harbor formula would ***not*** permit John's retirement benefit to be calculated as follows.

Pension cannot be: ½ x 30 years x ½ x $50,000 x 1.50% = $5,625 per year

Such a calculation would be a double proration because both the final average compensation and the service have been reduced due to the part-time nature of John's employment. If the calculation were actually done that way, this person would get one-fourth the benefit that a full-time employee would get, instead of the one-half that might be expected. The safe harbor formula permits only one proration factor. In this simplified example, John's benefit could be no less than $11,250. A similarly situated full-time employee would get a benefit of $22,500.

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