ARTICLE

Liquidator's conundrum on PF and Gratuity dues under IBC

Employees' dues is a crucial aspect in operations of a company. Though IBC gives second order of priority to employee's dues in waterfall mechanism, there seems to exist some loopholes in terms of employees' social security such as Provident Fund, Gratuity, Pension etc. in Liquidation vis a vis the NCLAT has given contradictory judgements in some cases such as Lanco Infratech and Moser Baer. In the present article, the author makes an attempt to analyse the issue from the perspective of judicial pronouncements and presents a practical approach to deal with the same. Besides, the author also provides suggestions for improvement in the process. ***Read on to find out more…***

R. Dharmarajan
The author is an Insolvency Professional (IP) member of IIIPI. He can be reached at dharma67@gmail.com

1. Introduction

One of the key tasks of the Liquidator is to distribute the proceeds from realisations as per the provisions of Section 53 of the IBC. The Liquidation process itself needs to be completed within one year, and here often, the Liquidator may face challenges with respect to dealing with statutory dues such as PF, Gratuity, ESIC and often had to deal with attachment of any of the properties or assets of the Corporate Debtor (CD) by the government agencies such as EPFO, pending payment of the full dues by the Liquidator, where he is in dilemma in dealing with these issues.

2. Distribution of Statutory Dues by the Liquidator

Some of the components of the statutory dues, which are significant for the Liquidator to consider, are as follows:

(a) Gratuity

Gratuity refers to the sum payable by the employer to his workers upon completing service for the prescribed period of time. The obligation falls on the Liquidator once the Corporate Debtor (CD) is under Liquidation. The Insolvency and Bankruptcy Code, 2016 (IBC or the Code) provides for the formation of 'Liquidation Estate' containing all the assets of the CD. It is these assets that will be distributed to the respective stakeholders in terms of the 'waterfall mechanism' under

[1] Section 53 of the IBC, 2016 available at https://ibbi.gov.in//uploads/legalframwork/af0143991dbbd963f47def187e86517f.pdf

Section 53 of the IBC which provides an order of priority for distribution of proceeds obtained from sale of assets of the CD. As per this order of priority[1] after full and final payment of the insolvency resolution process costs and the liquidation costs, two dues have been kept in second priority firstly, workmen's dues for the period of 24 months preceding the liquidation commencement date; and secondly, debts owed to a secured creditor that has relinquished security as per Section 52.

While the Payment of Gratuity Act[2] has not explicitly defined the term 'gratuity', it can be understood to be a sum payable by the employer to his workers/employees upon completing service for the prescribed period of time. The issue arises here is if the Gratuity falls under the 'Liquidation Estate' and is to be distributed in terms of Section 53 of the IBC, then the workers or employees may not get their share of the dues.

(b) Provident Fund (PF)

Under PF, it is essential to note the different components of Employees' Provident Fund Organization (EPFO) during Liquidation:

EPFO Components	Description
Workers or Employee's contribution that is deducted from wages or salaries of the workers or employees	The amount deducted from the wages or salaries of the workmen and employees for remittance to EPFO credit into the respective account of the workmen or employee is fundamentally not the assets of the CD': They are the assets of the workers/employees in possession of the CD, in the capacity of trustee or guardian.
Employers Contribution	Matching contribution amount by the employer to the respective account of the workers or employees.
Interests and Penalties	Interest payable to the EPFO on account of delays in remitting the sum by the employer to the respective worker or employees share of the PF dues (employee or employer's portion) and the resultant penal charges levied by the EPFO for the delays in remittance.

[2] Payment of Gratuity Act, 1972
https://clc.gov.in/clc/sites/default/files/PaymentofGratuityAct.pdf

3. Provisions of IBC for Distribution of Liquidation Proceeds

As per Section 53 (b) (i) of the IBC:

- Workmen's dues for the period of twenty- four months preceding the liquidation commencement date and debts owed to the Secured Creditors in the event such secured creditor has relinquished security in the manner set out in Section 52 of the IBC shall rank Pari-passu and should be distributed equally.

> **“Section 36 of the IBC specifically excludes certain assets which shall not be forming part of the Liquidation Estate and shall not be used for recovery in the liquidation.”**

- Followed by wages and unpaid dues owed to employees other than workmen, for a period of twelve months, preceding the liquidation commencement date.

Under the code, Workmen dues is defined under Section 3(36) as, 'workman' shall have the same meaning as assigned to it under clause(s) of section 2 of the Industrial Dispute Act, 1947, meaning workmen as per companies act Section 326, which means all salary, wages, allowance, accrued dues, compensations on death or disability and basically all sums due to a workman. This effectively means PF, Gratuity, and any other dues payable to the workman are also included under workmen dues.

4. Exclusions to Liquidation Estate- Section 36(4) (a) (iii)

Section 36 of the IBC specifically excludes certain assets which shall not be forming part of the Liquidation Estate and shall not be used for recovery in the liquidation, and specifically exclude 'all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund'.

The above provision is inserted possibly to avoid financial crisis arising out due to low proceeds of liquidation. This could be explained with an example. In case, the CD has no assets other than say Gratuity Fund of about 1 crores and employee contribution amount under PF of about 50 lakhs. Now if these sums form part of the Liquidation Estate then the Liquidator has to first allocate the above to pay for any unpaid corporate insolvency process costs and liquidation expenses, and if the CIRP and liquidation expenses amount to say Rs 50 lakhs, then the balance of 1 Croes alone will be available for distribution and that too to workers for the period of 24 months and employee dues

> **In the matter of *UCO Bank, Asset Management Recovery Branch Vs. the Recovery Officer, EPFO*, and other, the NCLT Chennai held that there is no hesitation in holding that the EPFO was within its power to issue the order of attachment.**

for the period of 12 months and other dues following the waterfall mechanism under Section 53 of the IBC, then the workers or employees may get just a paltry sum as their dues and their assets will be used in paying other stakeholders, and thus this could be the intent of this provision in the code under Section 36(4) of the IBC to avoid a situation like this.

The dilemma for the Liquidator here is that, there is a legal fiction contained in Sec 36(4)(a)(which specifically provides for exclusion of assets owned by third parties and further Sec 36(4)(a)(iii) specifically provides that PF, pension fund and Gratuity funds are excluded from the Liquidation Estate. Where the CD has not specifically provided funds for PF and or Gratuity then it is a further complication for the liquidator as EPF or Gratuity dues does not fall under the waterfall mechanisms under Section 53 of the IBC.

5. Judicial Pronouncements on Sec 36(4)

In the matter of *Alchemist Vs Moser Bear India Private Limited*, NCLT, 2019 it was held that even if there is a deficiency in pension fund, provident fund or Gratuity Fund, the Liquidator has to ensure that the funds are created and distributed to the workmen outside the Sec 53 waterfall. In this judgement the tribunal held that the liquidator must provide these funds, even if there was no diversion of such funds by the CD. Further, in the case of *Precision Fasteners Limited Vs EPF*, the liquidator appealed against the attachment of properties by the EPFO and prayed for treating them as null and void. NCLT, Mumbai bench, vacated the attachment and held, that the entire arrears towards the EPF should be paid, before paying off the other creditors

Reiterating the importance of the PF dues, the NCLT, Chennai Bench, in the case of *The Assistant Provident Fund Commissioner & Recovery Officer, EPFO vs. Florind Shoes Private Limited*[3] and another held that the Liquidator can sell the assets of the CD as stated under IBC and first pay off the dues payable to the applicant before distributing the assets as stated under Section 52 and Section 53 of the Code.

In the matter of UCO Bank, *Asset Management Recovery Branch Vs. the Recovery Officer, EPFO, and others*, the Recovery Officer, EPFO, attached the immovable properties belonging to Pondicherry Textile Corporation Limited against which the Corporate Insolvency Resolution Process (CIRP) was initiated on a later date. During the pendency of the CIRP, the Recovery Officer, EPF, proposed to sell off the properties attached by him. Auction-sale of the properties was contested by the UCO Bank. The Division Bench concluded – 'What is sought to be recovered by the petitioner-Bank from Respondent No.2 is its debts which are included in Section 11(2) of the EPF Act. Therefore, there is no hesitation in holding that the EPFO was within its power to issue the order of attachment'. Furthermore, in the matter of *Standard Chartered Bank Vs. JVL Agro Industries Ltd*, the NCLT Ahmedabad directed the Liquidator to procure a new gratuity policy for the 403 employees whose premiums were not paid by the CD to the Insurance Fund created by the CD. However, in Somesh Bagchi V NiccoCorpn Ltd, the NCLAT held 'Gratuity does not form part of the Liquidation Estate'.

The above rulings and pronouncements make it difficult for the Liquidator to deal with distribution from the Liquidation Estate, where there is either the assets of the workers in the form of PF or Gratuity is part of the Liquidation Estate or deemed to be part of the Liquidation Estate as per some of these judicial pronouncements.

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[3] NCLT Chennai, M.A.278 of 2019 in CP/522/IB/2018, decided on 5-12-2019.

6. Right to Life

In some of the judicial pronouncements, the Judiciary used the term 'Right to life', when it considered the workers dues such as PF, Gratuity or pension dues which are to take precedence over the other dues. In the Precision Fasteners Ltd V. EPFO case, the NCLT, Mumbai tribunal held that the 'right of all other creditors over the assets of the company is a property right, whereas workmen dues, more specially PF dues of workmen, are interwoven with Right to Life. The workmen all through their life save some portion of the hard earnings for their later life after retirement, and they cannot be treated on par with the creditors who are having a property right'.

> **NCLAT, in *Lanco Infratech* case specifically held that it is not the liability of the Liquidator if no separate funds were created by the CD and thus there is a contradiction from the Moser Baer judgement.**

7. Overriding Effect of IBC over other laws, Section 238

IBC, to have overriding effect over any other laws, where there is a conflict, is the intent of this section under the code. Does, Section 238's overriding effect be applicable to distribution of dues payable to workmen with regards to the provisions under the EPFO Act or provisions of the Payment of Gratuity Act.

In *Alchemist Vs Moser Bear India Private Limited*, NCLT, 2019' it was held that even if there is a deficiency in pension fund, PF or Gratuity fund, the Liquidator has to ensure that the funds are created and distribute that to the workmen outside the Sec 53 waterfall. In this judgement the tribunal held that the Liquidator to provide these funds, even if there was no provision of such funds by the CD. Further, the tribunal, has held that the overriding effect of section 238 of the IBC over any other law for the time being in force, will not have any bearing over the assets of the workmen (relating to PF, Pension Fund, and Gratuity), lying in the possession of the CD, because the asset is not considered as the part of the Liquidation Estate.

This order was impugned by the Financial Creditor (FC) State Bank of India, a secured Creditor of Moser Baer in *SBI Vs. Moser Baer* (Karamchari Union), where the limited question before the NCLAT, was whether gratuity dues formed part of the liquidation estate. NCLAT, in this case decided not to interfere with the order of the NCLT.

8. Contradicting Pronouncements

A contradictory view has been taken in the case of *The Regional Provident Fund Commissioner– I Vs. Karpagam Spinners Private Limited.* In this case, it was held by the NCLAT that, pursuant to Section 238 of the IBC, it will override anything inconsistent with the Code including the EPF Act and that the workmen dues as payable under the EPF Act, will not be considered in priority, to priority of payment under Section 53 of the IBC.

However, in the matter of *Savan Godiwala, (Liquidator of Lanco Infratech Ltd) vs. Apalla Siva Kumar* the Appelate Tribunal; the Liquidator submitted that, if there is no separate fund for gratuity payments, the same cannot be done from the running accounts of the CD. The NCLAT, in this case held among other considerations including the judicial precedent in Moser Baer case (NCLT), referred to Section 36(2) of the IBC to reason that the Liquidator holds the funds in the Liquidation Estate, in a fiduciary capacity for the purposes of distribution amongst creditors in terms of Section 53 of the IBC and further held that 'In a case, where no fund is created by a company, in violation of the Statutory provision of the Sec 4 of the Payment of Gratuity Act, 1972, then in that situation also, the Liquidator cannot be directed to make the payment of gratuity to the employees because the Liquidator has no domain to deal with the properties of the Corporate Debtor, which are not part of the liquidation estate'.

> ***In Somesh Bagchi Vs. Nicco Corpn Ltd*, the NCLAT held 'Gratuity does not form part of the Liquidation Estate'.**

Contradictions in the NCLAT pronouncements between the Lanco Infratech and Moser Baer are explained in the table below:

Lanco Infratech case	Moser Baer Case
NCLT directed that Liquidator should pay Gratuity dues to the employees even when the CD has not created separate Gratuity funds and held that Gratuity Fund do not form part of the Liquidation Estate even when no specific funds were created by the CD.	NCLT by order held that PF dues, Pension fund dues, Gratuity Fund dues do not form part of the Liquidation Estate and cannot be part of Section 53 dues
NCLAT, while hearing the appeal held that where there are no specific funds created for Gratuity, the Liquidator should not have been directed to make the payment for Gratuity as per the workers entitlement.	NCLAT upheld the stand of NCLT
NCLAT, in this judgement specifically held that it is not the liability of the Liquidator if no separate funds were created by the CD and thus there is a contradiction from the Moser Baer judgement.	NCLAT, in this judgement held that, the Liquidator cannot avoid the liability to pay Gratuity dues to the employees, on the premise that no separate fund was created by the CD.

9. Whether Interest and damages form part of PF dues

Under Section 7Q of the EPFMP Act 1952, an employer (CD) is liable for payment of simple interest at the rate of 12% on the PF contributions due to the EPFO, from the date on which the amounts become payable and due. Under the IBC context, where the CD has not provided funds to the EPFO, then the interest liability under this section accrues till the date of settlement of the dues and the EPFO, when they submit the claims to Liquidator under liquidation calculate interest under Section 7Q, till the date they submit the claim and often update the claims with additional interest till there is a settlement of dues of the EPFO. Thus, interest under EPFO is a running liability for the Liquidator to settle during the distribution under Liquidation.

In the case of *Tourism Finance Corporation of India Ltd. vs. Rainbow Papers Ltd.*, and others, the RP stated that the approved Resolution Plan has duly taken care of all the statutory dues, and the principal amount of PF has been taken into consideration. In contrast, the order of levying of interest by the PF authorities after the commencement of the CIRP is not permissible under the law. He further claimed that the provisions contained in Section 7Q and Section 14-B of the EPFMP Act, 1952, cannot be relied upon as the provisions of the IBC have an overriding effect on the same in terms of Section 238 of the Code.

The NCLAT, New Delhi, directed the RP to release the full amount of Provident Fund, including the interest thereon in terms of the provisions of the EPFMP Act, 1952 immediately, as these dues are not to be included as an asset of the CD.

10. Conclusion

While it is justifiable that the right to life is a very crucial fact to be considered by a liquidator while dealing with the distributions of dues to the workmen and Sec 36(4)(a)(iii) rightfully protects the dues of the workers even when a CD has not provided for PF or Gratuity Fund. Suggestions on how the PF and Gratuity dues payable can be dealt with under Section 53 of the IBC waterfall mechanism. Considering the provisions and various judgements, the present status of dealing with PF, Gratuity Fund and Pension Fund could be explained as follows:

> **There is need to amend waterfall mechanism prescribed in Sector 53 of the IBC. The Central Government should take a clear stand and initiative on this issue. Besides, the IBBI should come out with the revised set of Regulations**

There is need to amend waterfall mechanism prescribed in Sector 53 of the IBC. The Central Government should take a clear stand and initiative on this issue. Besides, the Insolvency and Bankruptcy Board of India (IBBI) should come out with the revised set of Regulations on treating PF, Gratuity dues and the treatment of Interest and penal charges where they do not directly accrue to the workers. This can save the Liquidator from dilemma related to treatment of these crucial dues under the IBC and also save time in litigation and to allow for timely completion of the Liquidation under the IBC.

Heads	Fund Created or Not
PF Principal Dues	If the CD has created PF Fund, then the same to be not forming part of the Liquidation Estate and the Liquidator to exclude that as per Sec 36(4)(a)(iii). If No fund Created by the CD, then the PF Principal dues payable to the EPFO be paid by the Liquidator, as a priority from the Liquidation estate.
Interest Payable Under Section 7Q of the EPFO & MP Act 1952	Interest payable under Section 7Q is more of a late payment charge and does not accrue to the workers or employees and is a Government due for delays by the CD. It is agreed that had the CD deposited the principal dues on time the workers/employees would have earned their interest contributions from the Government. However, when interest is claimed as default due under Section 7Q, the same is not being credited to the workers. Hence, interest which is an accrued liability under Section 7Q of the EPFO and payable to EPFO from the time there is a default on payment of EPFO dues till the date of actual payment. However, interest under this section does not accrue to the workers/employees and is more of a statutory dues to the Central Government agency and hence this be treated as Statutory dues payable to the Government agencies and be accorded lower priority in line with the waterfall mechanism under Section 53.
Penalties and damage payable under Section 14B of the EPFO	As suggested for interest payments under Section 7Q, the penal payments for damages be also treated as Governmental dues as these do not accrue to the workers and accordingly clubbed under other Statutory dues to Government and dealt in accordance with the waterfall mechanism under Section 53 of the IBC.
Gratuity	If Gratuity Fund is created separately by the CD, then the same to be excluded by the Liquidator under Section 36(4) of the Code for distribution. If no specific fund created by the CD for Gratuity, then the Liquidator to estimate two years dues of Workers and one-year dues of Employees and provide that as per Sec 53 Waterfall mechanism.