



Financial Issues When Leaving A Company

There are often many financial choices to make when leaving a company, especially if you are contemplating a retirement or "early retirement" situation. Frequently there are trade-offs that must be made, and you are only given a short time, a "window of opportunity" to make choices before they are made for you.

The choices for this type of termination incentive involve present and future benefits which require tax and financial planning decisions. Thus, the purpose here is to give you a general look at the most commonly-offered choices you may be asked to make.

Continued Medical Benefits

While today's 2000 law requires your company to allow you to pay for continued medical insurance for a period of 18 months after separation (COBRA provision), a frequent "bribe" to induce you to leave the company involves allowing you to stay in the plan until you are eligible for Medicare (age 65 currently). Another inducement provides that the company will pay all or a portion of your medical coverage until age 65, or until your death.

We all know how expensive medical coverage can be, especially as one grows older. This benefit can end up being a very valuable option. However, if you have a spouse who is also covered under a family plan, you may not need this option, so you can trade it off for another one instead.

Pension/Profit Sharing Payouts

This is a very important issue. If you are "Vested," that is you have rights to accumulated pension/profit sharing/savings plan monies, you may be given a choice on how to get the funds.

In addition, the company may offer to "accelerate" your pension calculation to give you more money than that to which you ordinarily would be entitled. As an example, if you normally would be given full benefits at age 65, but are being "retired" at age 55, the company may alter the age/service requirements to allow you full retirement benefits. This is an attractive inducement.

A growing trend in companies is to allow a "lump sum" payout instead of annuitizing the payout over a projected life span. This may be an important negotiating point for you. The tax treatments will vary according to how it is handled. If it is annuitized over your life, or over the joint life of you and your spouse (which is the most common method), you will receive a periodic check. The taxable portion is the annuitized amount of company contributions, and "pre-tax" contributions you have made plus all accumulated earnings within the plan. You pay tax in the year you receive the payments, so if you will be receiving monthly checks, you will pay tax each year.

For a lump sum payout, you get just that—one lump sum and you pay tax in the year it is received. However, you have several options here to reduce or defer the taxes. If it is a qualified singular payout from a qualified plan, and if you meet certain criteria, you may be eligible for special lump sum averaging in which the tax is calculated using a special averaging method. The tax savings here compared to paying regular tax on the lump sum can be enormous.



Also, you may be eligible to "roll over" this lump sum into a special IRA and pay no tax until you start withdrawing it from the IRA. At that point, you would pay tax based on your ordinary income tax rates at the time of withdrawal.

Which way should you go? Take a monthly annuitized check? Take a lump sum and pay regular tax? Take a lump sum and do special averaging? Take a lump sum and roll it into an IRA? Each of these issues requires some serious calculations of both your present tax bracket, your expected future tax bracket, your present needs for the cash, and possible estate tax considerations as well. There is no easy one-shot answer. It may require careful analysis and some "what if" scenarios.

Statistics show that approximately half of the people elect lump sum. If you were planning to start your own business, for instance, you may elect to take a lump sum because you may need the cash for the business. Also, if you think you could invest the money at better yields than you would be getting with an annuitization calculation or monthly pension check, a lump sum is attractive.

These decisions may be the most important of all the early retirement choices. They also may be the most complicated because they involve making detailed projections about such items as future tax brackets and tax laws, future cash needs, and rates of returns on investments. If the amount of money in question is considerable, you may need a coordinated effort among your tax adviser, a lawyer, a financial planner, a broker, and an estate planner. In this area, proper planning can make a tremendous overall difference in your after-tax analysis.

Life & Disability Insurance

If you are being covered by company-paid life and disability insurance, this is a good negotiating area, especially if you are over 45 or not in excellent health. If you have to re-apply for coverages on your own, it could be much more expensive, or even impossible to get. Although most company plans in this area will not allow for continuance after separation, you may wish to negotiate for the extra dollars it will cost you to implement similar plans on your own.

Extra Severance or Cash Incentives

This is a common company offer to get you to leave on a date most suitable to them. Extra lump sum pay is given based on the years you have been with the company. A popular variation is an extra week's pay for every year of service. This is a totally taxable payout, so you may want to try to time the payout most favorably according to your tax bracket (Regular and Social Security) for the current year vs the following year. How the tax will be withheld is also important. Is it being taxed at your regular rate, or is it being "flat" taxed? It's important to get good tax advice here!



Social Security Supplemental Pay

For people who will be near retirement age, but not eligible for maximum Social Security benefits yet, a possible offer is to "make you whole." The calculation is the difference between what you will get from Social Security now, and what you would get at maximum retirement age. You get this in a monthly check from the company. Unlike Social Security, however, this company check will be fully taxable, so a good negotiating ploy here is to ask for an extra check to cover the added-tax you will be paying. This is called negotiating for a "Gross-up" allowance.

Release Of Any Non-Compete Clauses

For workers who have signed a company non-compete clause (can apply to managers, technical workers, software applications, designers, etc.), a good "fringe" is to have this eliminated so you can find another job in your field immediately and/or in your same general work area. Since non-compete clauses are not very common in most fields, many termination incentive packages do not account for this automatically. You should bring this up if you fall under such a clause.

Use Of Company Facilities After Separation

This can be a very valuable, "tax-free" fringe to have. You would get the use of their facilities and/or so-called outplacement services in order to help you find another job. You are provided with an office, support help (typing, copying, etc.), free use of company phones, postage, and mailing services. In looking for a job, these items can add up to thousands of dollars, so don't ignore this possible option.

Becoming A Temporary "Subcontractor"

Sometimes a company will release you as an employee, but retain you for a temporary basis as an Independent Contractor. This gets you off their pension and benefits roles, and passes the full tax burden onto you.

While this may be an excellent way for you to get more money from the company, and possibly new and extra tax write-offs (since you may qualify as a self-employed taxpayer), there is a big caveat here. If you are contemplating a lump sum payout of your pension/profit sharing monies, and if you are eligible for special "lump sum" averaging, the continuance as an Independent may jeopardize your rights to this tax saving method under certain 2000 IRS rules.

In effect, in their eyes you haven't truly left the job, so you become ineligible for the special averaging. You must be very careful in this regard. You may need good tax advice, and maybe some good legal advice as well.

Timing Considerations

Basically, this involves timing the receipt of various taxable incentives according to the most favorable tax bracket. If you expect to be in a much lower tax bracket the year following your separation, you might want to try to defer some of the taxable package into the next year. This could be a sizable savings in taxes.



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For instance, if you are planning to go into your own business, and don't expect to have much taxable income for the following year, you would try to defer some of the company payouts into that year to reduce your tax liabilities.

As was mentioned earlier, if you are eligible for extra sub-contractor work from your company, the timing of when you will do this, and when you will get paid can have significant tax savings, especially as it applies to Social Security and Medicare taxes.

Collecting unemployment has timing considerations also since each state has its own interpretation of "severance" pay as it relates to when you can collect your unemployment. A similar issue develops for those who will be applying for Social Security, since the amount of outside earnings you can make directly affect how much Social Security you can collect until you reach age 70.

Conclusions

As you can see, there may be numerous choices and decisions to be made when you leave a company. With all the downsizing that is going on throughout the country, the probabilities of needing to consider these issues is much higher for a worker than in years past.

Further, since a lot of these choices fall under the "non-qualified" sections of IRS codes on benefits and fringes, it means you may have room to negotiate. But you must first be aware of your choices before you can make suggestions. Hopefully, this little synopsis gives you room for present – and future – possibilities in this regard.