WE ARE ONE ILLINOIS

FIXING "SAFE HARBOR" DOES NOT FIX TIER 2

WHAT IS THE "SAFE HARBOR" ISSUE?

Federal law allows state and local governments to be excluded from participating in Social Security if their employees are provided pension benefits that, at minimum, are equivalent to Social Security. The established IRS method to calculate benefits to assure they reach the threshold of being at least equal to Social Security is referred to as the Safe Harbor formula.

There is growing consensus among elected officials and the retirement systems that pension benefits in Illinois do not meet this bare minimum Safe Harbor threshold for a limited group of Tier 2 workers and that the state should take action to come into compliance.It's just a matter of how—and the most commonly cited approach is to raise the Tier 2 pensionable earnings cap to match the Social Security wage base.

However, making this minor adjustment to the Tier 2 benefit formula to come into compliance with federal IRS requirements does not meaningfully fix the inadequacy of the pension benefits provided.

THE PENSIONABLE EARNING CAP IMPACTS A LIMITED GROUP OF WORKERS

Unlike Tier 1, the Tier 2 benefit formula caps pensionable earnings. Because the formula that is used to establish the annual cap does not adequately grow with inflation, the salary cap for pension benefits has fallen well below the salary cap for calculating Social Security benefits. (The pensionable wage cap for 2024 is $125,489.19, compared to the Social Security wage base limit of $168,600.) Addressing this difference has been raised as a way to assure the Tier 2 benefit is at least equal to Social Security.

However, raising the pensionable salary cap to $168,600 and allowing it to keep up with the Social Security wage base will only modify pension benefits for high-earning workers whose salaries are over $125,489.19. For workers making under this amount, which are the vast majority of Tier 2 public employees in Illinois, increasing the pensionable salary cap will result in zero change to their Tier 2 pension benefit calculation.

COMPLIANCE WITH SAFE HABOR DOES NOT EQUATE TO ADEQUATE RETIREMENT BENEFITS

Modifying the Tier 2 benefit formula so that it meets the minimum threshold of replacing Social Security retirement income fails to recognize that Social Security is not enough to cover necessities such as housing, medical care, food and transportation in retirement. Moreover, the Safe Harbor standard ignores key differences between Tier 2 and Social Security that impact lifetime resource levels in retirement. Social security has a guaranteed escalator that ensures retirement income increases with the cost of living. In contrast, the annual annuity increases in retirement for Tier 2 are unpredictable and provide no inflationary protection.

Retirement security means receiving a pension benefit that (1) sufficiently substitutes employment earnings and (2) keeps up with rising costs throughout retirement. The minimum Safe Harbor threshold fails to address either of these and is therefore an extremely limited and inadequate approach. Coming into compliance with the IRS Safe Harbor requirement is not about fixing Tier 2, it is just about avoiding negative tax ramifications for the employer.

LEARN MORE AT FB.COM/WEAREONEIL