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PF, Pension & Gratuity dues - Claims Management in Liquidation process

Query - Whether the dues of workmen or employees in respect of PF, Pension & Gratuity which are pending before commencement of CIRP will be paid as per the provisions of section 53 or section 36.

1. PF, Pension & Gratuity dues can be categorized broadly as under;

1. Workmen & employees contribution towards provident fund deducted from the salary but not deposited by the employer (CD) with EPFO / Exempted PF Trust / NPS.
2. Dues in respect of employer's (CD's) contribution for Provident Fund / pension fund for paid salaries, not deposited with EPFO / Exempted PF Trust / Pension Fund Trust / NPS.
3. Dues in respect of employer's (CD's) contribution for PF / Pension in respect of unpaid salaries.
4. Dues in respect of employer's (CD's) contribution for gratuity fund, in respect of both paid & unpaid salaries.(Section 4 of Payment of Gratuity Act, 1972)
5. Balance outstandings in provident fund, pension fund & gratuity fund at the time of commencement of liquidation.

PF, Pension & Gratuity are terminal benefits that are basically employees' dues under statutory provisions which are provided through contributions to the dedicated funds, out of expenditure head - "workmen/employees cost" by a company. For PF, the contributions are placed with the EPFO or with the exempted PF Trust. For Pension, Gratuity, dedicated funds are created either internally (plan funds) or with trust created for management of these funds. Liability of the company towards these plan funds/trusts is calculated as per "Accounting Standard 15 (AS 15): Employee Benefits"

2. Following are various provisions of the Code;

Section 33 Initiation of liquidation. -

"(7) The order for liquidation under this section shall be deemed to be a notice of discharge to

the officers, employees and workmen of the corporate debtor, except when the business of the corporate debtor is continued during the liquidation process by the liquidator.”

Author’s Comments; This notice of discharge tantamounts to retrenchment of employees / workmen & accordingly retrenchment compensation becomes payable in terms of section 2(o) read with section 25F of “The Industrial Disputes Act” & gratuity under “Payment of gratuity Act, 1972”, irrespective of quantum of provisions under gratuity fund.

Section 36. Liquidation estate. -

“(4) The following shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation: -

(a) assets owned by a third party which are in possession of the corporate debtor, including -

(i) assets held in trust for any third party;

(iii) all sums due to any workmen or employee from the provident fund, the pension fund and the gratuity fund;”

Author’ comments; Dedicated funds created internally (plan funds) for PF, Gratuity Pension, Leave encashment etc will not form part of Liquidation Estate.

Section 53 Distribution of assets. -

“(1) Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period as may be specified, namely: -

(a) the insolvency resolution process costs and the liquidation costs paid in full;

(b) the following debts which shall rank equally between and among the following:

- (i) workmen’s dues for the period of twenty-four months preceding the liquidation commencement date; and*
- (ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52;*

(c) wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;

(f) any remaining debts and dues;”

Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.

Regulation 19. Claims by workmen and employees.

“(4) The liquidator may admit the claims of a workman or an employee on the basis of the books of account of the corporate debtor if such workman or employee has not made a claim.”

Author's comments; PF, Pension & Gratuity dues are basically employees' dues payable under statutory provisions & are provided through contributions to the statutory funds (EPF) / dedicated funds, out of expenditure head - "workmen/employees cost" by a company. Whether Liquidator is required to calculate the amount of claim in respect of these arrears, on the basis of account of the CD, under regulation 19(4)?

3. A. Dues under category 1 & 2.

Dues of PF, Pension & Gratuity under these categories (category 1 & 2) automatically forms part of provident fund & pension fund respectively with the CD, and these are to be paid by the Liquidator, under the provisions of section 36(4)(a)(iii), prior to any distribution of funds under the provisions of section 53.

NCLT Mumbai (2018.09.12) in Asset Reconstruction Co. (India) Ltd. vs. Precision Fasteners Ltd. [MA576 & 752 of 2018 in CP No. (IB) - 1339(MB)/2017] held that deductions made from the workman's wages are to be treated under section 36(4)(a)(iii).

31 It makes no difference as to whether it has been released from the Corporate Debtor or not, once deduction has been made from the workman's wages, it is to be deemed as the asset of the workmen and not as an asset of the Corporate Debtor or the company as the case may be. Therefore, we have not found any merit in the argument of the Liquidator counsel canvassing that sub-clause (iii) of clause (a) of subsection 4 of section 36 denotes in respect to the provident fund already released and lying with the EPFO, henceforth, the said argument of the Liquidator counsel is rejected.

3. B. Dues under category 3 & 4.

This aspect has seen divergent rulings of different benches of NCLT/NCLAT.;

i). NCLT Chennai in RPF Commissioner Vs. Karpagam Spinners, held that PF dues won't get any priority & upheld the decision of the liquidator to categorize EPFO dues under 53(1)(f) as 'other remaining debts & dues'.

ii). NCLT Mumbai in Asset Reconstruction Co. (India) Ltd. vs. Precision Fasteners Ltd. held that dues in respect of Provident Fund /Pension Fund /Gratuity Fund shall not be treated as part of the liquidation estate. [Section 36(4)(a)(iii)]

iii). NCLT (PB) New Delhi in Alchemist Asset Reconstruction Co. Ltd vs. Moser Baer India Ltd, Citing ruling of NCLT Mumbai in Asset Reconstruction Co. (India) Ltd. vs. Precision Fasteners Ltd. held that dues in respect of Provident Fund /Pension Fund /Gratuity Fund shall not be treated as part of the liquidation estate. It further held that, if there is any deficiency to the Provident Fund, Pension Fund, and Gratuity Fund, then the liquidator shall ensure that the fund is made available in the aforesaid accounts, even if their employer had not diverted the requisite amount. In appeal, NCLAT in State Bank of India vs. Moser Baer Karamchari Union & Anr, upheld the decision of NCLT (PB) New Delhi.

iv). NCLAT in Savan Godiwala Vs Apalla Siva Kumar held that if CD had not created fund for Gratuity, then Liquidator is not under any obligation to provide for the same. This ruling of NCLAT has far reaching consequences on the settlement of dues of workmen & employees.

3. C. Dues under category 5.

Balance outstanding in provident fund, pension fund & gratuity fund at the time of commencement of liquidation are to be paid by the Liquidator, under the provisions of section 36(4)(a)(iii), prior to distribution of funds under the provisions of section 53. Provisions of the Code are explicitly clear.

4. Case Law

i). NCLT Chennai (2019.01.21) in RPF Commissioner Vs. Karpagam Spinners [MA/99/2018 in TCP/225 (IB)/2017] held that EPF Dues won't get any priority.

"1. Under adjudication is MA/99/2018 filed in TCP/225(IB)/CB/2017. The application has been filed by the Applicant viz. The Regional Provident Fund Commissioner -1 with prayers as follows;

- i. Accord first priority to EPFP dues over all other dues as envisaged in Section 11(2) of the EPF & MP Act, 1952.....

- Iv. Direct the RP to drop the categorization of EPFO dues under 53(1)(f) as 'other remaining debts & dues'.

39 In light of the facts and circumstances and the legal position stated above, the verification and admission of the claim of the applicant viz. EPFO has correctly been recorded by the Liquidator vide his statement of verification, admission, rejection and determination of quantum of claim dated 23.04.2018. Therefore, the application filed by the applicant viz., EPFO is devoid of merits and stands rejected.

ii). NCLT Mumbai (2018.09.12) in Asset Reconstruction Co. (India) Ltd. vs. Precision Fastners Ltd. [MA576 &752 of 2018 in CP No. (IB) - 1339(MB)/2017] held that dues in respect of Provident Fund /Pension Fund /Gratuity Fund shall not be treated as part of the liquidation estate.

- Now in alignment with the provisions of EPF Act, in section 36(4)(1)(3), the Code has gone ahead saying that the dues in respect to Provident Fund/Pension Fund/Gratuity Fund shall not be treated as part of the liquidation estate, as long as such dues are not treated as part of liquidation estate, the provisions of IBC will not be applicable for realisation of such dues from the asset of the Corporate Debtor. The intriguing aspect lying in this scenario is that though it is a due payable by the Corporate Debtor, as to provident Fund/Pension Fund/Gratuity Fund dues are considered, the Code has treated it as an asset of the workmen lying with the Corporate Debtor.*
- In view thereof, the overriding effect of section 238 of this Code will not have any bearing over the asset of the workmen lying in the possession of the Corporate Debtor because that asset is not considered as the part of the liquidation estate, moreover, to apply section 238 over any other law for the time being in force, the other law must be inconsistent with the provisions of the Code, since section has excluded the PF dues of the workmen from the liquidation estate assets treating it as an asset of the workmen lying with the corporate debtor, section 53 is not applicable to say that these dues fall within the ambit of liquidation estate. Therefore, this argument of inconsistency raised by the Liquidator counsel has no merit, hence the same is rejected.*

iii). NCLT New Delhi (PB) (2019.03.19) in Alchemist Asset Reconstruction Co. Ltd vs. Moser Baer India Ltd.[Item No.119 (IB)-378(PB)2017] Citing ruling of NCLT Mumbai (2018.09.12) in Asset Reconstruction Co. (India) Ltd. vs. Precision Fasteners Ltd. [MA 576 & 752 of 2018 in CP No. (IB) - 1339 (MB) / 2017] held that dues in respect of Provident Fund / Pension Fund / Gratuity Fund shall not be treated as part of the liquidation estate.

- *A perusal of the aforesaid para shows that the provident fund dues, pension fund dues and gratuity dues are not treated as a part of the liquidation estate and would not, therefore, be recovered by Section 53 of the Code which provides for waterfall mechanism.*
- *5If there is any deficiency to the Provident Fund, Pension Fund, and Gratuity Fund, then the liquidator shall ensure that the fund is made available in the aforesaid accounts, even if their employer had not diverted the requisite amount,”*

In appeal to the above orders of NCLT dated 19.03.2019, NCLAT (2019.08.19) in State Bank of India vs. Moser Baer Karamchari Union & Anr.[CA (AT) (Insolvency) No. 396 of 2019] held that the provident fund, the pension fund and the gratuity fund do not come within the meaning of 'liquidation estate & **found no ground to interfere with the impugned order dated 19th March, 2019.**

- *16. In terms of sub-section (4) (a) (iii) of Section 36, as all sums due to any workman or employees from the provident fund, the pension fund and the gratuity fund, do not form part of the liquidation estate/ liquidation assets of the 'Corporate Debtor', the question of distribution of the provident fund or the pension fund or the gratuity fund in order of priority and within such period as prescribed under Section 53(1), does not arise.*
- *24. Once the liquidation estate / assets of the 'Corporate Debtor' under Section 36(1) read with Section 36 (3), do not include all sum due to any workman and employees from the provident fund, the pension fund and the gratuity fund, for the purpose of distribution of assets under Section 53, the provident fund, the pension fund and the gratuity fund cannot be included.*
- *25. The Adjudicating Authority having come to such finding that the aforesaid funds i.e. the provident fund, the pension fund and the gratuity fund do not come within the meaning of 'liquidation estate' for the purpose of distribution of assets under Section 53, **we find no ground to interfere with the impugned order dated 19th March, 2019.***

iv). NCLAT (2020.02.11) in Savan Godiwala Vs Apalla Siva Kumar [CA (AT)(Insolvency) No. 1229 of 2019] held that if CD had not created fund for PF & Gratuity, than Liquidator is not under any obligation to provide for the same.

- *25Thus it is the settled position of law, that the provident fund, the pension fund and the gratuity fund, do not come within the purview of liquidation estate' for the purpose of distribution of assets under Section 53 of the Code. Based on this, the only inference which can be drawn is that Pension Fund, Gratuity Fund and Provident Fund can't be utilised, attached or distributed by the liquidator, to satisfy the claim of other creditors. Sec 36(2) of the I B Code 2016 provides that the Liquidator shall hold the Liquidation Estate in fiduciary for the benefit of all the Creditors. The Liquidator has no domain to deal with any other property of the corporate debtor, which is not the part of the Liquidation Estate. **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 this case, we are not concerned with determination about the entitlement of Gratuity by the employees** of the Corporate Debtor'. Payment of Gratuity to employees depends on their entitlement of Gratuity, subject to the fulfilment of the conditions laid down under the Payment of Gratuity Act, 1972 and also on the availability of the fund in this regard.....
-The annual cash flow statement for the ending 31st March, 2017 show that Gratuity Fund was proposed. However, it is noticed that no such fund was created. In the circumstances, the Liquidator should not have been directed to make provision for the payment of gratuity to the workmen as per their entitlement.

Now with these two orders of NCLAT, mentioned supra above, an interesting situation has been created. NCLAT in it's orders dated 19.08.2019 has upheld the orders of NCLT dated 19.03.2019, interalia ruling under the "**doctrine of merger**" as under;

- 5**If there is any deficiency to the Provident Fund, Pension Fund, and Gratuity Fund, then the liquidator shall ensure that the fund is made available in the aforesaid accounts, even if their employer had not diverted the requisite amount,"**

Whereas, NCLAT in it's orders dated 11.02.2020 has ruled that;

-**In this case, we are not concerned with determination about the entitlement of Gratuity by the employees** of the Corporate Debtor'. Payment of Gratuity to employees depends on their entitlement of Gratuity, subject to the fulfilment of the conditions laid down under the Payment of Gratuity Act, 1972 and also on the availability of the fund in this regard.....
-The annual cash flow statement for the ending 31st March, 2017 show that Gratuity Fund was proposed. **However, it is noticed that no such fund was created. In the circumstances, the Liquidator should not have been directed to make provision for the payment of gratuity to the workmen as per their entitlement.**

Thus, the above two orders of NCLAT are contradictory to each other, in respect of providing for deficiency in "Gratuity Fund", which is against the "**Doctrine of Binding Precedent**" as enumerated by the Constitution bench of Hon'ble SCI in Union of India v. Raghubir Singh [(1989) 2 SCC 754]:

- "**The doctrine of binding precedent has the merit of promoting certainty and consistency in judicial decisions, and enables an organic development of the law, besides providing assurance to the individual as to the consequence of transactions forming part of his daily affairs. And, therefore, the need for a clear and consistent enunciation of legal principle in the decisions of a court.**"

5. An interesting anomaly in distribution of funds during the Liquidation Process.

Provisions in respect of distribution of funds under a resolution plan (CIRP), for operational creditors under Section 30 (2) reads as under:-

“Section 30 (2)(b) provides for the payment of debts of operational creditors in such manner as may be specified by the Board which shall not be less than-

- (i) the amount to be paid to such creditors in the event of a liquidation of the corporate debtor under section 53; or
- (ii) the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority in sub-section (1) of section 53,

whichever is higher,.....

Explanation 1. — For removal of doubts, it is hereby clarified that a distribution in accordance with the provisions of this clause shall be fair and equitable to such creditors.

This means that workmen dues upto 24 months & employees dues upto 12 months, prior to DOC (Date of commencement of Insolvency process) will rank in 2nd & 3rd priority [Section 53(1)], respectively in distribution of funds, and the balance dues of the workmen & employees, if any, will be paid in 6th priority [Section 53(1)]

The trouble arises when the case moves from insolvency (CIRP) to liquidation. Relevant regulations of Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, reads as under:-

Regulation 12(2) The public announcement shall-

- (a) call upon stakeholders to submit their claims or update their claims submitted during the corporate insolvency resolution process, as on the liquidation commencement date; and
- (b) provide the last date for submission or updation of claims, which shall be thirty days from the liquidation commencement date.

Regulation 16. Submission of claim.

(1) A person, who claims to be a stakeholder, shall submit its claim, or update its claim submitted during the corporate insolvency resolution process, including interest, if any, on or before the last date mentioned in the public announcement.

(2) A person shall prove its claim for debt or dues to him, including interest, if any, as on the liquidation commencement date.

Now all the stakeholders are required to update their claims including interest for the CIRP period as per the contract if any, with reference date shifted to Liquidity Commencement date.

The main losers are workmen & employees on the following counts.

1. Usually, employment contracts do not provide for payment of interest for delayed payments & code also does not provide for payment of interest for delayed payments to workmen / employees in the absence of any contract, whereas there is a provision for payment of interest @8% to class of creditors, in the absence of contract. Thus creditors, except workmen / employees will be able to update their claims. A similar provision of calculating interest on the

dues of workmen / employees , similar to class of creditors, is the need of natural justice.

2. Secondly, due to shifting of reference date from Insolvency commencement date to Liquidation commencement date, the priority of the part of the dues of workmen / employees gets shifted from 2nd / 3rd to 6th priority.

Example.(workman) suppose a workman had pending dues of say 32 months at the time of Insolvency Commencement date. So the dues of this workman will have the following priority of distribution of funds, under resolution plan.

1. 2nd priority [Section 53(1)] - Dues of 24 months of the period immediately preceding the Insolvency commencement date.
2. 6th priority [Section 53(1)] - Dues of the remaining 8 months

Now suppose that prior to Liquidity commencement date, CIRP continued for 330 days (11 months). The priority of the dues in the liquidation process of the concerned workman gets changed as below.

1. 2nd priority [Section 53(1)] - Dues of 13 months (24 months -11 months) of the period immediately preceding the Insolvency commencement date.(due to change in the reference date to Liquidity commencement date). Assuming that dues of the workman for the CIRP period has been paid / payable as IRPC.
2. 6th priority [Section 53(1)] - Dues of the remaining 17 months

Similar will be the position of an employee.

Thus the present system is unfair towards workmen / employees on two counts.

1. Priority of payment, of the part of their (Workmen / Employees) dues is lowered in liquidation process, while the priority of the payment of dues of all the other stakeholders remains the same
2. All the stakeholders except workmen / employees can update their claim amount with interest upto Liquidation commencement date.

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