Contingency Planning in the Post-Shutdown Economy

Employment and Labor

Financial Services

The beginning of 2020 marked the longest rally of sustained economic growth in the history of the United States. The climb boosted GDP 25 percent while unemployment fell drastically. Issues like cost cutting, workforce downsizing, and economic recession were relics amid a strong market landscape of competitive hiring and talent shortages. While many economists predicted a looming recession, they were looking in the wrong places. Interest rates and output gaps did nothing to predict the shutdown of the magnitude we experienced with the COVID-19 pandemic.

The unforeseen events precipitated by the pandemic forced many organizations to acknowledge the importance of workforce contingency planning. Businesses are constantly challenged to manage risks related to production, legal, finances, and marketing, but have historically given little consideration to risk as it relates to the economic factors with the potential to cause workforce disruption. Contingency planning produces a structured way of deciding how to handle unusual or unforeseen events and can help prevent or transform the impact of potential risks to an organization and its employees.

One tool gaining popularity for use in downsizing contingency planning is a Supplemental Unemployment Benefits (SUB) plan. Sanctioned by the Internal Revenue Service (IRS), organizations may replace their traditional severance plan with a SUB plan, allowing payments made through the plan to be reclassified from wages to benefits, thus making these payments exempt from employment taxes. Unlike traditional severance payments, all 50 states and the District of Columbia allow released employees to collect state unemployment benefits and company-issued SUB payments concurrently.

A hallmark feature of a SUB plan is the incorporation of State Unemployment Benefits. An employee files for state benefits and the employer pays the difference between the employee’s regular weekly wage and the amount of State Unemployment the employee is eligible to receive. Displaced

employees maintain their pre-displacement wage, while employers enjoy lower benefit costs compared to traditional severance plans. By incorporating State Unemployment Benefits, companies can significantly decrease their total severance liability — a crucial advantage for a large-scale reduction in force.

For example, an employee with a weekly base pay of US$1,000 who is laid off and eligible for a weekly State Unemployment benefit payment of US$616 would be paid the difference (US$1,000 minus US$616) of US$384 by his company as a SUB payment. Therefore, the SUB payable by the company has been reduced by the State Unemployment amount, from US$1000 to US$384 per week. Neither the payment nor the receipt of SUB pay is subject to FICA/FUTA tax. Across a large reduction in force, savings are magnified.

COVID-19 Shutdowns: A Case Study

A large services company faced with a widespread shutdown of operations resulting from the COVID-19 pandemic found it necessary to carry out an immediate and substantial reduction in force.

From July 2020 through December 2020, 5,099 furloughed and severed employees were paid through the plan. By utilizing a SUB Plan, the company saved US$17.7 million, or 48 percent, compared to traditional severance, while maintaining the income of the released employees while unemployed during their benefit periods.

An employer using a SUB plan may achieve cost savings via three mechanisms:

1. FICA-tax exemption: This reduces the benefit costs for the employer while ensuring slightly increased take-home pay for the displaced employee.
2. Integration with state unemployment insurance (UI): The displaced employee's income is maintained, but now comes from two sources, employer-paid SUB and state UI benefits, thus reducing the cost for the employer on a dollar-for-dollar basis.
3. Duration management: SUB pay acts as a bridge to a released employee's next opportunity. Because SUB pay is tied to the employee's eligibility for state UI, payments cease when a displaced employee obtains new employment. Companies may choose to pay a "reemployment bonus" of some percent of the remaining benefit allotment as a taxable bonus. Reemployment bonuses reward displaced employees for finding new work prior to the expiration of their benefit period while still creating savings for the employer.

Like with severance, payments under a SUB plan serve as consideration in exchange for a release and waiver. Employers can, therefore, have the same level of risk mitigation as with severance and provide terminated employees with income protection while unemployed, while achieving considerable cost savings.

Tax implications

In IRS revenue rulings and private letter rulings dating back to the 1950s, the IRS has taken the administrative position that supplemental unemployment benefits paid under a properly designed and administered plan are not subject to FICA or FUTA taxes. Over the decades, some of the original

requirements identified in the 1950s have evolved to make SUB pay more approachable for employers. For example, the IRS originally required employers to pay SUB pay from a trust that had been preapproved by the IRS.

Today, unless prohibited by state law, SUB may be paid from an employer's general assets or from a tax-exempt trust, including an Internal Revenue Code Section 501(c)(17) trust or an Internal Revenue Code Section 501(c)(9) Voluntary Employees' Beneficiary Association (VEBA) trust. While providing SUB pay through a tax-exempt trust fund may be advantageous from a tax perspective, if an employer chooses to implement a trust, the employer must ensure that the trust meets applicable IRS qualification requirements.

In addition, the employer is required to submit the trust to the IRS for preapproval. This may result in a delay in implementing the SUB pay plan. Regardless of whether an employer chooses to pay SUB pay from a trust or from its general assets, the SUB pay will be exempt from FICA and FUTA taxes.

SUB plan administration

There are legal and administrative requirements to consider when implementing a SUB plan.

A SUB plan must comply with the IRS guidelines as well as state regulations concerning SUB plans and State Unemployment in the state in which it operates; many states require plans to be filed or approved prior to implementation. Keeping close track of state regulations to ensure plan compliance is critical.

A key requirement of a SUB plan is that each individual paid under the plan file and be eligible for state unemployment. To accomplish this, weekly communication with released employees to determine eligibility for state unemployment benefits must occur. While this may be manageable for some organizations, others will benefit from outsourcing SUB plan administration.

The combined value of reducing burden on internal resources and utilizing a turn-key administration program can be significant. A chief element of evaluating a new strategy for paying separation benefits is exploring alternatives for its administration.

Navigating uncertain times

Personnel and restructuring strategies are critical actions deserving attention during periods of growth and planning — not as reactionary items during crisis management. As organizations across the nation are attempting to re-hire post-pandemic, they would be well advised not to dismiss the recent crisis as a singular event.

An important take-away from the pandemic is to recognize that these are times of uncertainty. Workforce contingency planning and preparedness are crucial measures for forward-thinking companies with longevity goals. These companies will learn from their recent experiences and establish procedures, such as a SUB plan, that define how to move forward through future unforeseen events.

Planning for all possible outcomes provides the advantage of having sufficient time to assess available action plans and create a thoughtful, people-focused approach.

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Lana R. Mellis is the head of client services at Transition Services, Inc., a full-service administrator of SUB Plans dedicated to making the administration of separation benefits as efficient and simple as possible. Serving clients since 2002 has provided TSI the capability to provide expert and efficient program design and implementation in all 50 states. TSI’s systems expertise and process disciplines ensure close monitoring of and adherence to relevant tax and unemployment regulations.

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Michael Mahoney is a shareholder at Olgetree Deakins. He is a member of the Employee Benefits and Executive Compensation Practice Group and the chair of the Payroll Tax and Fringe Benefits Subgroup. He focuses on employment tax matters at both the federal and state levels and strategic tax issues for a global workforce.

Mahoney advises employers on a multitude of fringe benefit issues, including the requirements for exclusion from income. In performing due diligence, he provides counsel through M&A to identify and quantify exposure resulting from, among other items, worker misclassification and accountable expense plan failures. Mahoney provides guidance to employers regarding the requirements of the Affordable Care Act, including reporting obligations.

He also offers counsel to numerous multi-national clients with respect to employee and employer tax issues arising from inbound or outbound short-term travel, long-term assignments, and permanent transfers. Such assistance includes the interpretation of international tax treaties, advising on opportunities to utilize totalization agreements, and providing holistic solutions to employers addressing tax obligations for various visa holders.