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Social Security Systems in US & India A study in Contrast

The future of the Social Security system in the United States and the ultimate fate of benefits have sparked a debate among politicians and the public in an effort to save what many believe is a doomed process. According to the Social Security Administration, more than 47 million Americans will have received approximately \$492 billion in benefits in 2004. Roughly, 70 per cent of these benefits are received by retired workers and their dependents, with the balance going to disabled workers and their dependents and the survivors of deceased workers. The number is staggering, especially with the longer life expectancy in 1940 an average 65 years was expected to live an additional 12.5 years and today that expectation is extended by five additional years. Part of the reason that the Social Security system has been the target of proponents of reform is that the current structure is very much a pay-as-you-go. Younger workers are covering the benefits received by the current recipient pool. There are roughly 3.3 workers for each Social Security beneficiary and by 2031 that number will shrink to 2.2 workers.

The Social Security Administration has determined that today in the United States, the Social Security benefit is a major source of income for many of the nation's elderly. With the maximum benefit for today's retiree at age 62 (with reduced benefits) at roughly \$1500/month and full benefits at age 67 of \$1700, it is easy to see that additional sources of retirement income are necessary to ensure a retirement that achieves most people's dreams. With employer pensions on the demise, reduced purchasing power of Social Security benefits, and possible impairment of the entire system, it becomes critical for future retirees to save for their retirement with a combination of tax-deferred and taxable accounts.

In 2005, workers will see their contribution to Social Security increase to a maximum of \$5,580 on earnings up to \$90,000 while benefit recipients will see an increase in 2005 of 2.7 per cent to help offset increases in the cost-of-living. While all of this discussion seems rather straightforward, things become more complex for the employee who works outside the United States, for the retiree who resides outside of the United States, and for non-citizens who work in the United States. There is a growing number of Americans working outside the United States and non-citizens working in the U.S. or for U.S. companies, where they are paying into the Social Security system, it is important to understand how their contributions will affect their future benefits. Most



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answers can be found at www.socialsecurity.gov/international/index.html.

In contrast, the vehicle of saving for retirement for those in the organized sector in India has been the Employees Provident Fund (EPF) governed by the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. This Act provides for compulsory contributory fund for the future of an employee (his retirement) or for his dependents in case of his early death.

The EPF is in some ways like a mix of social security system and qualified plans in the United States. It is compulsory for businesses having 20 or more employees to offer the EPF facility to their employees. Employees having a monthly salary of up to Rs.6,500 have to invest 12% of their salary compulsorily and the employers have to match the same. Employees and Employers may contribute more than 12% each, voluntarily. The amount contributed by an employee has certain tax benefits if his annual income is below Rs. 8 lakhs.

The returns on EPF are government regulated, but at present they are an attractive interest of 9.5% per annum. What makes this very attractive is that the returns are tax-free. In other words, when an employee retires and withdraws the amount accumulated in his EPF, he pays no tax. Employer's contribution is also exempt from tax up to 12% of the salary, beyond which it is taxable in the hands of the employee.

Key weaknesses are that EPF funds are invested only in government securities. Additionally, return is not market-related, which is leaving a gap in what is earned and what is promised to be distributed. This money is largely prohibited from being invested in equity markets, which allows for very little risk management and, therefore, whether you are 25 years old or 50 years old, the risk and return on your investment remains the same.

The pensions sector is going to see tremendous reforms in the coming years with privatisation of pension funds. The Indian financial markets are also likely to see structural changes with long-term money being channelled into them.

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