Employee pension scheme: Will higher EPS contribution help you in retirement planning?

Teena Jain Kaushal, Feb 22, 2023, 5:01 PM IST

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KEY HIGHLIGHTS:

Pension is paid at retirement based on your pensionable salary and pensionable service. The higher contribution will be adjusted from the date of joining. You do not receive any lumpsum amount under EPS.

The Employees' Provident Fund Organisation (EPFO) has issued guidelines to help employees contribute a higher amount under the Employees' Pension Scheme (EPS). According to new rules, you can now increase the pensionable salary to the actual basic salary which was earlier capped at Rs 15,000, which in turn will increase your pension amount. The option is available for existing employees and those who were members of EPS as on September 1, 2014.

The question, however, arises if one should opt for the higher contribution under EPS. While taking the decision it is important to understand that you do not receive any lumpsum amount under EPS. You only receive pension amount based on your pensionable salary at the time of retirement (average of 60 months) and pensionable service. The spouse receives 50 per cent of the pension amount after the subscriber passes away.

“I would suggest people stay put and not opt for higher contribution to EPS. The main reason is flexibility which comes with choosing of an annuity scheme at retirement . In EPS, when the person passes away 50 per cent of that amount is paid to the spouse. Post that there is no lumpsum that is paid to the beneficiary of the spouse. In comparison to this I can decide the type of annuity I want at retirement. I can opt for the return of purchase price /same amount of pension to go my nominee/beneficiary and post that a lumpsum can go the beneficiary," said Shantala Kumble, Senior Vice President, International Money Matters, a SEBI-registered investment advisor.

"I also have the flexibility to plan my withdrawals through an asset allocation that is suitable for me if the money accumulated in the EPF is received. I can plan my cashflows partly through annuities and partly through systematic withdrawals and could also plan them to be more tax effective. Further it must be noted that the contribution in the EPS does not earn an interest like the way it does in an EPF," added Kumble.

Another very important point to note is that if you authorise the higher deduction based on your actual salary then it will be adjusted from the date of joining the EPS'95. You will have to authorise your employer to transfer the due differential amount from your employer's contribution of PF to EPFO for drawing pension on the basis of actual salary instead of ceiling salary.

“While giving up the EPF money towards EPS there has to be sufficient other wealth to take care of health care, among other things," said Vishal Dhawan Founder and CEO Plan Ahead Weath Advisors.
Another reason to consider is your life expectancy. As it does not pay the lumpsum amount it is important to consider how long will one need the pension amount. “First opting or not opting for the EPS would depend on your life expectancy assumptions based on individual health and family history. This is important to consider as the pension amount is not paid as lumpsum to you. Post the death of the subscriber the half of the amount is paid to the spouse,” said Vishal Dhawan Founder and CEO Plan Ahead Weath Advisors.

Higher Pension

But one advantage of higher contribution is the higher pension amount post-retirement. So, earlier if a member who joins the scheme at the age of 23 and superannuates at the age of 58 (contributing to the ceiling of Rs15000) may get about Rs 7500 as pension if service is 35 years. (Pensionable Salary X Pensionable Service)/70 = (15000x35)/70 = 7500. But if you opt for the new rule then your pension will be calculated on the actual basic salary, which will in turn increase your pension amount.
“Opting for higher contribution to EPS can help one get higher pension. This has a dual advantage of pension being higher and safe and the fact that when people get lumspsum monies at retirement, they may not use it judiciously. I'm not sure if this will give higher return though. But this is a welcome option and one that people can definitely opt for,” said Shweta Jain, Founder, Investography.

How is pension under EPS calculated?

Both the employer and employee contribute 12 per cent of their basic pay towards EPF. However, while the employee's entire share is contributed towards EPF, from the employer's share 8.33 per cent goes towards EPS and 3.67 per cent goes towards EPF contribution every month.

Then pension amount at the time of retirement is calculated based on your pensionable salary and the pensionable service. The formula for calculating pension is :

Member's Monthly Pension = Pensionable salary X Pensionable service / 70

Where pensionable salary is the average monthly salary in the last 60 months. On death of the member the pension is automatically payable to the spouse.

A person is eligible to receive a pension after completing 10 years of service, provided the person has attained the age of 58 years to withdraw the pension amount. In case a person wants to withdraw early, then they can withdraw after attaining the age of 50 years but they will receive a lesser EPS amount. One can also earn the higher amount by deferring his pension for two years (up to 60 years) after which an additional rate of 4 per cent for each year is paid.