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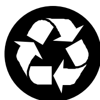

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Practice Pointer

How Does *Neville v. Neville* Introduce Social Security Into Ohio Divorces?

by Dave Kelley
QDRO Consultants/ Pension Evaluators

This Issue: Theory

What Social Security benefits and resulting present values are courts likely to examine as a result of *Neville*? What makes this seemingly simple question so very complex?

Next Issue: Practice

What will *Neville* valuations likely show? The second part of the article will offer age-based case studies to help the domestic relations attorney sort out potential scenarios. In addition, language for deferred distributions will be offered.

Overview

The recent Ohio Supreme Court decision of *Neville v. Neville*, 99 Ohio St.3d 275, 2003-Ohio-3624, 791 N.E.2d 434 (2003) has directly

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introduced Social Security into most divorces, especially those of 10 years or more. The court ruled that the differing Social Security entitlements of the parties were a "relevant and equitable factor" in the property division. In fact, the court awarded the homemaker-wife the house in recognition of the greater value of her husband's Social Security.

The impact of *Neville* is unclear for two basic reasons: the complexity of Social Security benefits and the difficulty of factoring in future events such as remarriage and future wages into the calculations.

Generally, however, the courts are likely to examine three Social Security benefits and their resulting present values in pure Social Security marriages, i.e. one in which no government pensions in lieu of Social Security have been acquired.

(1) The earned Social Security benefit of the higher wage worker;

Versus the greater of:

(2) The earned Social Security of the worker with smaller wages under covered compensation;

Or

(3) The Independent 50% Spousal Benefit;

Or

(4) The Independent 50% Spousal Benefit *and* potential 100% Divorced Widow(er)'s Benefit.

Practice Tip

The Social Security Manual published by The National Underwriter Company, P.O. Box 14367, Cincinnati, OH 45250-0367. Telephone: 1-800-543-0874, www.nationalunderwriter.com, is a well written, inexpensive book that should become your bedside companion.

Acknowledgements

Neville poses many open-ended questions to Ohio courts and attorneys. Hopefully, this two-part series will help define the discussion of many of those issues. My thanks go to the two teams that have worked for a month on the issues discussed in this series: first, to actuary Mike Libman and Joe Connare of Libman, Ryder & Company and then to ERISA attorney Gary Shulman, Heather Stoll, Brian Hogan and Dauna Hutter at QDRO Consultants for their efforts to reflect as accurately as possible the Social Security entitlements of those undergoing a divorce and the resulting present values. Their 100+ years of combined work in the actuarial and pension field made these articles possible.

What did the Ohio Supreme Court decide in Neville v. Neville, 99 Ohio St.3d 275, 2003-Ohio-3624, 791 N.E.2d (2003)?

Neville brings Social Security into the division of property in nearly every Ohio divorce. A unanimous bench ruled that "a trial court, in seeking to make an equitable distribution of marital property, may consider the parties' future Social Security benefits in relation to all marital assets." The surprising aspect of *Neville* is that the court recommended "that appellant be awarded the equity in the marital residence, explicitly balancing its value against appellee's Social Security benefits."

The decision surprised many. They believed that *Hisquierdo v. Hisquierdo*, 439 U.S. 572. 99 S.Ct. 802 (1979) preempts state courts from even considering Social Security benefits. In *Hisquierdo*, the U.S. Supreme Court ruled that the Supremacy Clause of the Constitution prohibits courts from directly partitioning Social Security benefits in a divorce as property.

Others felt the facts of *Neville* allowed the court no other choice if it wished to arrive at an equitable division of property. While *Neville* advocates agree that Social Security is not directly divisible, they argue that it should be considered in the totality of

circumstances in a divorce. The Iowa Supreme Court, for example, in *In re Marriage of Boyer*, 538 N.W.2d 293, 296 (Iowa 1995) used similar logic in contending that Hisquierdo should not force courts to "purge so obvious an economic reality in its assessment." Interestingly, Boyer was not cited in Neville.

The "totality of circumstances" argument is a strong one. It has been used effectively even in dividing military disability pensions which the U.S. Supreme Court in *Mansell v. Mansell*, 490 U.S. 581, 109 S.Ct. 2023 (1989) declared not subject to direct division. *Clausen v. Clausen*, 831 P.2d 1257 (Alaska 1992) is similar to *Neville* in that the Alaskan Supreme Court held that while the federal preemption prohibited the direct partitioning of the military disability pension, it should consider it in the split of marital property. The Court went on to say that, "We see no valid reason why veterans' disability benefits should not be considered in making an equitable allocation of property and thereby avoid the need to award spousal support. Our approach is, if anything, even more compatible with federal law as it provides a disabled veteran sole possession of his or her disability benefits both in law and in fact."

The *Neville* court faced the common scenario where one spouse has greater Social Security benefits than the other spouse. Judi Neville, a 50 year-old high school graduate, "had devoted her married life to raising their children." As a stay-at-home mom she had only amassed 12 of the necessary 40 quarters for Social Security coverage based on her own covered employment. However, because she was married for more than 10 years, she was covered under the 50% divorced spouse benefit.

The court recognized that full-time homemakers suffer economically at divorce. They cited a 1994 treatise <u>Social Security Law and Practice</u> by Editors Flaherty and Sigillo as justification for examining differing Social Security benefits because "a spouse's social security contributions and ultimate benefits have been increased by the work of the other spouse, and … that a nonemployed spouse loses spending power after a divorce through the inability to use the other spouse's social security benefits."

In fact, the decision noted that the R.C. 3105.171(C)(1) directs courts to consider "all" relevant factors in dividing property. Furthermore, R.C. 3105.171(F)(9) has a "catchall" wording that the court is to consider "Any other factor that the court expressly finds to be relevant and equitable." Clearly, the Ohio State Supreme Court now considers Social Security to be one of those "relevant and equitable" factors.

Exploring how Social Security will be factored into Ohio divorces as a result of Neville must start with a discussion of seven issues.

Introducing Seven Issues to Consider in Developing Neville Reports

At least seven significant concerns crop up in attempting to value Social Security benefits for a divorce. All issues will be dealt with in more detail later in this article.

I.) *Frozen Social Security Benefit v. Pre-Retirement COLA Benefit*. Should the frozen benefit at divorce be valued or the likely benefit at retirement assuming an increase due to the yearly reindexing of benefits? Keep in mind that a plan participant who terminates covered compensation at the age of 50 continues to see their benefit increase for at least 10 years before retirement as a result of ongoing wage indexing. In other words, should a pre-retirement cost of living adjustment (COLA) be factored in?

II.) *"Coattail" v. Frozen Benefit*. Should the projected "coattail" benefit available to former spouses be valued rather than the frozen benefit accrued during the marriage?

This "Coattail" is in addition to the Pre-Retirement COLA available under the plan. "Coattail" refers to the fact that a former spouse receives 50% of the primary insurance amount of the worker based on the benefit accrued *at retirement not at the date of divorce*. That means that a former spouse rides along with the worker during the years subsequent to the divorce and continues to accrue both the pre-retirement COLA as well as the benefit of additional years of earnings.

III.) *Remarriage Penalty*. Because the spousal benefit is lost upon remarriage, should the probability of remarriage be factored into the valuation?

IV.) *Marital Portion*. Is a pure time based marital fraction the best method of determining the amount of Social Security earned during the marriage or is a refinement based on determining the average indexed earnings acquired during the marriage over the total average indexed earnings a more accurate method?

V.) *Actuarial Expertise*. Typical present value software is quite inadequate to value spousal/widow(er) benefits which factor in multiple life expectancies, varying benefits with different reduction factors and varying retirement ages.

For example, a divorced spouse widow's benefit of 100% of the primary insurance amount (PIA) is available to a former spouse as early as age 60 (actually age 50 if disabled!) and is, obviously, contingent upon the death of the plan participant. However, until the demise of the worker, the divorced spouse receives benefits at 50% of the PIA starting as early as age 62, subject, of course, to early retirement reductions factors.

VI.) *Offsets to Social Security*. Numerous offsets exist to Social Security.

This is especially true when government pensions like Civil Service or state plans like the Ohio Public Employees Retirement System or the State Teachers Retirement System of Ohio are involved. There are two basic offsets: the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP). Under the GPO, a person receiving a government pension in lieu of Social Security loses two dollars of their spousal or widow(er)'s benefit for every three dollars of the government pension they receive. Under the WEP those who work under both covered compensation and under a government plan without a Social Security component lose about half their potential Social Security. This reduction phases out if one has between 20 to 30 years of "substantial" earnings under covered compensation.

VII.) *Fiscal Soundness of Social Security*. Because the evaluator is making assumptions about the future, should valuations reflect the fiscal soundness of the plan and potential changes in the system? For example, because means testing is one of the more politically palatable possible changes in the system should divorces involving young and affluent couples factor in Social Security differently than older, middle income couples? While some changes are likely in Social Security, it remains the third rail of American politics – touch it and die. Means testing, higher payroll taxes and higher taxes on benefits are likely. Its demise is not.

But before these issues are discussed it is important to have a general but clear sense of how Social Security works. *Little of the following discussions will make much sense until the material in the following section is understood.*

A Brief Primer on How Social Security Benefits Are Calculated

Three Basic Social Security Factors

A worker's retirement benefits are dependent on three basic factors:

(1) *Years of Social Security covered employment*. To achieve full retirement benefits a worker must be employed for at least 35 years. Younger workers with high wages will not reach high benefit levels until their work careers expand. This also means that divorced spouses who do not work outside the home under covered compensation for a long period will never be able to match the Social Security benefits of a former spouse who was the primary earner. [Incidentally, this is the genesis of the suggestion by some that wages earned during a marriage by the sole worker under covered compensation should be divided for Social Security purposes between the husband and wife.]

(2) *Level of compensation*. Retirement benefits are directly linked to the worker's earning history indexed at the time of retirement eligibility. Indexing is little understood and is different than the post-retirement cost of living adjustment that is widely reported in the news.

(3) *Age and type of retirement*. The normal retirement age (NRA) under Social Security at which full benefits are payable is 65 years and 2 months for those born in 1938 and who will reach age 65 in 2003. The NRA is gradually being increased to 67 which will be applicable for those born in 1960 and after. Note that retirement at age 62 will still be available but the benefit as a percentage of the full benefit is being reduced. For example, for someone born in 1941 and who retires in 2003 at the age of 62, the benefit will be 76.7% of the full benefit available at age 65 years and 8 months. Someone born in 1960 who retires at age 62 in 2022 will only receive 70.0% of the NRA benefit which would have been paid at 67 years of age.

Determining the Average Indexed Monthly Earnings and the Primary Insurance Amount

Here is how the actual benefit—based on the all important Average Indexed Monthly Earnings (AIME)—is calculated and then how the Primary Insurance Amount (PIA) is determined. This is the simplified version but does not leave out especially pertinent information. Also note that Social Security is a social safety net that is meant to replace a greater percentage of the wages for lower wage earners. You will see how this is done by multiplying different levels of the average indexed monthly earnings by three decreasing percentages.

There are three steps in the process: Index the earnings record, determine the Average Indexed Monthly Earnings (AIME) and then apply a three tier benefit multiplier to the AIME to determine the Primary Insurance Amount (PIA). Now to a more detailed analysis:

(1) The worker's wages under covered compensation are indexed against the national average wage level *at the time of eligibility* (typically age 62 for retirement benefits) to more accurately reflect the time adjusted value of those wages. Indexing is extremely important because it means, in essence, that every year all of a non-retired worker's past earnings are worth more because of this constant reindexing. This reindexing is based on the increase (if any) in the average nationwide (covered and noncovered) total wages. In a sense, this is a Pre-Retirement cost of living adjustment (COLA) for Social Security. However, this Pre-Retirement COLA is not the same as the Post-Retirement one, which is based on increases in the Consumer Price Index for All Urban Wage Earners and Clerical Workers. For example, for a worker who reaches age 62 in 2003 and who earned $6,000 in 1975, the wages would currently be indexed at $22,886.50. However, in 2001 those 1975 wages were indexed at $21,181.87.

For the past five years, here is how the Post-Retirement COLA based on the CPI differed from the Pre-Retirement COLA based on the total national wages.

	CPI (Post-Retirement)	Wage Indexing (Pre- Retirement)
1999	1.3%	5.84%
2000	2.5%	5.23%
2001	3.5%	5.57%
2002	2.6%	5.53%
2003	1.4%	2.39%

The distinction between the increase in total wages in the country (and the resulting Social Security taxes!) and the CPI for Post-Retirement benefits is important in a largely pay-as-you-go system like Social Security. In fact, if the wages increase less than the CPI and reserves in the trust fund fall below 20% of the necessary amount to fund benefits for a year, Post-Retirement benefits would be based on the wage increase percentage and not the CPI.

(2) The highest indexed and nonindexed (the last two years of earnings are not indexed!) earnings for up to 35 years are added and then divided by 420 (35 years x 12 for the months). If there are less than 35 years of earnings, tough luck! The total indexed and nonindexed earnings are still divided by 420. This is the reason for the earlier comment that extended periods spent out of the paid workforce will likely limit a worker's retirement benefits. The result is the Average Indexed Monthly Earnings (AIME).

(3) Multiply the AIME by the tiered percentage. In 2003 those "bend points" are:

(a) 90% of the first $606

(b) 32% of AIME in excess of $606 through $3,653

(c) 15% of AIME in excess of $3,653

(4) The total of the three tiers of multiplication is the Primary Insurance Amount (PIA) which is the amount of the worker's benefit at Normal Retirement Age (NRA). The PIA is also the basis for the divorced spouse and widow(er)'s benefits.

Reduction Factors for Worker, Divorced Spouse and Divorced Widow(er)

Simply peruse this section to recognize that all three groups: worker, divorced spouse and divorced widow(er) have different early commencement reduction factors. The age of full retirement benefits is gradually being increased to age 67.

Those reductions are:

(a) For worker: 5/9 of 1% for the first 36 months from full retirement age and 5/12% thereafter. Earliest commencement is age 62.

(b) For divorced spouse: 25/36 of 1% for the first 36 months from full retirement age and 5/12% thereafter. Earliest commencement is age 62.

(c) For divorced widow(er): 19/40 of 1% from full retirement age. The earliest commencement age is 60. Note: for widow(er)s whose full retirement age is greater than 65, the reduction factor is .715 at age 60. This is frozen. For other ages between age 60 and full retirement, the factor is interpolated.

Impact of Yearly Indexing on Ohio Divorces

What does this wage indexing mean to divorces you handle? Trouble and confusion. In our experience Ohio courts have normally dealt with frozen accrued Social Security benefits – not those resulting from reindexing on a yearly basis until retirement. After all, courts and attorneys are used to the frozen accrued benefits under ERISA plans and want to compare "apples and apples." Factoring in Pre-Retirement

COLA to Social Security may seem speculative. Keep in mind that Ohio courts have just recently begun to routinely accept post-retirement COLA present values.

However, simple is not always equitable. To ignore the very real pre-retirement growth component of Social Security as "speculative" is as myopic as ignoring the post-retirement COLA. Insistence on using the frozen Social Security benefit at the time of divorce to superficially make this non-ERISA benefit similar in form to ERISA benefits essentially distorts – and lessens - the value of the Social Security for merely cosmetic purposes. You should not compare apples and oranges as though they are apples and apples simply because one believes they should look more similar.

The previous concentration of courts on frozen benefits at the time of divorce may likely give way to a more expansive understanding of Social Security to take into account the very different nature of Social Security benefits and the inherent Pre-Retirement COLA because of yearly reindexing before retirement. In other words, if courts will be examining Social Security benefits more carefully, those benefits need to represent the actual monthly amounts that are likely to be received as closely as possible making prudent, conservative assumptions.

What Are the Eligibility Factors and Amounts for the Divorced Spouse and Divorced Widow(er) Benefits?

Once divorced spouses have met certain requirements, they have the independent right to a separate benefit computed as 50% of the Primary Insurance Amount (PIA) of the worker. A divorced widow(er) receives a benefit of 100% the PIA. Note that the Maximum Family Benefit (MFB) does not apply to former spouses. It is entirely conceivable that a worker could leave a number of former spouses each with an independent right to a benefit 50% the size of the worker's PIA when the worker retires.

To qualify for the independent 50% divorced spouse benefit, all the following requirements must be met by the former spouse:

(1) Must have been married for at least 10 years to worker and not one day less!

The worker need not have been employed under covered compensation during the marriage which is, of course, very different than spousal rights under military pensions where the 10 year rule means there must be an overlap of the marriage and military service.

(2) Must be at least age 62 and not entitled to a Social Security benefit greater than the divorced spouse's benefit.

(3) Must be currently unmarried. However, divorced spouse benefits may revert immediately after a divorce or death of subsequent spouse.

(4) Must have divorced for at least two years. (This is waived if the worker was eligible for benefits before the divorce.)

(5) Must be the divorced spouse of a wage earner who is entitled to retirement or disability benefits. That means that the worker must also be at least age 62 and have earned the required quarters of coverage.

Practice Tip

Ten years. Ten years. Ten years. Never allow a divorce action to take place if the 10-year qualifying threshold for spousal Social Security is looming and a signed warning waiver has not been obtained! This is a critical factor for all those undergoing a divorce. For a younger spouse who can enjoy the "Coattail" spousal effect in which they receive 50% of the worker's PIA *at retirement and not at divorce*, the value of the benefit can be startling – frequently eclipsing the value of the worker's Social Security earned during the marriage. Of course, the

loss of the 50% spousal Social Security benefit by remarriage or the termination of a marriage before 10 years could also be devastating for an older individual.

To qualify for the 100% divorced widow(er)'s benefit, all the following requirements must be met by the claimant:

(1) Must have been married for at least 10 years to a worker who died fully insured.

(2) Must be at least age 60 (50 if disabled!).

(3) Must not be married *unless the marriage took place after reaching age 60*.

(4) Must not be eligible for a benefit greater than the widow(er)'s benefit.

To completely explain the widow(er)'s benefit is complex and beyond the scope of this article. Here is a sample why. A divorced widow(er) of a fully insured deceased worker has numerous options to maximize the benefit. For example, an individual could first draw a reduced benefit at age 62 based on their own covered compensation and then switch to a full – or even enhanced – widow's benefit at a later date.

Discussion of the Seven Issues

Earlier, we introduced the following seven issues to consider in valuing Social Security. Let's deal with those areas in more detail now for those desiring – or needing - more complete mastery.

(I) *Frozen Social Security v. Pre-Retirement COLA Benefit*. As argued earlier, the inherent nature of Social Security should be reflected in future present value reports. That means that the frozen benefit is less realistic than the wage indexed benefit at the time of retirement. This will increase the traditional Social Security values courts are used to seeing. Because many of the concepts behind Social Security are obscure and the exact amount of the future pre and post retirement COLA increases not certain, this will not necessarily be an easy sell to many Ohio courts.

In our estimation, however, it is a necessary step towards equitably implementing *Neville*.

(II) *"Coattail" v. Frozen Benefit*.To be consistent with the logic of reflecting likely Social Security benefits as realistically as possible, it is important to consider the impact of a possible "Coattail" effect for the 50% divorced spouse and 100% divorced widow(er) benefits. Because the former spouse receives 50% of the final PIA of the worker, it is important to make a conservative projection of what the worker's future wages will be and the resulting benefit. This conservative projection will allow the parties to see that the "Coattail" effect for the divorced spouse will often overshadow the amount of the Social Security earned during the marriage by the worker.

Thus, worker Social Security benefits are likely to reflect the yearly increase due to wage reindexing while divorced spouse/widow(er) benefits are likely to reflect that yearly increase *and* the impact of continued employment. Under this scenario, the worker's Social Security earned during the marriage will reflect a conservative wage indexing increase. The official Social Security software developed by the Office of the Actuary currently offers three alternatives to reflect the pre-retirement COLA due to wage indexing. Those alternatives offer 2%, 3% and 4% increases and help alleviate the contention that "overly speculative" assumptions are being made if the more conservatives percentages are used.

Be prepared. The size and value of the divorced spouse's (and widow(er)'s) benefit will likely stun many under the suggested "Coattail" scenario.

(III) *Remarriage Penalty*. Divorced spouse benefits are lost upon remarriage. While a large percentage of Ohioans who divorce remarry, it is their choice to do so. To factor in a remarriage probability is certainly possible and would focus on the person's age at the time of divorce. But such an exercise seems futile for a number of reasons.

First, a divorced spouse can reclaim the 50% benefit by divorcing a current spouse at any time! Thus, former spouses have a myriad of "financial planning" strategies available to them. Second, to merely reduce a spousal benefit by a remarriage factor is far too simplistic. For example, a single reduction would not reflect the fact that second marriages are more likely to end by divorce than first marriages.

Finally, consider the impact that *Neville* cases will have on remarriage. Parties to a divorce in Ohio are far more likely to understand their Social Security entitlements as a result of Social Security reports generated by *Neville* than they previously were. Such knowledge is also likely to change behaviors with more and more people forgoing formal marriages if it is financially advantageous to do so.

(IV) *Marital Portion*. Determining the marital portion of a Social Security benefit is not nearly as simple as applying a time based coverture fraction to the benefit. Time based coverture divides the years of service while married by a denominator of the total years of service at retirement. As we have seen, Social Security accrues based on the actual earnings after they have been indexed. Some years of low wages – even after indexing – simply are not worth as much as higher indexed wage years. If one wishes to accurately reflect the benefit "earned during the marriage" employing a refinement to time-based coverture is necessary.

Because Social Security benefits are based on one's earnings after they have been indexed, a more accurate method to reflect the marital portion of Social Security than a simple time based fraction is to employ a coverture fraction using the Average Indexed Monthly Earnings. The numerator would be the Average Indexed Monthly Earnings during the marriage and the denominator the total Average Indexed Monthly Earnings at retirement. This would avoid treating years of low or partial wages as being equal to years of larger wages when they are, in fact, not. It would also avoid the tendency to believe, for example, that wages of $20,099.55 in 1989 are worth less than wages of $30,469.84 in 1999. In fact, they are worth exactly the same after being indexed in 2003: $32,921.92.

(V) *Actuarial Expertise*. The actuarial challenge of Social Security present values will be easier to explain with the tables and graphs in the next issue. Suffice it to say, however, that determining survivorship present values or the "tale of the tail" is challenging enough even before one adds in the varying retirement ages and potential benefits.

(VI) *Offsets to Social Security*. The "Government Pension Offset" (GPO) eviscerates spousal and widow(er)'s benefits for those who work under government pensions which are not under Social Security and have a spouse working under covered compensation. Under the GPO a participant in a non-Social Security covered government plan loses two dollars of her or his spousal Social Security benefit for every three dollars they receive from the government pension. For example, if a retiree is receiving $9,000 a year from a STRS or CSRS pension he or she will lose all spousal Social Security benefits up to $6,000. In essence, few government plan participants will ever enjoy a spousal Social Security benefit.

Participants who have worked in non-Social Security jobs at one point in their lives, but have also accrued the 40 Quarters necessary to earn Social Security benefits as a result of their own covered earnings, will not earn their entire benefit because of an offset commonly called the "Windfall Elimination Provision." (WEP) Typically, they lose about half their benefit.

The Windfall Elimination Provision (WEP*)* is more complex than the GPO. As pointed out earlier, the Social Security Administration (SSA) separates a worker's average indexed monthly earnings (AIME) into three layers and multiplies the figures using three factors. In 2003, for example for a worker who turned 65 in 2003 the first $606 of his or her AIME earnings would be multiplied by 90%; the AIME in excess of $606 through $3,653 would be multiplied by 32%; and the remainder by 15%.

In the modified formula, when a worker receives a pension from a job for which no Social security taxes were withheld, the 90% factor is reduced to 40%. This reduction to 40% gradually phases out at 5% a year as one exceeds 20 years of "substantial" Social Security earnings ($5,100 in 1980 to $16,125 in 2003) until it disappears with 30 years of substantial earnings. Thus, a worker with 25 years of substantial earnings would multiply the first $606 by 65% and not 40 or 90% (40% + 5% X 5 years)

(VII) *Fiscal Soundness of Social Security*. One of the most predicable challenges to Social Security present values being used to offset real property is the common perception that it won't even be around when people retire. That, of course, is incorrect but it is important to offer an analysis of the fiscal health of Social Security to overcome this erroneous contention. However, Social Security does have two commonly known problems: the growing longevity of Americans and the graying of America with fewer and fewer workers making transfers of monies directly to retirees.

The 2003 Social Security Trustees Report projects that the OASI and DI trust funds will become exhausted in the year 2042. This means that under the intermediate projections of the trustees, the Social Security Administration (SSA) will be able to pay full benefits until the year 2042 if no changes at all are made to the system. The Report offers the following options for preserving the solvency of the system until 75 years from present: "The combined payroll tax could be increased 1.92 percentage points, benefits could be reduced immediately by 13%, a transfer of $3.5 trillion in general revenue (net present value) could be made, or some combination of approaches could be adopted."

Clearly, this important aspect of the report is strongly at odds with the widely held belief that the system is on the verge of bankruptcy. Given the very strong, widespread and consistent support Social Security has received from the public, it is clear that an extension of solvency to 75 years from the present based on transfer of general revenue and increased payroll taxes rather than reduced benefits is (at minimum) highly probable *if* the aforementioned trustees' intermediate projection is reasonably accurate.

The main difficulties in gauging the reliability of such figures is the nature of Social Security relative to the rest of the federal budget and the appropriateness of the economic assumptions made. While Social Security is legally an off budget item (meaning that its revenues and outlays are supposed to be counted separately from the rest of the federal budget) the qualification has very little practical effect. Take, for instance, the following chart from the Congressional Budget Office's (CBO) August 26, 2003 report:

	02	03	04	05	06	07	08	09	10	11	12	13	(04-08)	(4-13)
On-Budget Deficit (-)	**-317**	**-562**	**-644**	**-520**	**-425**	**-421**	**-434**	**-426**	**-417**	**-298**	**-143**	**-105**	**-2,444**	**-3,833**
Off-Budget Surplus	**160**	**162**	**164**	**179**	**199**	**219**	**237**	**255**	**273**	**289**	**304**	**317**	**999**	**2,436**

Almost without exception media reports on the deficit note that the projection had grown to $450+ billion and do not mention the projected on-budget deficit is $162 billion higher. The Iraq occupation is, of course, now adding at least another $87 billion to that deficit. It is by now a standard practice for politicians to obscure the real size deficits by subtracting the consistent Social Security surpluses. This sleight of hand is quite rarely pointed out.

The above chart indicates that the SSA surplus will not exceed the on-budget deficit until 2012 indicating that (granted the CBO's numbers are correct) the entirety of the Social Security surplus until 2012 will be spent to fund other programs. Conversely, the 2003 Trustees Report projects that the Trust Fund will grow from $1.378 trillion in 2003 to $3.556 trillion in 2012. There is little chance anything approaching such growth will happen absent very significant and quite unlikely changes in federal policy that close the on-budget deficit to a size significantly smaller that the Social Security surplus.

To make matters worse, the above chart reflects assumptions that are in many respects quite dubious. It does not take into account emergency supplementals (such as the costs of wars), likely increases in statutory spending (such as prescription drug benefits) and it assumes that none of the tax cuts set to expire at the beginning of the next decade will be extended. These doubtful assumptions, if compensated for, turn an already gloomy outlook into a notably more dire situation. For example, the CBO's August 2003 "Budget and Economic Outlook" report forecasts that if the tax cut provisions are extended and "A Medicare prescription drug benefit was provided at the cost assumed in the Congressional budget resolution," a projected surplus of $211 billion in 2013 would turn into a $324 billion deficit.

Discarding the fiction that the funding and outlook for Social Security is meaningfully divorced from the rest of the federal budget shifts the points of focus from the future of the Social Security Trust Fund and the inadequacy of the current payroll tax rate to finance the Baby Boomers' retirement toward the future of the federal budget as a whole and Social Security's place within it.

Ultimately, the future of Social Security (as with any government program) is a political question. In order to forecast whether sufficient political will to fully fund the program will exist, three questions are especially pertinent: (1) "How much will it cost?"; (2) "What programs or expenditures will it be competing for funds with?"; and (3) "What level of tax increase and/or budget cuts would be needed to fully fund the program?" To separate and answer these questions it is necessary to again point out that Social Security surpluses are currently being used to make enormous deficits look merely very large. As the Social Security surpluses shrink and eventually disappear (in 2018 in the most recent projection) the outlook for the budget as a whole deteriorates accordingly.

The current projections are that the cost of Social Security will rise from its current rate of 4.38% of GDP to 5.40% in 2020 and to 6.43% in 2030, thereafter rising more slowly. As the Trust Fund begins to be depleted (likely sometime in the 2010's) and Social Security is converted into a strictly pay-as-you-go system, the necessary concomitant rise in payroll taxes will become especially steep. The cost of Social Security rises from just over 10% of taxable payroll at present to almost 20% at the end of the 75 year projection with the vast bulk of the increase coming as the Boomers retire in the 10's, 20's and 30's.

A 20% payroll tax would no doubt be odious to workers who might tolerate 10 or even 15% rates. The problem could be solved in part by a transfer of general funds, but such a scenario faces very significant hurdles – not the least of which is taxes are likely to be raised to close the budget deficit, to meet the growing cost of health care, to repair decaying infrastructure and to service debt, meaning the populace will likely be reluctant to accept yet more taxes. Additionally, it is quite difficult to see what budget items could feasibly be cut to avoid the large scale tax increases that will be necessary to meet those priorities just enumerated.

It is worth mentioning two important aspects which set the U.S. apart from the rest of the developed world: our level of military spending is enormous in comparison and our tax rates are particularly low. In fact, our tax rates are the lowest in the industrialized world. This is noteworthy because if cultural changes in the U.S. lead to significant changes in either of these characteristics, the outlook for full funding of Social Security would likely improve enormously. However, it is very difficult to predict whether these characteristics will persevere and as such it would seem more reasonable to assume the status quo in relation to these two factors.

Given the reality that (especially absent changes) Social Security will become an enormous strain on the federal budget, a significant reduction in guaranteed benefits is not out of the question as it largely has been during the first six decades of the program's history. Since it is also highly questionable that the U.S. public would allow a large proportion of the aged population to go without food and shelter, one of the more likely scenarios for change would be for the program to gradually transform from a more universal entitlement to a specifically targeted welfare program. It might be argued that such a change is unlikely because it would eliminate an aspect of the program that has helped it garner much of its popularity. This is an important consideration, but likely not as important as the competing consideration of the level of taxes that would needed to pay benefits to those not in dire need of them.

The chief component of such change would likely be the extensive use of means testing. In other words, in order for an individual to procure benefits under such a scenario they would need to show they are required to provide necessities. In short, it would be fair to say that those members of the Baby Boom who have substantial assets to provide for the retirement face the prospect of large scale reductions in the benefits they are likely to see; especially given that those in the most desperate need of benefits cannot have theirs substantially cut without causing the type of widespread social dislocations that would be virtually certain to provoke strong political motivation to remedy the problem. The pressure towards such modifications in the program will not commence in 2042 (the date at which the Trust Fund is currently projected to become exhausted.) Rather, it is far more likely that the pressure will be

acute by 2018 (the date at which projected payroll tax revenues fall below Social Security outlays.)

Conclusion

Except for divorces of high net-worth individuals there seems inadequate justification to argue that Social Security will not be here for the next four to five generations in much the same form. Means testing is likely as are higher taxes to both workers and recipients to shore up the program.❖

Ohio Supreme Court Opinion

Attorney Discipline

Office of Disciplinary Counsel v. Herman

Citation: 99 Ohio St.3d 362, 2003-Ohio-3932, 792 N.E.2d 1078 (2003)

Headnote: One-year suspension for altering amount client would receive from QDRO

Summary: Pursuant to a divorce decree rendered in Auglaize County, attorney for husband was ordered to prepare Qualified Domestic Relations Orders (QDROs) consistent with the parties' agreement at hearing. Husband's attorney prepared one of the QDROs, reviewed it and signed it with his client, and forwarded the QDRO to wife's attorney. Husband's attorney instructed wife's attorney to review the QDRO, have wife sign it, and file it with the domestic relations court.

The QDRO prepared by husband's attorney provided that wife was to receive $5113 of husband's 401(k) account. Wife's counsel changed the figure to $10,111.64 and forged the names of husband and his counsel. Wife's counsel did not notify husband's counsel of the change in the terms of the QDRO.

Husband's attorney prepared a second QDRO for a different pension plan, providing that wife receive 45% of the marital portion of the plan. Wife's counsel altered the order to provide for a 50% share, without informing husband's counsel or husband.

Wife's attorney submitted the falsified QDROs to the plan administrator. When husband's attorney learned of the situation, he contacted the sheriff's department to report the criminal conduct.

A grand jury indicted husband's attorney for felony and misdemeanor counts of perjury, forgery and falsification. The attorney entered a plea of no contest on the misdemeanor charges in exchange for the dismissal of the felony charges.

The Board of the Disciplinary Counsel concluded that the attorney's conduct violated DR 1-102(A)(3), engaging in illegal conduct involving moral turpitude, DR 1-102(A)(4), engaging in conduct involving dishonesty, fraud, deceit or misrepresentation, DR 1-102(A)(5), engaging in conduct prejudicial to the administration of justice, DR 7-102(A)(5), knowingly making a false statement of fact, and DR 7-102(A)(6), knowingly participating in the creation or preservation of false evidence.

The Board decided upon a one-year suspension with six months of the suspension stayed. The Board based this decision upon the fraudulent actions of the attorney as an officer of the court and his intent to deceive the client and opposing counsel. The Ohio Supreme Court upheld the decision of the Board. ❖