

Severance payments: One time income or income over time?

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In the recent opinion in *In re Marriage of Tong & Samson*, 2011 DJDAR 10824 (2nd Dist. July 18, 2011), the 2nd District Court of Appeal answered the question of whether to allocate lump sum severance payments over a period of time or to attribute those funds in the month they are received, where the support order includes an *Ostler & Smith* component. *Ostler & Smith* orders are based upon the opinion in *In re Marriage of Ostler & Smith*, which upheld a support order providing that a certain percentage of the supporting party's sporadic or hard to predict income (bonuses, commissions, overtime, self-employment income, etc), or any income above a certain threshold during a specified period, be paid to the supported spouse at specific time intervals (annually, quarterly, monthly, etc.). Most severance payments are received in a single payment.

Employers, however, often set forth a formula indicating how they reached the entire amount of the severance payment. The formula often states, for example, that the severance payment represents "x" amount of years or months of salary, plus some percentage of bonuses and commissions. *Tong and Samson* held that severance payments intended to replace future income must be allocated over a period of time, and not as income received in one payment.

It may be to one's benefit, depending on the figures involved, that the lump sum compensation be considered income in the month received and not allocated over a period of months.

In *Tong and Samson*, the husband, a mutual funds wholesaler, earned a base salary with a commission for sales above pre-set levels. The wife sought spousal support following separation. Pursuant to the stipulation of the parties, the husband agreed to pay a base amount of support and, pursuant to an *Ostler & Smith* order, a percentage of his income in excess of \$25,000 in any individual month. A year after the parties reached this agreement, the husband, after 28 years of employment, was laid-off. His employer paid him a lump sum severance in the amount of \$309,700 two months after he was terminated. Documents produced in connection with the severance package showed that all but \$5,000 of the \$309,700 received, was specifically intended to compensate him for one year's salary and six months of commissions.

After receiving the severance payment, the husband filed an order to show cause regarding how the severance payment would affect the support order, specifically the *Ostler & Smith* component. He argued that the holding in *In re Marriage of Stephenson* (1995) 39 Cal. App. 4th 71, applied. (In *Stephenson*,

the husband's severance package after retirement was allocated over a period of months, as if he had received the severance package on a monthly basis.) The wife argued that *Stephenson* was distinguishable from their matter based on the fact that the husband in *Stephenson* filed his order to show cause prior to termination, not after. She also claimed that the husband was attempting to retroactively modify support by filing the order after termination.

The trial court agreed with the wife, and denied the husband's order to show cause for impermissibly attempting to retroactively modify support. It ordered him to pay support arrearages based in part, on the *Ostler & Smith* order, as the income in the month he received the severance payment was in excess of \$25,000.

The appellate court reversed the trial court's decision regarding the severance payment. It held that the husband was not attempting to retroactively modify support as his order to show cause did not seek to modify the base amount of support, the \$25,000 threshold, or the percentage of income above the \$25,000 threshold. Further, the court held that the holding in *Stephenson* applied, and that the severance payment must be allocated over a period, not a single payment.

The wife argued that the husband's entire severance package was compensation in the month it was received, and subject to the *Ostler & Smith* percentage. Finding that there was no evidence that either party knew that the husband would be terminated or receive a lump sum severance payment at the time they reached the support stipulation, the appellate court held that it was error for the trial court to accept the wife's argument that the severance payment was compensation in the month it was received only, and that the entire amount was subject to the *Ostler & Smith* percentage.

The wife further contended that part of the severance payment was compensation for the husband's years of service, drawing a comparison to the characterization of post-separation bonuses or severance payments. The appellate court rejected this argument, holding that severance payments — whether the amount is based upon years of service or some other consideration — are designed to replace future wages. As such, it is not helpful to consider why the employee received the severance payment, as it relates to support. The important determination is what period the severance payment was intended to compensate the employee.

The appellate court found that the trial court must determine how to allocate the severance payment over an appropriate period. The court concluded that it would be appropriate to allocate the husband's severance pay pursuant to the intent of the employer (12 months of salary, and six months of commissions), though the trial court is not bound by the employer's intent.

The *Tong and Samson* decision appears to be fair and logical: Severance payments, generally, are intended to replace the terminated employee's income for a period of time. Therefore, in the event a supported spouse demands an *Ostler & Smith* payment on a lump sum severance payment, the supporting spouse should cite to this case and, if necessary, file an order to show cause in line with the one filed by the husband in this matter.

Conversely, it may be to one's benefit, depending on the figures involved, that the lump sum compensation be considered income in the month received and not allocated over a period of months. The principal question to ask is what will save the most money? If the severance package is small, relative to the monthly support obligation, then treating the income as received in one payment is a superior option because this allows for the termination or modification of one's support and will ultimately save considerably more money than allocating the severance over a period of months and potentially delaying the termination or modification of support.

In fact, the husband in *Tong and Samson* would have had to pay approximately \$96,250 to the wife had she won on appeal (35 percent of severance payment over \$25,000). This amount, \$96,250, is equal to roughly 10 months of the husband's support obligation. Therefore, depending on how many months the trial court ends up allocating the severance package over on remand, the husband may have been better off paying the *Ostler & Smith* percentage.



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