



Relieving the Cost and Administrative Burdens of Severance Plans

Today, Fortune 1000 companies are seeking cost-effective alternatives to traditional severance plans. They are finding that a proven sixty year old concept, Supplemental Unemployment Benefit ("SUB-Pay") Plans, may provide the answers.

A SUB-Pay Plan is an "alternative severance plan" designed to reduce a company's overall severance costs, as well as accelerate a former employee's transition to new employment due to an involuntary reduction in force, job elimination, reorganization, or similar circumstance. SUB-Pay Plans offer three distinct advantages over traditional severance plans:

- 1) Payments are not subject to employer FICA or FUTA taxes, or employee FICA taxes, when paid under a properly designed SUB-Pay Plan;
- 2) Payments are integrated with the receipt of state unemployment insurance ("UI") benefits and are not considered "wages" against the receipt of state UI benefits;
- 3) If benefits are recognized as SUB-Pay at the state level, SUB-Pay is also not subject to SUTA taxes.

SUB-Pay Plans can save companies 7.65%-45% or more in severance costs from payroll tax savings and the coordination of state UI benefits. Furthermore, SUB-Pay benefits are paid on a periodic basis reducing the cash flow impact to the company.

And, following the US Supreme Court's landmark ruling in *Quality Stores, Inc. v. United States* in 2014, the only way for a company to receive a guaranteed FICA tax savings is to have a SUB-Pay Plan that is compliant with various IRS Revenue Rulings.

SUB-Pay Plans Are Not As Complicated As You May Think

While the potential for increased savings and reduced severance cost sounds like an intriguing proposition, many companies feel that a SUB-Pay Plan may be too complicated to understand, difficult and time consuming to implement and administrate, and possibly create a financial burden to their former employees at the time of a layoff. At their core, SUB-Pay Plans are not complicated. They can be implemented in almost 30 days, and in most cases can help a company's former employees get back to work quicker.

While there are federal and state requirements to operate a SUB-Pay Plan, their eligibility is clearly defined.

For example, for federal requirements, SUB-Pay benefits must be periodic and cannot be made as a lump sum; former employees are eligible for SUB-Pay benefits if they are laid off by the company, either in an involuntary permanent or temporary reduction in force or in a temporary layoff; and the receipt of SUB-Pay benefits is contingent upon the former employee remaining eligible to receive state UI benefits. Employees leaving the company voluntarily or who are discharged for misconduct are not eligible for SUB-Pay benefits.

Once the federal requirements are met, individual states have their own requirements for how a SUB-Pay Plan should be designed. For example:

- 1) Many states have specific SUB-Pay Plan design criteria that must be met, and approved, before the plan can be used in the individual state;
- 2) Some states do not allow the simultaneous receipt of severance and state UI benefits (i.e., severance is considered wages against the receipt of state UI benefits), however with a SUB-Pay Plan the former employee can collect both SUB-Pay and state UI benefits at the same time;



- 3) Other states allow the simultaneous receipt of severance and state UI benefits. In these states, since the former employee can receive severance and UI benefits simultaneously, it would benefit a company and the former employee to have a SUB-Pay Plan to achieve a tax savings benefit.

Regardless of specific state requirements, SUB-Pay Plans allow a company to offer a more equitable, national scope separation benefit where each former employee receives the same level of benefit across state lines.

Beneficial for Both Company and Former Employees

Since severance plans do not offer a tax savings, and since lump-sum severance payments hit a company's balance sheet and cash reserves immediately, a SUB-Pay Plan may be a better overall strategy because it reduces severance costs. And, once a SUB-Pay Plan has been established, it can continue to be used indefinitely for any future involuntary staff reductions.

Former employees benefit as well with the use of a SUB-Pay Plan. They can receive 7.65% more net income due to a FICA tax exemption, be eligible for state UI benefits in those states where traditional severance pay is considered "wages" against the receipt of state UI benefits, and can receive up to 100% of their pre-layoff wage for the duration that they are on the SUB-Pay Plan.

In addition, a SUB-Pay Plan shifts the focus of paying severance from an "entitlement benefit" to a "transitional benefit" and enables a former employee to get back to work quicker. Since the former employee receives a combination of SUB-Pay benefits and state UI benefits at the same time that equals their pre-layoff wage, the individual may more than likely search harder and wider for new employment rather than being complacent and deplete their severance pay and state UI benefits.

Administration Options

As long as federal and state requirements are met, a company can dictate how a SUB-Pay Plan is designed based on its own corporate culture. For example, the company can decide what happens to a former employee's remaining benefit when they are rehired.

While SUB-Pay Plans have many requirements such as a written plan document and timely IRS filings, administering such a program does not need to be overly complex. While these plans do not have to be complicated, as with any benefit plan, the complexity depends on the goals of the sponsor and how a plan is designed to meet those goals. Generally, best practices for plan administration include:

- 1) A plan sponsor needs expertise in plan design, regulations and administration;
- 2) Communications including educating the former employees on plan requirements and step-by-step instructions to simplify the plan administration;
- 3) Implementing methods for former employees to report their eligibility status for receipt of state UI benefits on a regular basis;
- 4) A service center to assist former employees with questions, resolve reporting errors and reach out to individuals who fail to report their state UI benefit status is essential to administering the plan.

Overall, while some employers create and administer SUB-Pay plans in-house, outsourcing SUB-Pay administration to a reputable company can significantly alleviate the additional work and stress layoffs can bring to HR and payroll departments. A dedicated SUB-Pay Plan partner provides former employees with a ready resource to help them during their transition period including individual call center assistance and web support services. An outsourced provider can also act as an "advocate" for former employees when issues arise with an opening of a state UI benefit claim.



SUB-Pay Plans Put Your Severance to Work for You

SUB-Pay Plans are particularly beneficial to companies planning future downsizings due to acquisitions, restructurings, seasonal employment or economic conditions. Also, companies who may incur significant FICA taxation on severance payments should consider a SUB-Pay Plan. These plans are not as complex as many think, and there are administrative options for plan sponsors. In the end, a SUB-Pay Plan can relieve a company of both the cost and administrative burdens associated with severance plans, as well as help their former employees gain more net income and transition to new employment quicker than with a traditional severance plan.

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.