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Supplemental unemployment benefit (SUB) plans are receiving renewed attention during the economic slowdown caused by the COVID-19 global pandemic. Attorneys John E. Schembari and Sevawn Foster Holt of Kutak Rock LLP explain the basics of SUB plans.

SUB plans are designed to assist employees following an involuntary termination by supplementing state unemployment insurance benefits (UI). Employers and unions may want to consider whether these plans are an appropriate option for providing laid-off or furloughed workers with adequate resources during the COVID-19 global pandemic while lessening the financial strain on employers that is associated with traditional severance programs.

How SUB Plans Work

SUB plans provide employees with weekly severance payments to supplement state UI. They are exempt from Medicare and Social Security taxes (FICA), and they do not reduce the amount the employee is eligible to receive from state UI. Employers can offer a severance plan that is not tied to state UI, but the payments are not exempt from FICA, and they reduce the amount the employee can receive from state UI.

Many multiemployer SUB plans are structured so that employers contribute a specified percentage of wages per employee per hour worked to a trust fund. The trust fund is managed by an independent board of trustees, with equal representation from management and labor. The trustees of the trust fund pay out benefits that supplement state UI to eligible former employees experiencing a layoff or reduction in force. SUB plans offered by companies to nonunion employees, however, are typically unfunded.

Because properly designed SUB plans are exempt from FICA taxes and do not offset state UI, employees can receive greater severance benefits

at a lower cost than with a traditional severance plan. For example, assume an employer wants to provide a \$600-per-week severance benefit and the state UI benefit is \$300. With a traditional severance plan, the \$600 severance benefit may cost the employer almost \$700—the \$600 benefit plus FICA tax (employer and employee) and a full offset of state UI. With a properly designed SUB plan, the employer could provide a \$600 total severance benefit at a cost of only \$300 (no FICA expense, and the SUB plan benefit can be combined with state UI). This savings could go directly to the employer's bottom line, or it could be shared with the laid-off workers in the form of a higher severance benefit. Due to its interplay with state UI, SUB plans offer employers a unique opportunity to support workers who are involuntarily terminated due to the COVID-19 global pandemic.

Statutory Requirements to Establish a SUB Plan

SUB plans must satisfy various legal requirements. First, if a trust is established, it must be valid under local law and evidenced by an executed written document that is part of a written plan. Multiemployer SUB plans are subject to the Taft-Hartley Act, which generally requires management by a joint board of trustees. In addition, the plan must be established in accordance with Section 501(c)(17) of the Internal Revenue Code (IRC) to provide SUB benefits. The SUB plan also must provide that the property and income of the trust cannot be used for, or diverted to, any purpose other than providing SUB benefits prior to the satisfaction of all liabilities to the employees

covered by the plan. Finally, the trust must file an application for recognition of exemption on Form 1024 along with an annual return.

SUB plans are “employee welfare benefit plans” under Section 3(1) of the Employee Retirement Income Security Act (ERISA). Accordingly, they must be nondiscriminatory with regard to eligibility and benefits. A SUB plan cannot limit eligible employees to, and the benefits cannot discriminate in favor of, officers, shareholders, supervisory employees or highly compensated employees (HCEs). Benefits payable under the plan will not be considered discriminatory merely because they bear a uniform relationship to the total compensation of the employees covered by the plan. A plan must satisfy these statutory requirements throughout the entire taxable year of the trust for the trust to be exempt for that year.

Advantages and Disadvantages

SUB plans have distinct advantages but also some administrative burdens. To provide flexibility, SUB plans can be customized based upon the specific financial and cultural objectives of each business. A SUB plan saves substantial severance costs—a minimum of 7.65% in FICA savings and up to 45% when state UI is coordinated with separation pay. Finally, a SUB plan can reduce the impact of severance costs on a company’s cash flow because the benefits must be made on a periodic basis and cannot be made in a lump sum.

Despite the advantages, a SUB plan must be properly designed and administered in order to take advantage of the potential tax benefits. In addition, SUB plans must comply with IRS, ERISA, Taft-Hartley Act and state law requirements. Some confusion exists as to the effect of the new Coronavirus Aid, Relief, and Economic Security (CARES) Act, which provides financial assistance to individuals and businesses to offset the economic impact of COVID-19. Specifically, the CARES Act is silent as to how its enhanced state UI benefits and special Federal Pandemic Unemployment Compensation of \$600 per week apply to SUB plan eligibility and calculations. Employers are encouraged to work with legal counsel to ensure compliance with the CARES Act and any subsequent guidance that may be issued. Employers should also ensure they are monitoring paid leave laws and properly distinguishing between when a worker is entitled to paid leave versus SUB plan benefits.¹

Finally, unemployment benefits must be carefully monitored to maintain proper withholding and benefit amounts. Some employers choose to hire a third party to administer SUB payments, monitor each individual’s ongoing eligibility and keep track of state UI. This administrative cost must be factored into the determination to pay SUB plan benefits.

Endnote

1. See www.kutakrock.com/newspublications/publications/2020/04/summary-of-covid19-paid-sick-leave-laws-chart and www.kutakrock.com/newspublications/publications/2020/03/summary-chart-of-paid-sick-leave.