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Employee Pension Scheme- Higher Contribution of Pension- Is it worth it?

What is EPS 95

The EPS 95 allows for a guaranteed pension for the subscribers with an option to start the pension from age 58 or 60. This pension is available for the subscriber as long they live and 50 percent of the amount to the surviving spouse after that. The pension also covers the surviving children if the deceased member falls within the definition, they shall also be entitled to a monthly pension in addition to a widower pension. The pension, in that case, is equal to 25 percent of the widow/er pension to each of the children subject to a maximum of two children till the age of 25 years.

Retirement Planning hosts a major role in personal finance and hence one should give top priority to retirement planning. The EPS scheme’s higher pension benefits provide much-needed financial security and peace of mind regarding retirement expenses. This scheme also helps us to follow the principle of saving first and then doing expenses.

Key Benefits of Ultra long-term investments for retirement include:

1. There are very few or no assured return products for a long-term horizon hence reinvestment risk always pertains to short-term or medium-term investments. Ex-Most high-yielding regular income options available now — such as the Senior Citizens Savings Scheme and the Pradhan Mantri Vaya Vandana Yojana — have a lock-in period of 5-10 years. It would be a big challenge to get such a high rate of returns 10 years down the line at the time of reinvestment.
2. One can manage all other goals through various loans but there will be no loan for retirement expenses.

However, the decision to opt for it or not should be taken only after a detailed analysis of the financial status of an individual.

The higher contribution may be suitable in the following conditions.

- If one does not have any other sources of regular income after retirement like a personal pension, annuity plan, or any other fixed passive income from investment or rent etc, a higher EPS pension may be beneficial.
- If one is not willing to plan and manage funds for retirement, then a higher contribution is advisable.
- If one can manage short and medium-term financial goals with less in-hand salary (due to higher contributions) then you can think of a higher contribution.

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Example:

Let us assume a person started his employment on April 1, 1996, with a basic salary of Rs 5,000 that grows annually at 7.5%. If this employee does not opt for a higher pension, he/she will end up with a pension of Rs 7,929 after 35 years of service in 2031 under the old rule with wage ceilings.

However, if the employee goes for a higher EPS contribution, he/she will get an increased pension of Rs 26,879. But for this, the employee needs to contribute an extra amount with accumulated interest, which will be equal to Rs 9.74 lakh at the time of retirement.

This means that the extra contribution which grows with the EPF interest rate during employment will earn an annual return of 23.4% after retirement. **Therefore, unless the EPFO changes the pension calculation rule significantly, employees will benefit by going for a higher EPS pension.**

Reason for not opting includes:

- Opting for a higher pension requires you to contribute more to the EPS hence will reduce the free in-hand cash flow during contribution period.
- Monthly pension is taxable, but lumpsum EPF amount given after retirement is tax exempted.
- The provisions of the EPS do not return the corpus to the family, so this makes the scheme a not-worthwhile pension option.
- Reduction in the lumpsum corpus at the time of retirement.

Example:

Mr. 'X' became a member of the EPF in 1998. He has not exercised the joint option. His salary increased to Rs.50,000 in 2015. His employer contributes Rs.6,000 (i.e. 12% of his basic wage) towards EPF. Of the employer's contribution, Rs.1,250 (i.e. 8.33% of Rs.15,000; the statutory wage cap) will go to the EPS. The remaining Rs.4,750 (i.e. Rs.6,000 - Rs.1,250) will go to the EPF. He exercises the joint option within 03/03/2023 as per the Supreme Court Judgment since the EPS contribution is above the statutory wage cap of Rs.6,500. After submitting the joint option, his employer will contribute Rs.4,165 (i.e. 8.33% of Rs.50,000; his actual salary) and Rs.1,835 (Rs.6,000 - Rs.4,165) towards EPF. The EPFO will calculate the monthly EPS amount of 8.33% of the actual salary and transfer the difference amount from the EPF to the EPS. In such cases, the EPFO will return to the joining date or 01/11/1995, whichever is later, and transfer the difference from the PF account to the EPS account.

But the higher pension contribution will reduce the EPF lumpsum corpus that the employee gets upon retirement.

Eligibility

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As per the Supreme Court's order dated November 4, 2023, an employee is eligible for a higher EPS pension if:

a) He/she has retired prior to September 1, 2014, and was making higher contributions to their EPF account. However, their higher EPS pension request was rejected by the EPFO.

b) He/she was a member of EPS or EPF on September 1, 2014, and continued to remain the same after.

Conclusion: As from the above illustration, its is clear that opting for higher EPS contribution has its own pros and cons and hence decision should be taken after a thorough understanding of the financial profile and specific requirements of the person.

Research Desk

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