Are you planning to retire in 2007? If so, it's likely that you've been thinking about how to make the most of the lump-sum payment you'll have coming for unused annual leave. Many employees save up every hour they can before retiring at the end of the year.

But there are some misconceptions about how the lump-sum payment process works, so before you start counting on a big fat check, let's look at some facts you may not know.

The check comes from your agency, not OPM. Payments for unused annual leave are issued by the payroll office of the agency you retire from, not by the Office of Personnel Management. Therefore, it comes soon after you retire (or resign, for that matter).

The check may reflect a higher salary than your final pay rate. An agency calculates a lump-sum payment by multiplying the number of hours of accumulated and accrued annual leave by the employee's applicable hourly rate of pay, plus other types of pay the employee would have received while on annual leave (such as across-the-board annual pay increases). The calculation excludes retention allowances paid for the sole purpose of retaining an employee in federal service. If an employee retires from a foreign post and receives a foreign post allowance, they should have this extra pay included in the lump-sum payment if they retire directly from their overseas assignment.

The check is (almost) limitless. There is no limit to the number of hours of leave an employee can be paid for. Back in the days when members of the Senior Executive Service were allowed to carry over unlimited amounts of leave from year to year, some retirees would receive payment for more than a year's worth of unused vacation time. Now, there are restrictions on the amount of leave employees can carry over. Most federal employees can only carry over 240 hours. Since 1994, SES members are typically restricted to 720 hours. During the last year of employment it is possible for an employee to accumulate an additional 208 hours of leave (Eight hours of leave per pay period for 26 periods). This means that a final annual leave balance could be as much as 448 hours, or for a high-level executive, 928 hours.

You may get one lump or two. Sometimes the lump-sum payment is made before the latest federal pay increase has been incorporated into an agency's payroll system. In these situations, employees will receive their initial lump-sum payment shortly after retirement and then a supplemental check reflecting the pay adjustment two to four weeks later. This situation typically occurs when an employee retires at the end of the leave year, right before the new pay increase takes effect. The 2007 pay increase will be included in lump-sum payments to those employees who retired at the end of 2006. Some of those payments will require a supplemental payment to allow the payroll system time to catch up.

You have to earn the leave to be paid for it. That may sound obvious, but you'd be surprised at how many times I get this question. Some people think that you can retire at the beginning or middle of a year and be paid for all of the leave that you will accrue that year. Not true. If the balance in your leave account says "24 hours of annual leave," then you will be paid for 24 hours.

To earn leave you have to complete the leave period. If you are a full-time employee, you must complete the 80 hours of work for a pay period in order to accrue leave for that period. For example: To accrue leave for period 17 this year (which ends on Saturday, Sept. 1), you must finish the 80 hours of work for that period by close of business on Friday, Aug. 31 (assuming you work a Monday-to-Friday schedule). On the other hand, if you are planning to retire on Thursday, Jan. 3, 2008, you will forfeit the final leave accrual for leave period 26 unless you work a compressed schedule and complete your work week by Thursday afternoon. There is no such thing as a partial leave accrual or pro-rated accrual of leave in these situations.
You can get paid for other kinds of leave, too. If you have unused (and unexpired) compensatory leave, credit hours and restored annual leave, you will be paid for that, too. Comp time and credit hours are not projected to the salary of the future, but instead are paid at the salary you had when you earned the leave. You will not be paid for unused home leave. This type of leave is used only for people assigned to foreign posts outside of the United States and its territories.

Use your sick leave if you can. If you are sick or qualify to use your sick leave in a particular situation, then use it. This is true even if it means that by using such leave you will lose a month of service in the computation of your retirement. (Civil Service Retirement System and CSRS Offset employees receive credit for unused sick leave in their retirement benefits). Suppose, for example, that John needs to take 80 hours of leave for a medical condition before he retires later this year. And suppose he has 80 hours of annual leave that he could take instead. If he uses the sick leave, he will lose a month of service in the computation of his CSRS retirement benefit. What should he do? Assuming his annual salary is $65,000 (an hourly rate of $31.14), using 80 hours of annual leave would cost him about $2,500 in a lump-sum payment when he retires. On the other hand, a month of service in the computation of his retirement is worth only $103 per year. If John uses the annual leave and forfeits the $2,500 payment, he would have to be retired more than 24 years before he breaks even.

What’s withheld is different from your regular paycheck. Federal, state and Social Security taxes are withheld from the annual leave lump-sum check. Retirement contributions, insurance premiums and Thrift Savings Plan deductions are not withheld. Most payroll systems use a "flat" withholding for federal taxes since the lump-sum payment could be quite large. If the payroll office withheld taxes as if the lump sum was a normal biweekly check, it might send you to the highest tax bracket for that pay period.

For Social Security purposes, income counts when earned, not paid. If you are eligible for Social Security benefits but younger than full Social Security retirement age (65-67, depending on the year you were born), there is a limit to how much you can earn and still receive full Social Security benefits. If you are younger than full retirement age during all of 2006, Social Security will deduct $1 from your benefits for each $2 you earned above $12,480. But that income counts when it is earned, not when it is paid. If you have income that you earned in one year (such as annual leave), but the payment was made in the following year, it should not be counted as earnings for the year you receive it.

But Social Security does count the lump sum as earned income. Social Security will include the lump sum as wages for computing your benefits. Employees who are subject to Social Security withholding (those in the Federal Employees Retirement System and CSRS Offset) will receive credit from Social Security in their earnings history since the lump-sum annual leave payment is subject to the 6.2 percent Social Security withholding tax.

Some people are paid the wrong amount. Just check out this story about a class-action suit involving employees whose agencies failed to take into account annual pay raises in calculating their lump-sum payments. (Here's some more information about the case.)

I hope that clears up most of the questions you might have had about the lump-sum annual leave payment. If you need more information, see this OPM fact sheet.

Tammy Flanagan is the senior benefits director for the National Institute of Transition Planning Inc., which conducts federal retirement planning workshops and seminars. She has spent 25 years helping federal employees take charge of their retirement by understanding their benefits.