Being paid to quit? Tread carefully on buyout offers

Your company is offering an early retirement package, and your first inclination might be to go for it.

But there's a lot to think about.

"Make sure that the severance package will be enough for you to make the transition to the next phase of your life," says Scott Bishop, director of financial planning at STA Wealth Management in Houston. For Baby Boomers in particular, who may decide not to work again, "whether or not you accept the terms of your severance plan ... may be the most important decision you make in your lifetime."

The typical severance is based on the departing employee's annual salary and years on the job. For instance a business might offer one or two weeks' — or even months' — salary, for each year that a worker was employed by the company.

Increasingly Americans are having to make a decision about whether to accept such packages.

"I do think they are offered more ... today," says John Challenger, CEO of Challenger Gray & Christmas, a human resources consulting firm. "In an era where long-term employment was more the norm, companies didn't have to deal with it as much. ...Today, that safety net for most companies is to offer a severance or early retirement program of some kind, to offer outplacement to help people find a new role and often offer some kind of health (insurance) continuation during that period of time."

Bishop said there are several points to consider before taking severance:

Understand the terms of the payout.

"You may be able to take a lump-sum severance payment and then invest the money to provide income, or use it to meet large expenses. Or, you may be able to take deferred payments over several years to spread out your income tax bill on the money."

Determine whether you are going to stop working, or look for another position.

"If they are closer to retirement age, they have a lot more decisions than people looking to take the severance package and start a new job," Bishop says. "For those looking to retire north of age 55, they need to figure out if they can retire. Are they Medicare eligible? Can I start Social Security?"

So, run the numbers, keeping in mind the impact of inflation, and ask yourself, "Is this going to be enough money to last me the rest of my life?'" he says. Besides the severance payments, "look at money in the bank, pension, 401(k). ... How much debt do you have? Do you still have a car payment? Kids' tuition? Maybe you need to sell the house and move into a smaller house or apartment. And if those are decisions you can live with and be happy, maybe you can retire."

Know if there's a non-compete clause.

If you are contemplating finding another job, you need to make sure the severance offering doesn't include a non-compete clause, where you can't work for a competitor for a period of time, or you're forbidden from hiring your former company's employees.

Prepare to pay taxes.

Once it's time to start making withdrawals on your 401(k), realize that you will have to pay taxes, and possibly even a penalty if under age 55. Taxes are also owed on pension income. And depending on when you take your severance, you may owe more to Uncle Sam than you anticipated.

"In terms of taxation, if you get two years of salary and that's $200,000 and you already made $50,000, you may have a bigger tax bite," Bishop says. "Severance is not tax free."

Figure out your health insurance.

If you're close to retirement, and your company offers health care to retirees, you may want to see if you can access that benefit early. If not, you may need to consider COBRA, or one of the exchanges created in the wake of the Affordable Care Act.

Hold off on collecting Social Security.

Putting off drawing on Social Security can hold you in good financial stead. Each year between the ages of 62 and 70 brings an 8% raise, "so if you're in good health, it's a great return to wait," Bishop says.

Have a financial plan.

To maximize income in retirement, an investment plan is crucial. "The more you're reliant on your portfolio because you're retired, the less you can handle a market correction," says Bishop. "If you have a prudent investment plan, you should be moving money around or rebalancing on a periodic basis."

So professional guidance is crucial.

"When you're making decisions that may be irrevocable, it's important to seek advice from a CPA or financial adviser," he says. "Don't make all your decisions based on your gut."