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Fiduciary and Prevailing Wage Solutions

# HARNESSING THE POWER

Supplemental Unemployment Benefit Plans,  
a win-win for you and your employees.

by Jeffrey Bennett





## INTRODUCTION

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Supplemental Unemployment Benefit (SUB) plans provide compensation to employees in addition to state unemployment insurance during periods of layoff. SUB plans, when designed correctly, offer employers a way to provide employees with enhanced income during periods of unemployment without diminishing state unemployment benefits and are not subject to FICA or FUTA taxes.

SUB plans ease financial stress faced by employees during periods of layoffs, thereby generating peace of mind and worker loyalty, as well as significant tax advantages compared to severance pay.

Although SUB plans can be beneficial for employers in any industry, this paper focuses on the construction industry and specifically merit shop construction companies that are subject to prevailing wage rules under the Davis-Bacon Act or other state prevailing wage laws.

Let's explore how construction companies can fund SUB plans with fringe benefit payments required under prevailing wage regulations, and implement best practice strategies while remaining compliant with applicable federal and state laws.

## BRIEF HISTORY / BACKGROUND

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“SUB plans originated in response to organized labor’s claims during the 1950’s that state unemployment benefits were insufficient to aid employees during periods of layoffs.<sup>1</sup>” Organized labor considered it critical that supplemental unemployment benefits be excluded from the definition of “wages” because a workers’ receipt of “wages” triggered the cessation of state unemployment benefits. Therefore, by classifying supplemental unemployment benefits as something other than “wages,” laid off workers are eligible to receive both state unemployment benefits and supplemental unemployment benefits simultaneously. Furthermore, because supplemental unemployment benefits are not “wages,” tax consequences attach differently, thereby providing planning opportunities to contractors.

The exemption for supplemental unemployment benefits treatment as “wages” was codified in 1956 when the IRS created an administrative exception through the issuance of Rev. Rul. 56-249. This ruling both removes supplemental unemployment benefits from classification as “wages” and excludes these benefits from FICA and FUTA taxes. Subsequent revenue rulings (60-330 & 90-72) have broadened the scope of Rev. Rul. 56-249.

## ESSENTIAL REQUIREMENTS OF A SUB PLAN

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With some limited exceptions, all SUB plans seeking to meet the qualifications to be exempt from wages (and therefore exempt from FICA and FUTA taxes) must be substantially the same or identical to those described in Rev. Rul. 56-249, as modified by Rev. Rul. 90-72. Together, these rulings require SUB plans to supplement state unemployment benefits and to link the benefits to the receipt of state unemployment compensation.

### Key elements of a SUB plan:

#### 1. BENEFITS ARE PAID ONLY TO UNEMPLOYED FORMER EMPLOYEES WHO ARE LAID OFF BY THE EMPLOYER.

##### Explanation:

Section 3402(o)(2)(A) of the Internal Revenue Code defines a lay off for purposes of SUB as an involuntary separation from employment (whether or not the separation is temporary) resulting directly from a seasonal lay off, reduction in force, discontinuance of a plant or operation, or other similar condition.

The definition of a layoff can be further expanded, if permitted by state unemployment law, to include a reduction of hours of service that renders the employee eligible to collect state unemployment benefits.

Note:

- The definition of a lay off does not include an employee terminated for cause or an employee who voluntarily resigns.
- Benefits must cease to be payable as of the date that the employee returns to work for any employer (even if it is not the employer who established the SUB plan).

#### 2. ELIGIBILITY FOR SUPPLEMENTAL UNEMPLOYMENT BENEFITS DEPENDS UPON MEETING PRESCRIBED CONDITIONS AFTER TERMINATION OF EMPLOYMENT.

##### Explanation:

The primary condition is that an employee must be eligible for state unemployment benefits.

There are three limited exceptions to this rule that were established in Rev. Rul.90-72 which permits an employee to receive SUB if they are NOT eligible for state unemployment because:

1. The employee does not have sufficient employment to be covered under the state system;
2. The employee has exhausted the duration of state unemployment benefits

OR

3. The employee has not met the requisite waiting period.

**3. THE AMOUNT OF WEEKLY BENEFITS PAYABLE IS BASED UPON STATE UNEMPLOYMENT BENEFITS, OTHER COMPENSATION ALLOWABLE UNDER STATE LAWS, AND THE AMOUNT OF REGULAR WEEKLY PAY.**

**Explanation:**

This is a very broad requirement that allows room for creative benefit formulas. More information about this requirement, and some ideas on the strategies available, can be found on page 10.

**4. NO EMPLOYEE HAS ANY RIGHT, TITLE, OR INTEREST IN THE BENEFITS UNTIL SUCH EMPLOYEE IS QUALIFIED AND ELIGIBLE TO RECEIVE BENEFITS AND THE BENEFITS DO NOT ACCRUE UNTIL A PRESCRIBED PERIOD AFTER TERMINATION OF EMPLOYMENT.**

**Explanation:**

Employees have no right to SUB until they have met the requirements of their employers SUB Plan.

**5. THE BENEFITS ARE NOT ATTRIBUTABLE TO THE RENDERING OF PARTICULAR SERVICES BY THE RECIPIENT DURING THE PERIOD OF UNEMPLOYMENT.**

**Explanation:**

The employer cannot require that the employee perform any services whatsoever in return for SUB.

**6. BENEFITS MAY NOT BE PAID IN A LUMP SUM.**

**Explanation:**

SUB benefits must be linked to state unemployment benefits. Receipt of SUB in the form of a lump sum rather than periodic payments would allow the same amount of benefits to be received regardless of how long an individual remains unemployed, and thus would not satisfy the requirement to be linked to state unemployment benefits.

## **ADVANTAGES & REQUIREMENTS OF USING A TRUST**

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Most employers elect to provide SUB plans through a trust fund rather than directly through the company.

A trust fund that meets the necessary qualification requirements is tax exempt and, therefore, the contributions made by the employer to fund SUB benefits are deductible at the time of contribution. Any earnings on the corpus (assets) of the trust are also exempt from taxation.

A supplemental unemployment benefit trust organized under IRC 501(c)(17) or 501(c)(9) are the most common types of tax qualified exempt trusts.

## Necessary requirements of a trust:

### **1. THE TRUST IS A VALID, EXISTING TRUST UNDER LOCAL LAW AND IS EVIDENCED BY AN EXECUTED WRITTEN DOCUMENT.**

#### **Explanation:**

You must have a written trust document.

### **2. THE TRUST IS PART OF A WRITTEN PLAN ESTABLISHED AND MAINTAINED BY THE EMPLOYER SOLELY FOR THE PURPOSE OF PROVIDING SUB.**

#### **Explanation:**

The trust document must reference a specific written plan document that meets the requirements for SUB.

### **3. THE TRUST IS PART OF A PLAN, WHICH PROVIDES THAT THE CORPUS AND INCOME OF THE TRUST CANNOT BE USED FOR, OR DIVERTED TO, ANY PURPOSE OTHER THAN THE PROVISION OF SUB OR THE ADMINISTRATION OF THE PLAN.**

#### **Explanation:**

Once funds are contributed to the trust, the funds can only be used for SUB benefits. Funds cannot revert to the employer or be transferred to other benefit plans (i.e. retirement, death benefits, etc.). However, IRC 501(c)(17) permits sick and accident benefits to be paid under the plan provided they are subordinate to the separation benefits.

### **4. THE TRUST IS PART OF A PLAN WHOSE ELIGIBILITY CONDITIONS AND BENEFITS DO NOT DISCRIMINATE IN FAVOR OF HIGHLY COMPENSATED EMPLOYEES.**

#### **Explanation:**

A Highly Compensated Employee is an individual who:

Owned more than 5% of the interest in the business at any time during the year or the preceding year, regardless of how much compensation that person earned or received, or

For the preceding year, received compensation from the business of more than \$120,000 (if the preceding year is 2016 or 2017), and, if the employer so chooses, was in the top 20% of employees when ranked by compensation.

### **5. THE TRUST IS PART OF A PLAN, WHICH REQUIRES THAT BENEFITS ARE TO BE DETERMINED ACCORDING TO OBJECTIVE STANDARDS.**

#### **Explanation:**

Benefits cannot be determined solely in the discretion of the trustees or plan sponsor.

## ADVANTAGES & STRATEGIES FOR CONSTRUCTION COMPANIES SUBJECT TO PREVAILING WAGE REGULATIONS

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Construction companies that contract with the government (federal government, many state governments, municipalities, school districts, etc.) are subject to special requirements that dictate mandatory wage and fringe benefit payments commonly referred to as “prevailing wage regulations” (Davis-Bacon Act, McNamara-O’Hara Service Contract Act and state prevailing wage laws).

The fringe benefit portion of the prevailing wage regulations are particularly complicated and often misapplied by contractors, especially those that are merit shop and not subject to a collective bargaining agreement that provides bona fide fringe benefits. The fringe benefit portion of prevailing wage regulations typically require a contractor to provide a certain dollar level of bona fide fringe benefits for each hour worked or provide an equivalent amount in additional wages.

■ **“Working the Fringe — Prevailing Wage Bona Fide Fringe Benefit Plan Strategies for Merit Shop Contractors”** provides a more comprehensive analysis of the rules and effective compliance with prevailing wage regulations. It can be downloaded at our website: [directadvisors.com/prevailing wage](https://directadvisors.com/prevailing-wage).

In addition to supplemental unemployment benefits, other bona fide benefits often include:

- Pension / retirement plan (defined benefit or defined contribution)
- Medical insurance
- Dental insurance
- Life insurance
- Disability insurance
- Vacation / holiday / sick pay
- Apprenticeship & safety training

Supplemental unemployment benefits are particularly well suited for construction companies that commonly have interruptions in their work and therefore, reduced needs for labor during these interruptions. Some examples of possible interruptions may include:

- Seasonal shutdowns
- Weather conditions
- Job scheduling
- Equipment or material supply problems
- Delays caused by engineering or other sub-contractors

Interruptions such as those outlined cannot always be effectively handled with a temporary layoff. Acquiring and keeping skilled workers has become a determining factor in most companies’ ability to grow. Laying off valuable workers during an interruption can have unintended consequences such as morale issues resulting from reduced income or employees finding work with another employer — including a competitor!

These consequences are well understood in the construction industry and often result in companies keeping workers “busy” on other things such as “shop work” rather than risk the workers not being available when they need them.

Supplemental unemployment benefit plans can be the solution to the risks associated with temporary layoff:

- **Payments from the SUB plan** can provide the additional income necessary to equalize or even exceed the wages the employee receives while working;
- **Depending on state rules**, employees can receive payments for short work weeks (less than 40 hours worked), where their hours were interrupted by weather or some other short term factor;
- **The payments received by employees** are tax advantaged because they are not subject to FICA taxes (7.65%); and
- **SUB plans can be funded with fringe benefit payments** already required under prevailing wage regulations and therefore do not create an additional company expense or liability.

## PLAN DESIGN STRATEGIES

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Although SUB plans can be beneficial for construction companies subject to prevailing wage regulations, care must be taken in the design of the Plan to insure maximum effectiveness.

### Trust / Funded Plans

SUB plans work best when they are administered through a trust, as referenced above. Irrevocable contributions of fringe benefit dollars paid to a trustee pursuant to a bona fide fringe benefit trust fund, plan or program on a regular basis by contractors engaged in public works qualify as a “funded plan” under 29 USC Section 5.26-5.27.

Contributions to funded plans can be credited towards meeting the prevailing fringe benefit requirements of the Davis Bacon Act, Service Contract Act and state prevailing wage laws, and does not need United States Department of Labor Approval (state rules vary).

### Contribution Formulas

The contribution formula of the Plan dictates the amount of money the employer is obligated to fund to the employees benefit account. If the intent is to fund the Plan solely with fringe benefit dollars obligated under prevailing wage regulations, the contribution formula must be written with this clear intent.

A properly written contribution formula limits an employee to only receiving the amount that has been credited to their benefit account and protects the employer from any obligation to make additional payments to the Plan.



## Benefit Formulas

As discussed above, an essential requirement of a SUB plan is:

**The amount of weekly benefits payable is based upon state unemployment benefits, other compensation allowable under state laws, and the amount of regular weekly pay.**

A common incorrect assumption regarding this requirement is that the SUB plan weekly benefit can be no more than what would have normally been earned as regular weekly pay when combined with the state unemployment benefit.

This is incorrect because “based upon” means just that, and provides flexible variables in how to calculate benefits.

For example, benefit formulas can include a multiple of state unemployment benefits and/or a multiple of regular weekly pay up to a maximum threshold. As long as the formula is “based upon” the required criteria, the formula is compliant.

## SUMMARY

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Providing a supplemental unemployment benefits plan as part of your prevailing wage fringe benefit strategy can be a win-win for your company and your employees. Making a temporary lay-off a welcome respite rather than a time of stress and financial difficulty can help build employee loyalty and secure your valuable workforce.

Funding a plan with prevailing wage fringe contributions is tax efficient and provides an enormous cost advantage over paying fringe contributions as cash wages.

The rules related to supplemental unemployment benefit plans combined with prevailing wage regulations can be extremely complicated. The strategies to most effectively deal with them in a compliant fashion require knowledgeable experts with the proper trust accounting and administrative tools to provide flexibility in Plan design, timely and accurate statements and reporting, as well as online portals for you and your workers.

## HOW WE CAN HELP

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DirectAdvisors, established in 2001 and located in Albany, New York, provides bona fide benefit plan consulting and third party administrative services to merit shop (non-union) construction companies that are subject to the Davis-Bacon Act, Service Contract Act and state prevailing wage regulations. Our clients are located throughout the United States and range in size from 10 to 3,000 employees.

In 2018, our construction company clients will contribute tens of millions of dollars of prevailing wage fringe benefit contributions to The DirectAdvisors Trust (health & welfare benefits) and retirement plans managed by our team.

Our solutions are free from any conflict of interest as we do not sell any financial or insurance products. We work with existing agents, brokers and insurance companies.



**Jeff Bennett** is co-founder of DirectAdvisors. Jeff is an authority in fiduciary process and investment management for retirement plans. He has consulted with merit-shop construction companies for more than 20 years. A former human resources director, he holds the ASPPA Qualified Plan Financial Consultant designation. Jeff is an Accredited Investment Fiduciary (AIF) and Certified Plan Fiduciary Advisor (CPFA). He is also an active board member of the Albany chapter of Entrepreneurs Organization.



**Tom Santa Barbara** is co-founder of DirectAdvisors. Tom is an expert in plan design and fiduciary investment management. For more than 25 years, he's provided insights and guidance to commercial enterprises and nonprofit organizations subject to prevailing wage regulations. Tom is an Accredited Investment Fiduciary (AIF) and Certified Plan Fiduciary Advisor (CPFA). He is also an active board member and incoming President of the Empire State Chapter of the Associated Builders & Contractors.

### Consulting Inquiries:

[jeff@directadvisors.com](mailto:jeff@directadvisors.com)

[tom@directadvisors.com](mailto:tom@directadvisors.com)

### Media Inquiries:

[media@directadvisors.com](mailto:media@directadvisors.com)

### Speaking Inquiries:

[speaking@directadvisors.com](mailto:speaking@directadvisors.com)



Member of:



421 Loudon Road, Albany, NY 12211  
(866) 796-1173 | (518) 362-2119  
[directadvisors.com](http://directadvisors.com)

The content of this analysis regarding the applicability of the Davis Bacon Act, Service Contract Act and state laws to contractors engaged in public works projects reflects our best professional judgement of the implications of the law as of the date of circulating the document (September 2015). Readers are cautioned that federal and state rules and regulations regarding these acts constantly evolve. Please be advised that all individuals should consult with their legal and accounting professionals before relying upon the information contained herein.  
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