



Does Your Severance Plan Make the Cut?

Businesses continue to experience long-term residual effects from the Great Recession. Today, employers in virtually all industries are still assessing their workforce needs and are looking to attract and manage employees in the most cost-efficient and tax-effective manner possible. As part of a broader workforce strategy, many companies are also focusing on how severance practices are impacting a company's brand as much as the bottom line. Consequently, employers are reviewing their severance policies – many of which have remained unchanged for years – to find new value-creating opportunities that can also save money for their company and their separated employees at the same time.

21st Century Severance Planning

The design of a company's severance plan depends on an employer's objective. Severance pay can serve many purposes. It can be a recruiting tool, an employee benefit for long-tenured service with the company, or a program to reduce workforce size. However, severance programs that were in place twenty years ago may not be the best strategy today. Whatever the objective, employers and advisors should not assume that all severance plans are alike – or that they must bear the full cost of these programs. In this new era of business, there is a type of severance plan that:

- 1) Reduces severance costs,
- 2) Reduces a company's administrative workload, and
- 3) Provides more benefits to separated employees.

A Severance Strategy That Works

In light of the recent U.S. Supreme Court ruling in *United States v. Quality Stores, Inc.*, there's been renewed interest in an alternative severance program known as a Supplemental Unemployment Benefit Plan ("SUB-Pay") Plan. SUB-Pay Plans allow eligible employers to supplement a portion of the cost of their severance plans by amounts payable under the receipt of their separated employees' receipt of state unemployment insurance ("UI") benefits.

When utilized in compliance with IRS regulations, SUB-Pay Plans are an efficient vehicle for a company to provide more benefits to separated employees while achieving significant savings by supplementing state UI benefits along with an exemption of payroll tax benefits at the same time. Employers who may incur significant FICA taxation on severance payments may want to consider a severance plan design that constitutes a SUB-Pay Plan.

SUB-Pay Plans Benefit Both Company and Employee

SUB-Pay Plans were first established in the 1950's and had historically been utilized by large, industrial employers through collective bargaining with their unions to supplement a separated employee's receipt of state UI benefits. The current applicability of SUB-Pay Plans, however, extends well beyond the traditional union environment. If properly structured, these plans can yield significant tax and financial advantages to employers and employees.

A SUB-Pay plan can save a company 7.65 percent in severance costs from FICA payroll tax savings on separation payments made to reduced workforce, and depending upon the state, the employer's experience rating, and the time of year that the reduction in force occurs, a percentage of federal and state unemployment tax savings as well.

A SUB-Pay plan also can save a company 45 percent or more of total severance costs by supplementing the separation payments with state UI benefits the separated employees are eligible to receive. For example, if an employee's pre-layoff wage was \$1,000 a week and the state UI benefit is \$500 a week, the company pays only \$500 a week in SUB-Pay to keep the separated employee at their pre-layoff wage, and the company saves



7.65 percent in FICA tax too. Also, because SUB-Pay must be made on a periodic basis, there is predictability to the payroll process that can be a significant benefit to the company's cash flow.

There are a number of significant benefits to the separated employee as well. Separated employees:

- 1) Gain 7.65 percent more net income due to a FICA tax savings, and
- 2) Receive up to 100% of their pre-layoff wage for the duration of their separation plan.

Contrast this with lump-sum severance payments that, when added to employee's year-to-date compensation, may elevate the employee into a higher tax bracket. Because SUB-Pay Plans are paid on a periodic basis, the former employee is provided with steady income during their transition to reemployment, and may be relieved of the additional tax burden associated with lump-sum severance payments.

As with other types of severance plans, once a SUB-Pay Plan is established it can continue to be used indefinitely for any involuntary staff reductions.

Elevate Severance Planning to a Best Practice

In today's uncertain economic environment, it's a fact that companies need to continually realign and right-size staff. While smart severance policies can make a difference in these situations, companies that have competitive severance practices in place are ahead of the game when it comes to optimal talent management.

Finally, in light of the recent *Quality Stores* decision, employers should review their severance plans to determine whether or not payments under those plans comply with the statutory definition of SUB-Pay payments in order to achieve significant tax and financial advantages for both themselves and their separated employees.

About the Author

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About Total Management Solutions

TMS is a trusted advisor to Fortune 1000 and mid-sized US companies, helping them change, manage and administrate their corporate severance plans. Through our SUB-Pay Plans we help companies reduce the high cost, stress and burden associated with implementing employee severance plans resulting from a merger, acquisition, business realignment or economic downturn. With a SUB-Pay Plan, our clients typically save 45% or more of traditional severance costs, while providing more separation benefits to laid-off employees.

With over 25 years of experience, TMS is the pioneer and only company solely dedicated to the design, implementation and administration of SUB-Pay Plans. Each SUB-Pay Plan is customized to meet your company's financial and cultural requirements and is supported by a management team of experts in SUB-Pay Plans, sophisticated technology and unparalleled customer service. Once the SUB-Pay Plan is designed and implemented, TMS manages the day-to-day aspects of the plan administration for you, while our personal service provides displaced employees with full support services from our in-house Client Service Support Center.