



# IBC : Priority of PF dues, gratuity dues and employee benefit dues

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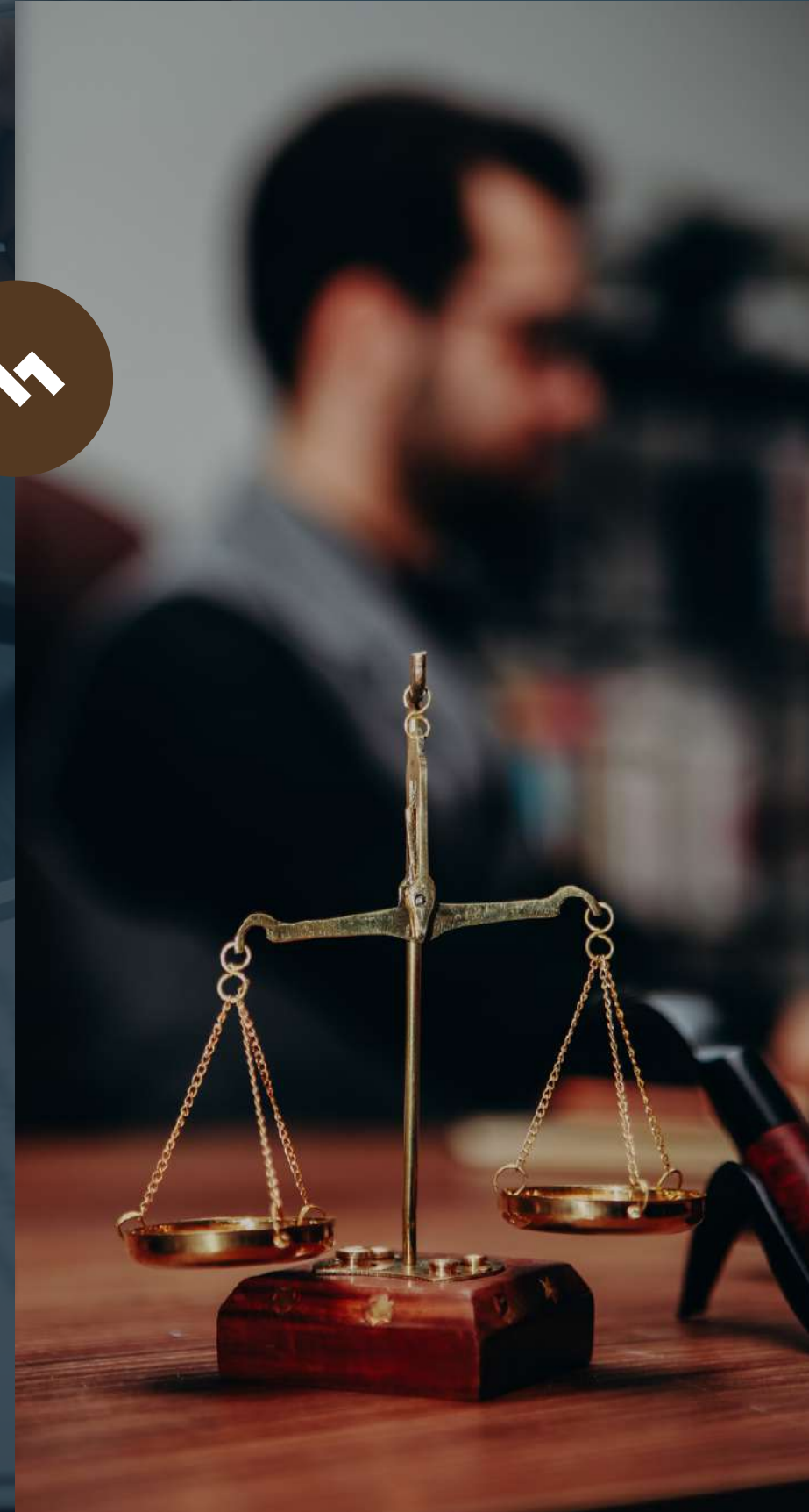
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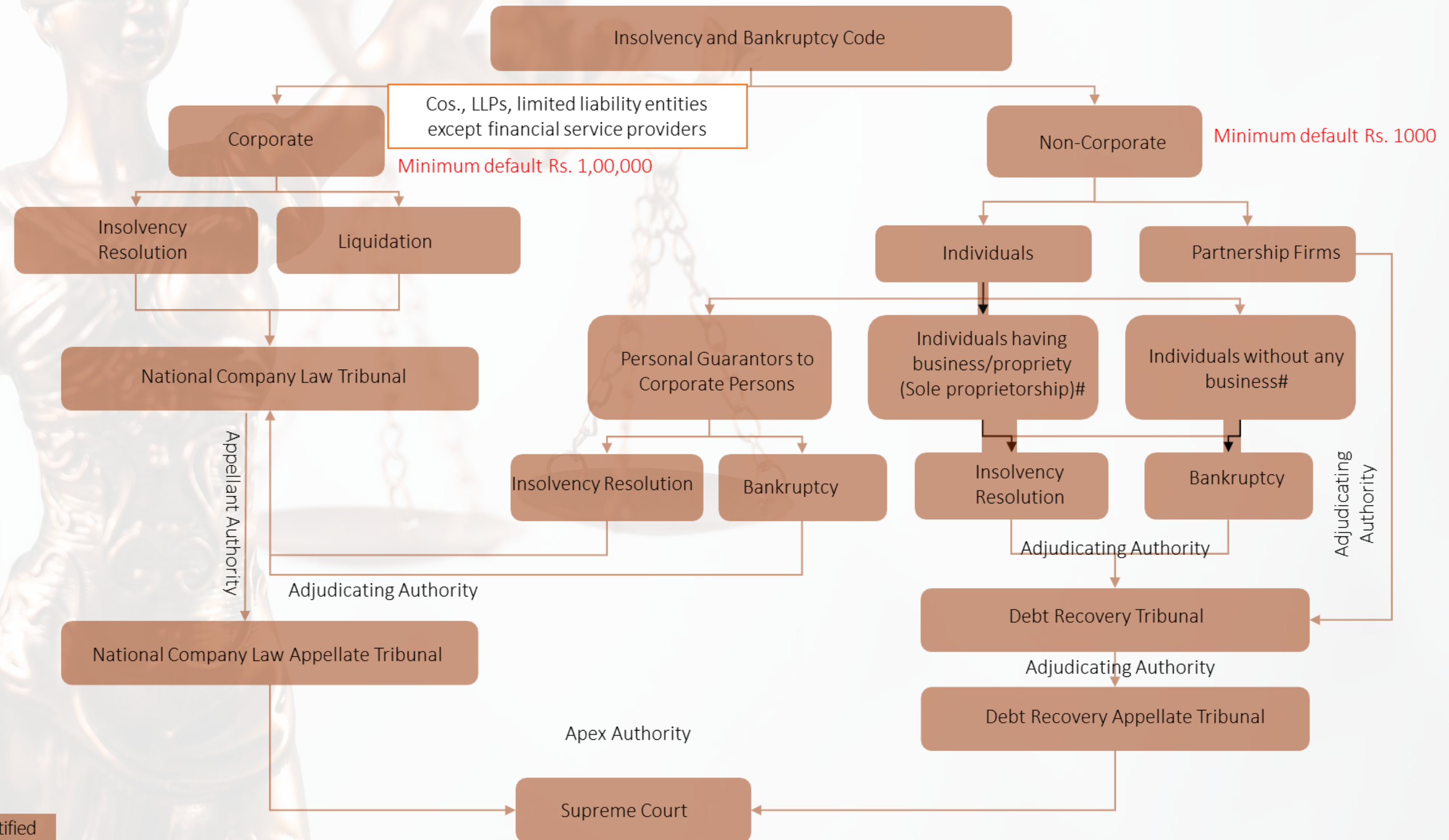
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# Agenda:

- Framework of IBC
- Parties under CIRP
- Waterfall Arrangement: Sec. 53 of IBC
- Liquidation Estate: Section 36 of IBC
- Components of Employee and Workmen dues
- Landmark Supreme Court Rulings
- Possible Scenarios



# Framework of IBC



#not yet notified

# Parties under CIRP



**Financial Creditor**  
Sec. 7 of IBC

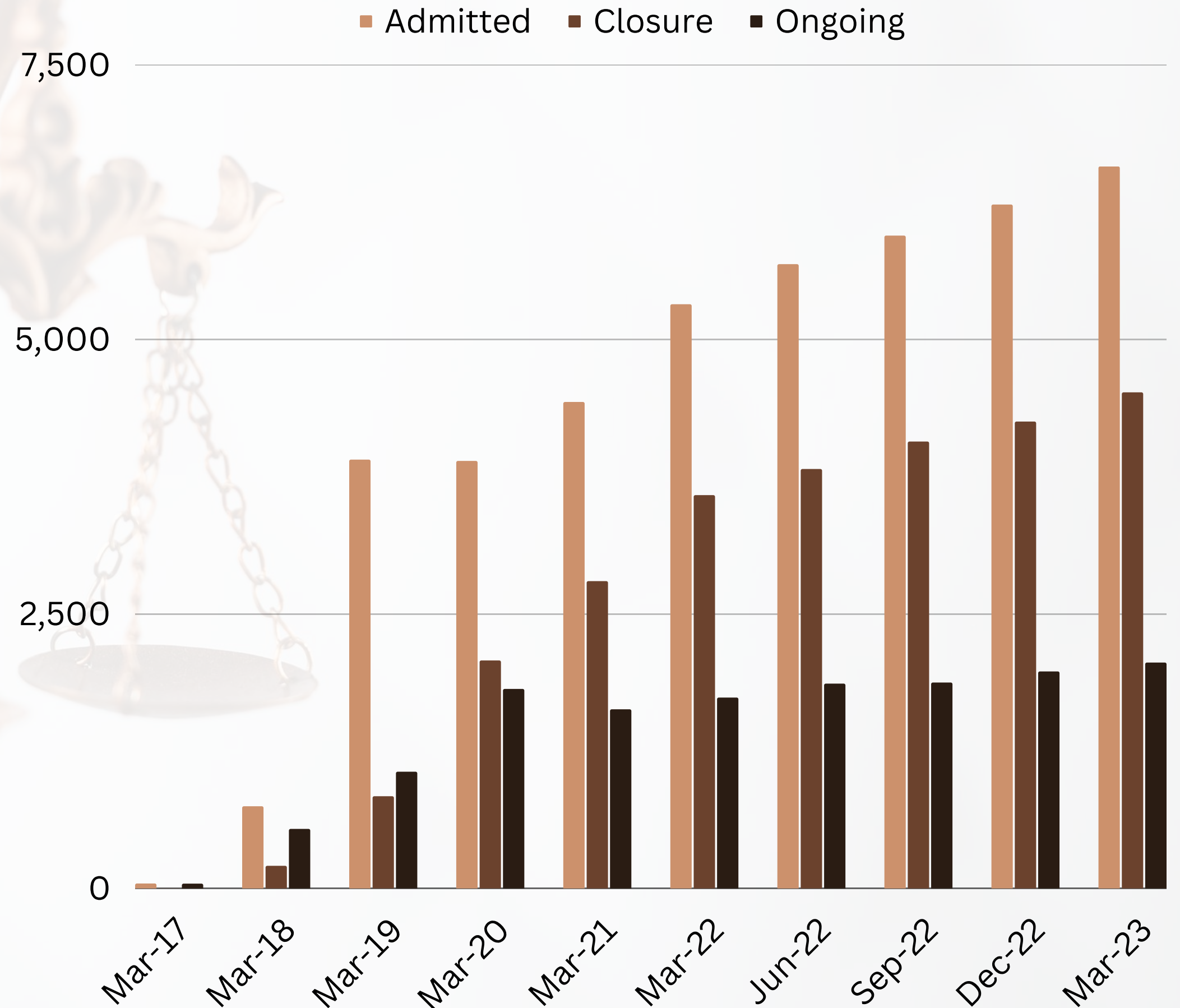


**Operational Creditor**  
Sec. 9 of IBC



**Corporate Debtor**  
Sec. 10 of IBC

# Corporate Insolvency Resolution Process



# Model of Closure of CIRPs

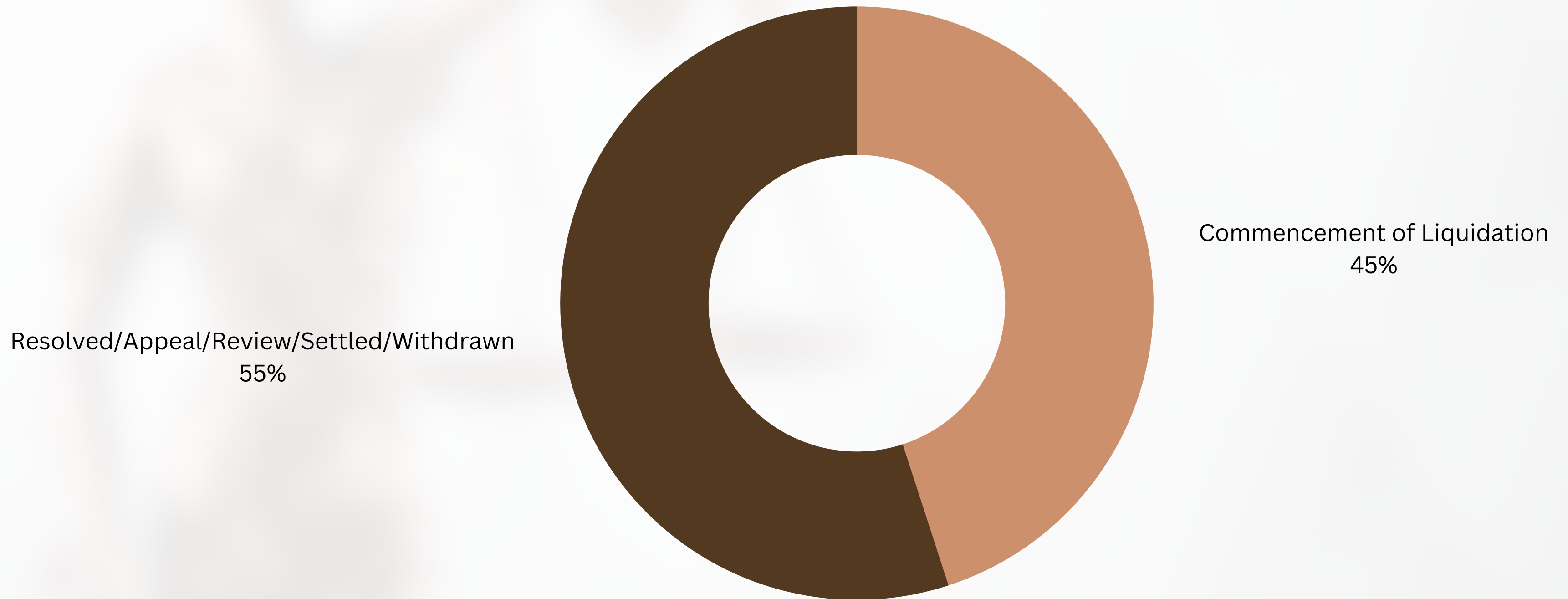


Fig.2: Closure of CIRPs

The insolvency resolution process costs

*Workmen dues (for the period of 24 months preceding the liquidation commencement date) and Secured creditor (in case he has relinquished security)*

*Wages and any unpaid dues owed to employees (other than workmen) for the period of 12 months preceding the liquidation commencement date*

Unsecured creditors

State and Government dues and Secured creditor for any amount unpaid following the enforcement of security interest

*Any remaining debts and dues;*

Preference shareholders, if any;

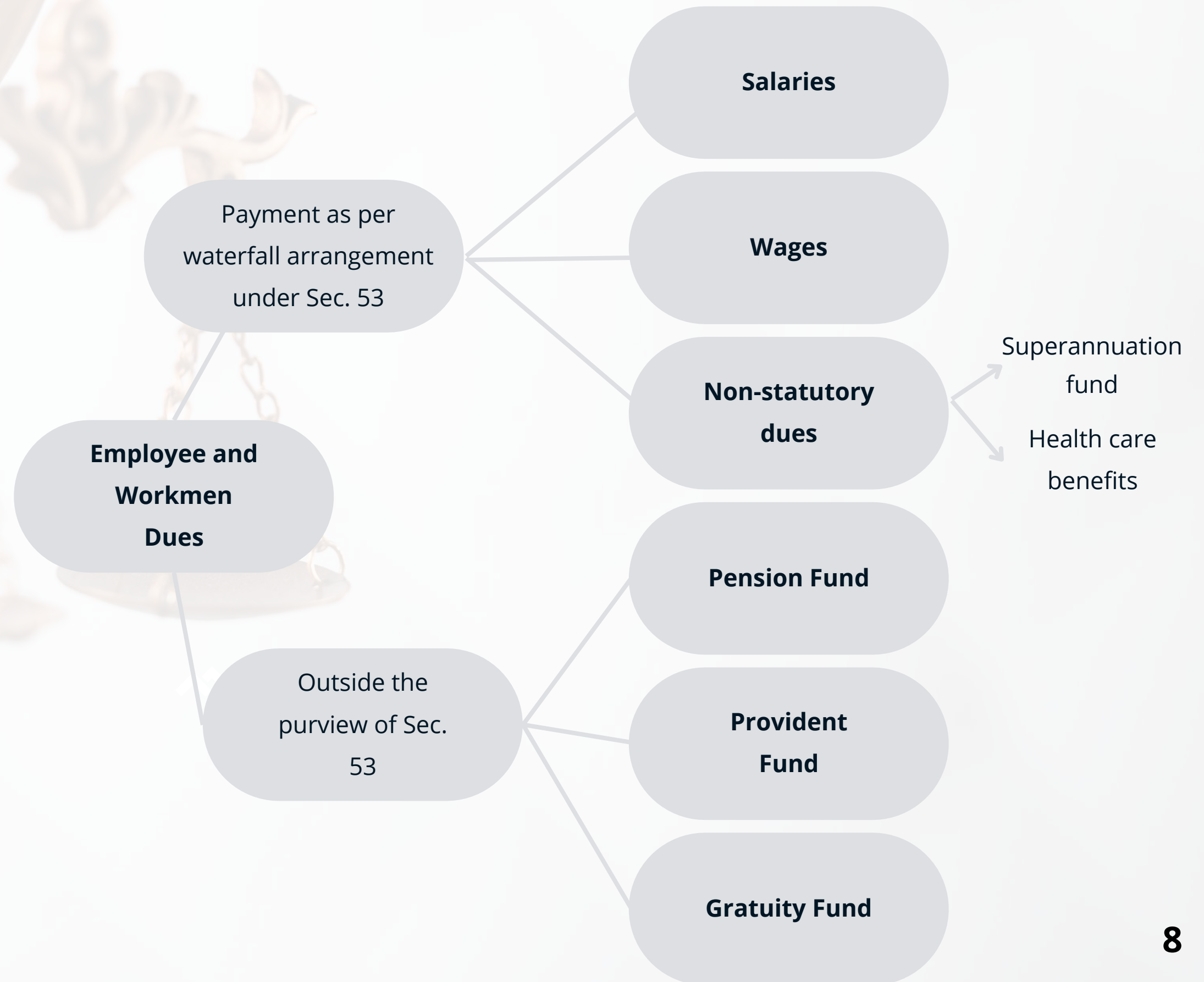
Equity shareholders or partners, as the case may be

# Sec. 53 of IBC

Order of priority of payment by the proceeds from the sale of liquidation assets

Waterfall Arrangement

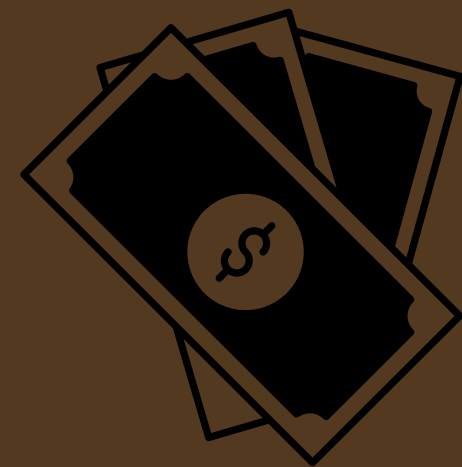
# Components of Employee and Workmen dues



*“Workmen’s dues” shall have the same meaning as assigned to it in **section 326 of the Companies Act, 2013**: All sums due to any workman from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the workmen, maintained by the company.*



# Sec 36: Liquidation Estate



## Sec 36: Liquidation Estate

- The liquidator shall form an estate of the assets mentioned in section 36(3) of this Code
- Liquidator shall hold the liquidation estate as a fiduciary for the benefit of all the creditors.

*Sec. 36(4)(iii) - all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund **shall not be included in the liquidation estate assets** and shall not be used for recovery in the liquidation*  
Precision Fasteners Ltd V. EPFO case, the NCLT, Mumbai Bench



# Liquidation Estate



## Inclusions

- Assets over which C. Dr. has ownership rights.
- Assets in or not in possession of C. Dr. including but not limited to encumbered assets
- Movable/Immovable tangible assets
- Intangible assets
- Assets in respect of which security interest has been relinquished by a secured creditor
- Assets subject to the determination of ownership by the court or authority
- Any assets or their value recovered through proceedings for avoidance of transactions
- Any other property belonging to or vested in the C. Dr. at the insolvency commencement date
- All proceeds of liquidation as and when they are realised



## Exclusions

- Assets in possession of C. Dr., but owned by a party
- Assets held in trust, bailment, contracts
- Contract of use of asset; not title
- Assets in security collateral held by financial services providers and are subject to netting and set-off in multi-lateral trading or clearing transactions
- Personal assets of any shareholder or partner of a C. Dr., provided the assets are not held under avoidance transactions
- Assets of any Indian or foreign subsidiary of C. Dr.
- Any other assets as may be specified by the Board

*As per NCLAT Ruling in the recent, PF dues, gratuity etc. are not included in Liquidation Estate- Moserbaer Karamchari Union vs. SBI*



# Landmark Supreme Court Case Rulings

## Question of law

- Whether the amounts due to workmen towards the gratuity fund, the provident fund and the pension fund fall under the purview of the liquidation waterfall mechanism as these dues do not constitute a part of the "liquidation estate" of the corporate debtor?

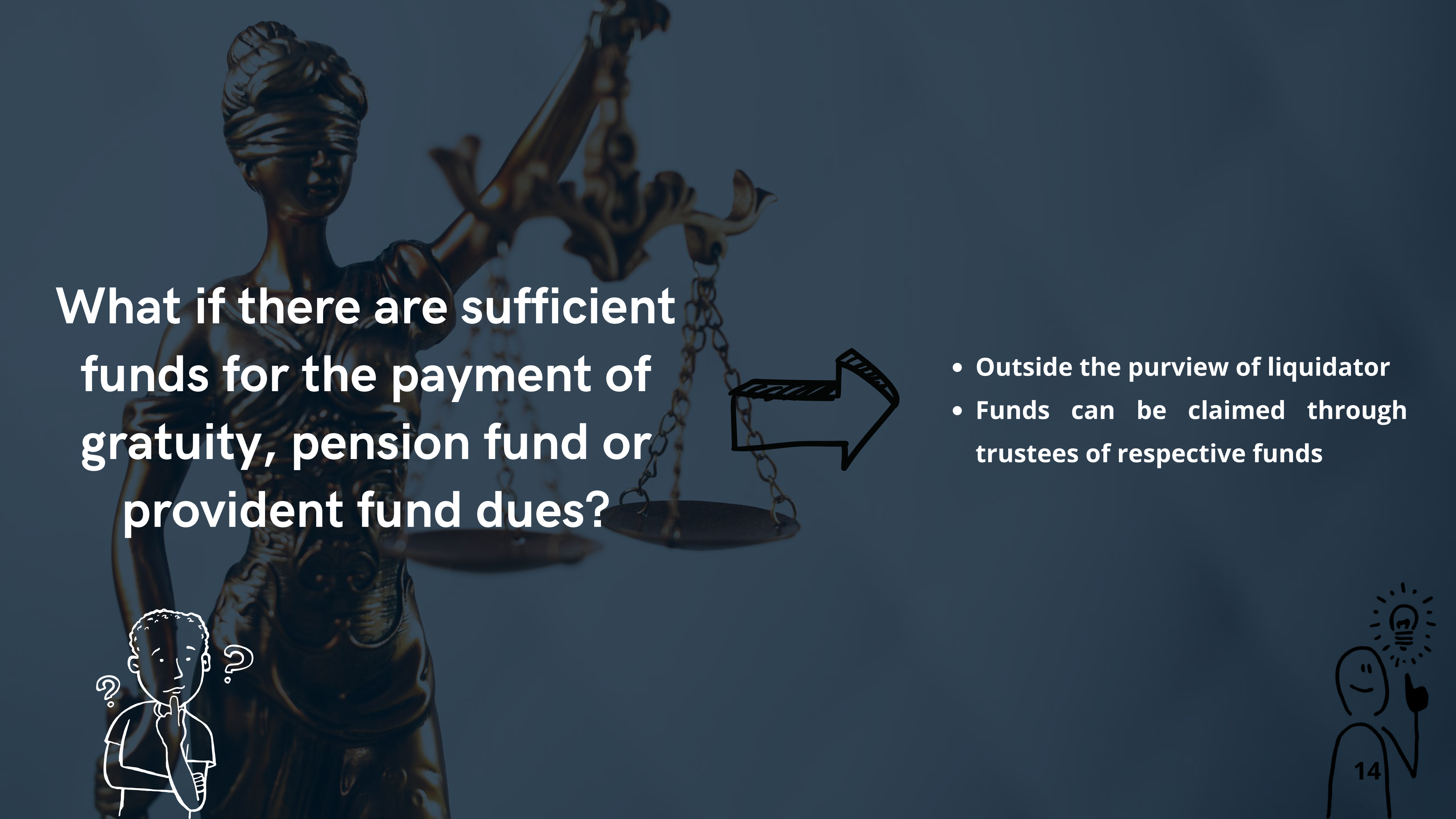
## Judgements

- NCLAT held that the provident fund, the pension fund and the gratuity fund owed by a corporate debtor to its workmen **do not fall within the purview of "liquidation estate"** for the purpose of distribution of assets under Section 53 of the Insolvency and Bankruptcy Code, 2016
- The **Supreme Court of India** ("SC") has **upheld the order** of the National Company Law Appellate Tribunal ("NCLAT")




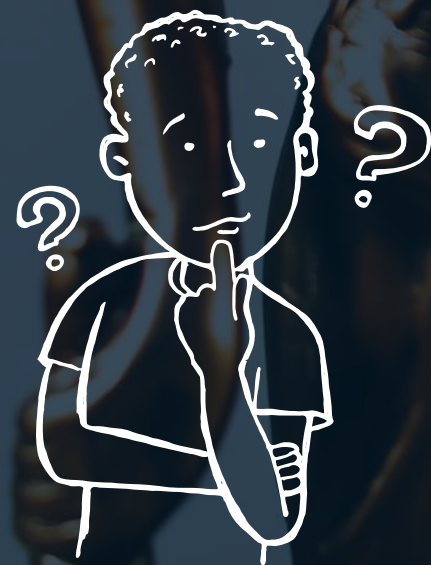
# Possible Scenarios

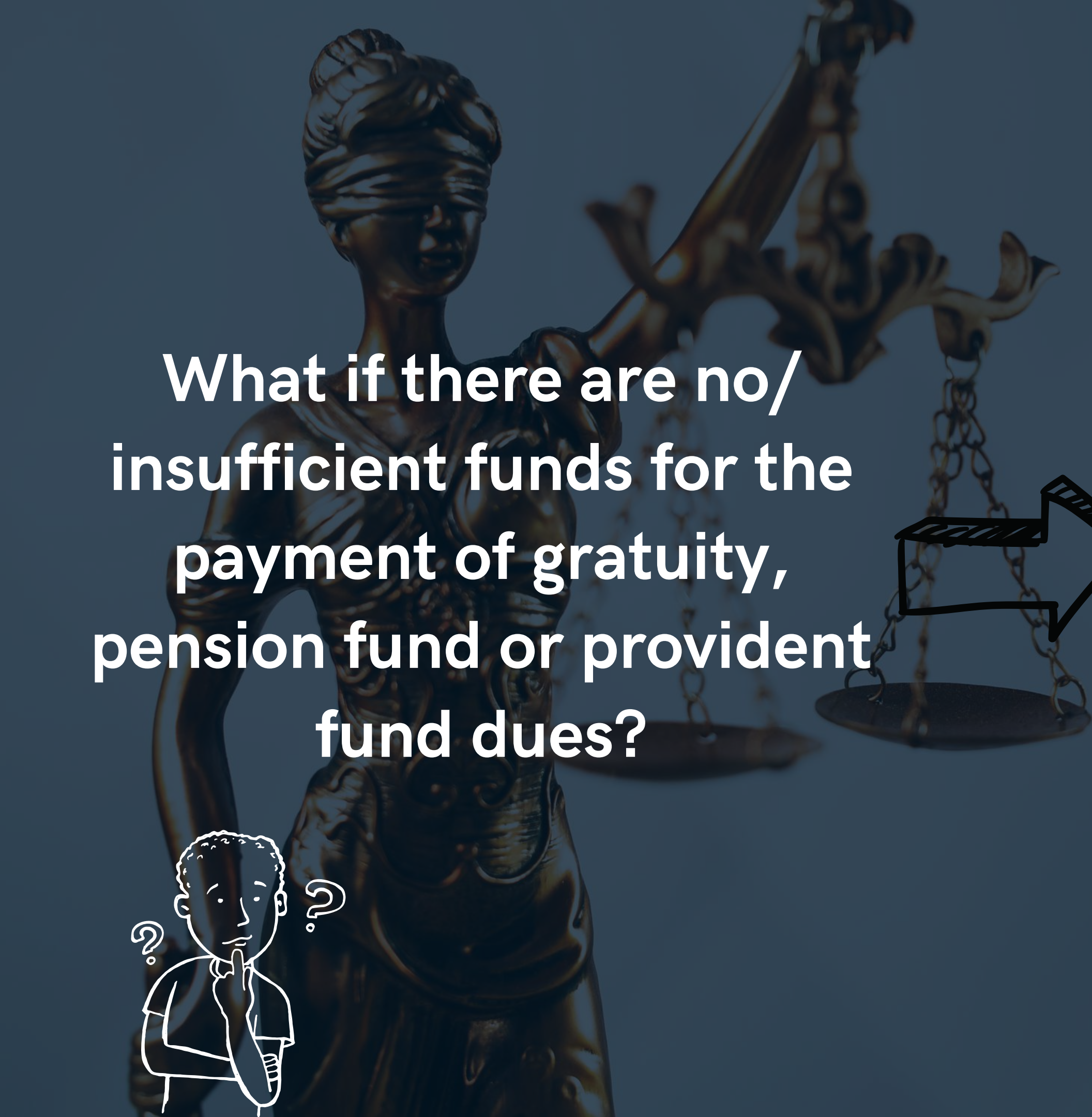




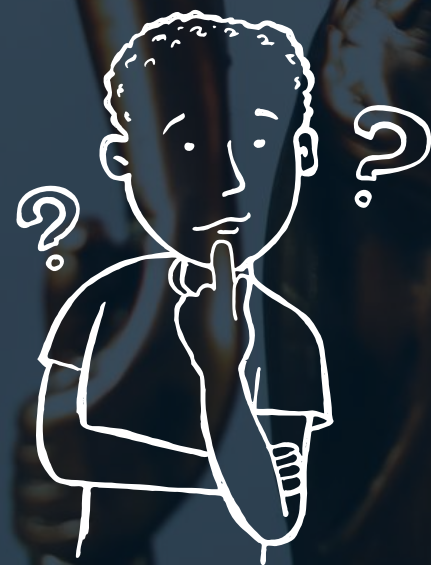
**What if there are sufficient funds for the payment of gratuity, pension fund or provident fund dues?**

- 
- Outside the purview of liquidator
  - Funds can be claimed through trustees of respective funds





What if there are no/  
insufficient funds for the  
payment of gratuity,  
pension fund or provident  
fund dues?



- Is the liquidator bound to make the payments.?
  - Does these funds form a part of the liquidation estate?
1. *The Assistant Provident Fund Commissioner & Recovery Officer, EPFO vs. Florind Shoes Private Limited*
  2. *Standard Chartered Bank Vs. JVL Agro Industries Ltd*
  3. *Savan Godiawala, Liquidator Of Lanco Infratech Limited vs Apalla Siva Kumar*
  4. *Somesh Bagchi V NiccoCorp Ltd, the NCLAT held 'Gratuity does not form part of the Liquidation Estate'.*
- To be paid by the liquidator as a priority from the liquidation estate



## Question of law

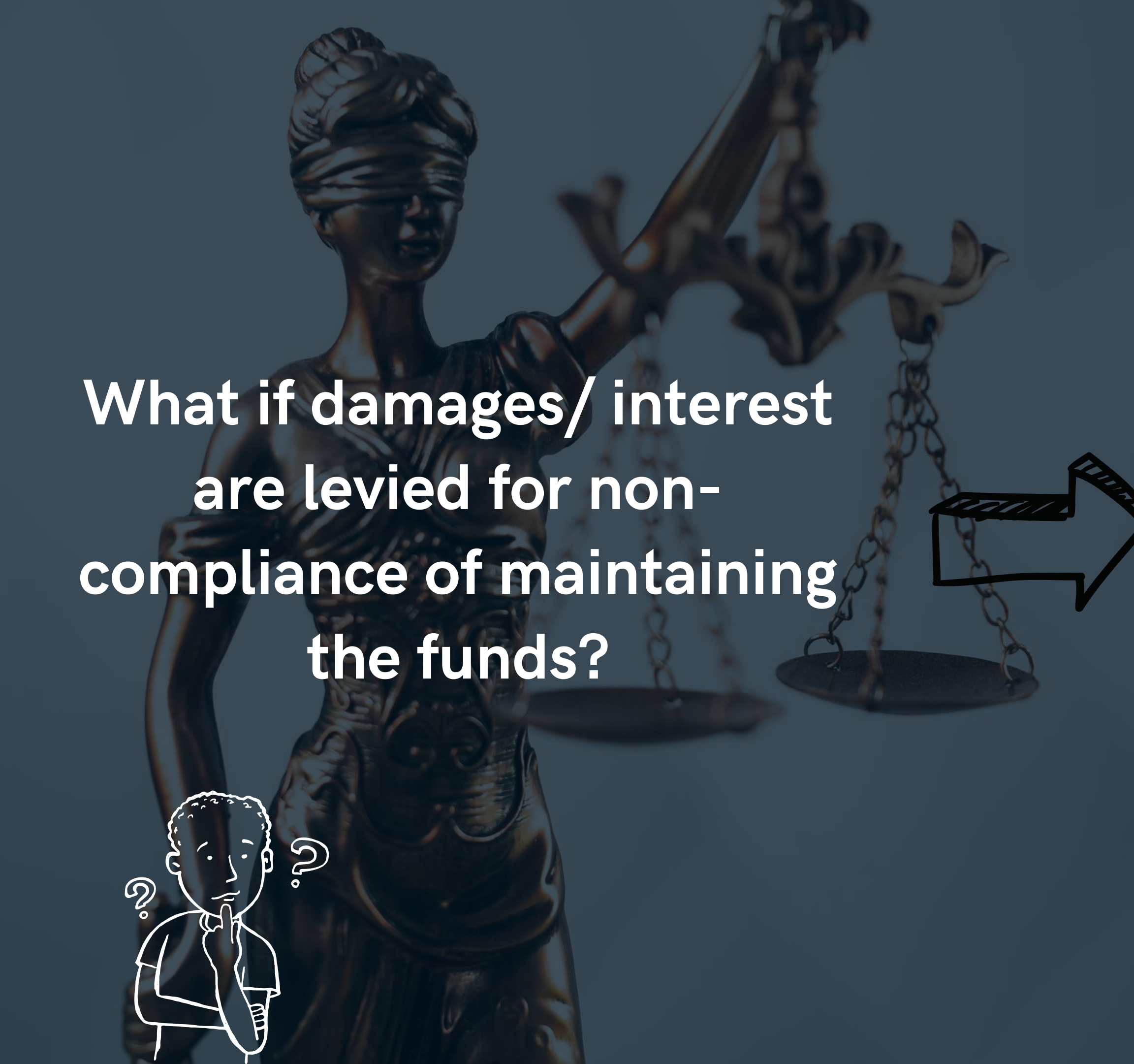
- Whether the liquidator avoid the liability to pay gratuity to the employees of the corporate debtor ("CD") on the ground that the CD did not maintain a separate fund for payment of gratuity to its employees?

## Judgements

- NCLT directed the liquidator to make **necessary arrangements for payment of gratuity to the employees** of the CD in priority to any payments made under the **waterfall mechanism** and according to their eligibility
- However, NCLAT referred Section 36(2) of IBC which states that the liquidator must hold the liquidation estate in fiduciary for the benefit of all the creditors. Therefore, **the liquidator has no domain to deal with any property of the CD which is not a part of the liquidation estate**. Accordingly, the liquidator cannot be directed to make payment of gratuity to the employees in the absence of a separate fund for this purpose as gratuity does not fall under the purview of the liquidation estate of the CD.
- The Supreme Court stated that this order was not in conformity with the observations made by the NCLAT in the Moser Baer Case wherein such payment was allowed to the workmen. Hence, **the order passed by the NCLT was restored by the Supreme Court**







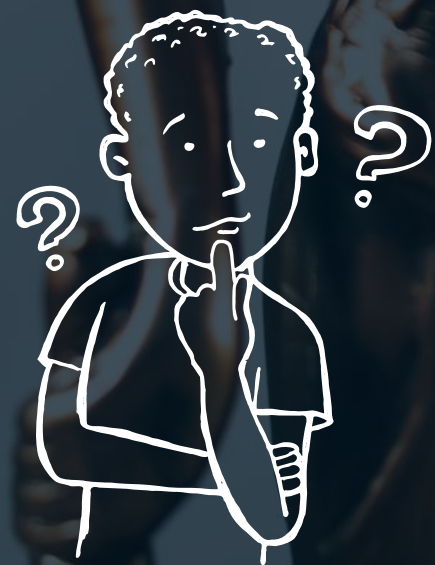
What if damages/ interest  
are levied for non-  
compliance of maintaining  
the funds?

- Is the liquidator bound to make the payments.?

1. Jalan Fritsch Consortium Vs. Regional Provident Fund Commissioner & Anr.

2. Tourism Finance Corporation of India Ltd vs. Rainbow Papers Ltd

- To be paid by the liquidator as a priority from the liquidation estate



Since there is no such provision under Payment of Gratuity Act, 1972, what about the damages which might incur due to the non-payment of gratuity?



# The Jet Airways (India) Limited Case

*Jalan Fritsch Consortium Vs. Regional Provident Fund Commissioner & Anr.*

## Question of law

- Whether the judicial precedents which laid down that the dues towards provident funds, pension funds and gratuity funds do not form part of the liquidation estate of the corporate debtor apply in the context of CIRP of a corporate debtor?
- Whether the damages imposed by Employees' Provident Fund Organisation (EPFO) in respect of the arrears in employees' provident fund contributions is required to be paid along with provident fund dues, pension fund dues and gratuity dues?

## Judgements

- The judicial precedents which laid down that the dues towards provident funds, pension funds and gratuity funds do not form part of the liquidation estate of the corporate debtor apply in the context of CIRP of a corporate debtor as well
- With reference to the Supreme Court judgement in the matter of Maharashtra State Cooperative Bank Limited v Assistant Provident Fund Commissioner and Others which referred Section 11(2) of the EPFO Act, 1952 which says "any amount due from an employer". Therefore, non-payment of damages will lead to non-compliance.

# What about non-statutory employee benefit dues??



- Is the liquidator bound to make the payments as per Sec. 53 or Sec. 36(4)(iii)?
- To be paid by the liquidator as per Sec. 53 of IBC





# Questions?

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