GFM
Wealth Advisory

PROFESSIONAL PRACTICE
FINANCIAL PLANNING ASSOCIATION of AUSTRALIA

Australian Financial Services Licence No. 229401

190 Through Road
Camberwell VIC 3124
T: (03) 9809 1221 F: (03) 9809 2055
enquiry@gfmwealth.com.au
www.gfmwealth.com.au
ABN 69 006 679 394

Case Study

Timing Your Retirement

SMSF Specialists
Investment Management
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Timing Your Retirement

Many of our clients often ask us the question: When is the best time to retire?

To the extent that you are able to “plan” your retirement, this can depend on a range of complex and competing factors, many of which resolve around taxation and the ability to contribute to superannuation.

We haven’t illustrated one individual case study as it would be too difficult to use one scenario to demonstrate the value of seeking advice in this area & the costly taxation impacts of getting it wrong.

1. Meet Damian:

Damian is thinking of retiring. He is 64 and on a salary package of $115,000 p.a. inclusive of superannuation. He is salary sacrificing to the maximum of $35,000 in concessional contributions.

He will retire in either June or July of this year. He has accrued a total of $37,000 in annual and long service leave. His wife, Maria, also 64, has already retired and earns no income from any other sources.

Damian would like to understand the taxation impacts of retiring in either late June or early July.

If he retires on the last day in June, all of his annual and long service leave will be added to his assessable income already earned in that Financial Year. If he retires on the first day in July, his annual and long service leave will effectively be added to no other taxable income.

	Retire in June	Retire in July	
Income from Employment	$105,023	$105,023	$ -
Annual and Long Service Leave	$37,000	$ -	$37,000
Less: Salary Sacrifice	$25,023	$25,023	$ -
Taxable Income	$117,000	$80,000	$37,000
Tax on Assessable Income	$31,237	$17,547	$3,572
Less: Low Income Rebate	$ -	$ -	$445
Less: Seniors and Pensioners Tax Offset	$ -	$ -	$3,204
Net Income Tax Payable	$31,237	$17,547	$ -
Plus: Medicare Levy	$2,340	$1,600	$ -
Total Tax Liability	$33,577	$19,147	$ -
TAX SAVING			**$14,430**

As can be seen, there is a rather substantial tax saving of $14,430 by retiring one day later and in the next Financial Year.

This is due to the combination of the fact that the annual and long service leave is being added to nil assessable income, rather than a year’s worth of income, as well as the fact that Damian and Maria turn 65 next Financial Year and get the use of the Seniors and Pensioners Tax Offset.

2. Making concessional super contributions of more than $35,000 p.a.:

There is a contribution allocation strategy to maximise deductions for a particular Financial Year within a self-managed superannuation fund. This strategy is also known as a "Contributions Reserving" and is too complicated to explore in great depth in this article.

The table below details the benefit of Damian making additional salary sacrifice contributions that exceeded the limit of $35,000 p.a.

	Retire in June	Retire in July	
Income from Employment	$105,023	$105,023	$ -
Annual and Long Service Leave	$37,000	$ -	$37,000
Less: Salary Sacrifice	$25,023	$27,298	$ -
Taxable Income	$117,000	$77,725	$37,000
Tax on Assessable Income	$31,237	$16,808	$3,572
Less: Low Income Rebate	$ -	$ -	$445
Less: Seniors and Pensioners Tax Offset	$ -	$ -	$ -
Net Income Tax Payable	$31,237	$16,808	$3,127
Plus: Medicare Levy	$2,340	$1,555	$ -
Total Tax Liability	$33,577	$18,362	$3,127
TAX SAVING			**$15,215**

As can be seen, a further taxation saving of $785 is generated. It is important to note that contributions tax of $341 would need to be paid on the extra amount salary sacrificed, reducing the net additional benefit to $444.

3. Taking Annual and Long Service leave gradually rather than as a lump sum:

This strategy does require an accommodative employer and isn't always possible for everyone.

Accrued unused annual leave and long-service leave when you leave work must be paid to you in cash and cannot be salary sacrificed to super. As accrued unused leave paid to you does not qualify as an Employment Termination Payment, it will be taxed as normal income subject to your marginal tax rate.

However, if annual and long service leave are taken as salary gradually over a period of time, oddly enough, that can be salary sacrificed into super in the same manner as ordinary income.

The disadvantage to an employer of permitting this is the fact that annual and long service leave continues to be accrued. Furthermore, the 9.5% superannuation guarantee is also required to be paid when taken gradually as a lump sum. Finally, it could also be argued that it is administratively easier for a number of different reasons for a company to pay out annual and long service leave as a lump sum.

Nevertheless, using Damian as an example again, let's assume he has an accommodating employer and has the ability to salary sacrifice his annual and long service leave. We will assume that he has accrued

$70,000 in annual and long service leave rather than $37,000. The table below details the taxation benefits of him taking annual and long service leave gradually, combined with a lump sum. We have assumed that he earns his ordinary income for around seven fortnights and salary sacrifices 100% into the superannuation environment. At that point in time, he takes the remainder of his annual and long service leave as a lump sum. We haven't factored the additional benefits of receiving the superannuation guarantee and the further accrual of annual and long service leave.

	100% Lump Sum	Partial Lump Sum
Annual and Long Service Leave	$ -	$31,963
Annual and Long Service Leave (Lump Sum)	$70,000	$38,037
Less: Salary Sacrifice	$ -	$31,963
Taxable Income	$70,000	$38,037
Tax on Assessable Income	$14,297	$3,909
Less: Low Income Rebate	$ -	$429
Net Income Tax Payable	$14,297	$3,479
Plus: Medicare Levy	$1,400	$761
Total Personal Tax Liability	$15,697	$4,240
Plus: Contributions Tax on Salary Sacrifice	$ -	$4,795
TOTAL TAX LIABILITY	**$15,697**	**$9,035**
TAX SAVING		**$6,662**

As can be seen, a tax saving of $6,662 would be extracted in this scenario.

We have illustrated three different scenarios in the benefits of timing your retirement to minimise the taxation payable.

In our next edition of Trade Secrets, we will work through other Case Studies around the timing of retirement that link in with maintaining eligibility to contribute to superannuation past the age of 65 as well as minimising the capital gains tax payable on the sale of an asset near retirement.