Severance Pay Overview

By Vincent Chiappetta

Layoffs happen. Downsizing is common. Mergers create overlap problems, and employees are cut. Must an agency offer compensation to employees who are terminated involuntarily? By Federal law, no. However, most agencies do offer severance pay in one way or another. Why bother? Why do agencies offer compensation when they don't have to? Instituting a well thought out severance pay program can offer employers and employees mutual benefits. A severance pay program can help stave off potential lawsuits initiated by terminated employees. Further, offering such a program creates a more competitive applicant pool, and makes a newly hired employee feel more secure and valued.

What is Severance Pay?

Severance pay is compensation offered to employees who are terminated through no fault of their own. There are no Federal laws directly regulating severance pay, and public employers are not even required to offer it. However, limited state law may require some form of severance pay in specific circumstances. Further, if an employer and employee agree in a contract that the employee is entitled to severance pay, then the employer is bound by the contract. In either case, whether an employer is obligated to pay severance pay or not, many states require employers to give adequate notice to affected employees in advance of a layoff.

Severance benefits can consist of cash payments or other benefits such as extended health insurance or career counseling. Cash benefits are paid either in one lump sum or in installments. Because severance payments are typically considered wages, they are taxable, and employers can deduct severance payments from their business costs.

Why Offer Severance Pay?

An employer might offer severance pay for a number of reasons:

- **To avoid lawsuits (exchanging severance for releases).** The less angry and more whole an employee feels after termination, the less chance that employee will initiate a lawsuit.
- **To remain competitive with other agencies or organizations.** Employers who offer severance pay packages are more attractive to applicants than employers who do not. To remain in competition, an employer might consider offering more security in the form of a severance plan.
- **To ease an employee's transition to new employment/reward employees for a job well done.** Word spreads about organizations that treat their employees well. Offering employee assistance programs, career counseling, or enough pay to contribute to a smooth employment transition does not go unnoticed.

How Do You Implement a Severance Pay Policy?

1. Decide who is eligible. Some employers institute a "golden parachute" policy, which offers severance pay to top executives should they be terminated due to changes is ownership or a merger. Others offer severance pay only to employees who are permanently laid off. As an

employer, you have to decide who will receive severance pay and under what circumstances. Will you offer severance pay when faced with voluntary termination, involuntary termination, downsizing, or poor performance? Keep in mind tax implications and discriminatory issues when making this decision.

2. Decide what severance to offer. Extended salary, continued health or life insurance, letters of reference, or outplacement services all can be included in severance packages. Keep your benefit plan consistent to avoid discrimination suits.

3. Set payment maximums and minimums. After deciding to implement a severance pay policy, an employer should design appropriate payment amounts by setting maximums and minimums. Employers typically offer one week of severance pay for each year of employment. Once an employee is tenured, he or she would receive two weeks of severance pay per year. No plan generally offers severance pay over one year or less than one week.

4. Choose lump sums or periodic payments. Employers can choose whether to offer severance pay packages in one lump sum or in periodic installments. Employers should note that if a large number of employees are terminated at once, paying all employees in one lump sum may create an incredible dent in company funds. Spreading payment out over time may be more economical if a situation like this occurs.

5. Put the policy in writing. Most large agencies adopt a written policy. Although a severance package on a case-by-case basis offers some attractive flexibility, larger organizations advise HR professionals to write a policy to avoid legal problems down the road.

6. Keep age discrimination in mind. The Age Discrimination in Employment Act mandates that no employer who offers severance pay may discriminate based on age. However, employers may offer additional benefits to employees over 40, who might have trouble finding a new job due to age discrimination practices.

Conclusion

Ultimately, you must determine your organization's specific goals and implement accordingly. Remember to stay consistent, and to look for ways you can create equitable programs that satisfy not only the employees, but also you the employer.