

***Payment of Gratuity and Provident Fund to the Operational Creditors and Workmen under the Insolvency and Bankruptcy Code, 2016***

Simran Walia\*

---

**ABSTRACT**

*The Insolvency and Bankruptcy Code, 2016 (“IBC, 2016”) is all-inclusive in nature which is enacted with the main intention to decide the insolvency and bankruptcy matters in a simpler and faster way. IBC, 2016 is comprehensive of all the rules and amendments related to insolvency and bankruptcy process in India. The main objective of this statute is to maximize the value of assets of the Corporate Debtor and to help the financially deficient companies to improve their business.*

*Workmen and employees, working in a company, are among the individuals who are protected by the provisions of IBC, 2016. However, the statute does not explicitly provide how all the elements included in the remuneration of the workmen and employees should be dealt with after the initiation of the Corporate Insolvency Resolution Process (“CIRP”) under the IBC, 2016. Furthermore, it does not provide any guidelines as to how certain dues owed to the workmen and employees should be treated during the CIRP. The paper analyses deeply the important judgments which have cleared this grey area in determining*

---

\* Simran Walia is a fourth-year student at Rajiv Gandhi National University of Law, Patiala.

*the payment of dues owed to the workmen and employees by the Corporate Debtor.*

## TABLE OF CONTENT

I.	Introduction .....	109
II.	Exclusion of PF and Gratuity dues from the Liquidation Estate of the CD .....	111
	A. Overriding conflict .....	112
	B. Constitutional effect .....	113
	C. The landmark case of Jet Airways Ltd. ....	116
III.	Conclusion .....	117

## I. INTRODUCTION

The Employees Provident Fund Act, 1952 (“**EPF Act**”) was enacted by the Indian Parliament with the aim of providing a sense of social security to those individuals who are employed in a company. The statute was enacted to fulfill the Directive Principles of State Policy (“**DPSP**”) provided under Articles 38,<sup>1</sup> and Article 43 of the Constitution of India.<sup>2</sup>

The Employees’ Provident Fund and Miscellaneous Provisions Act, 1952 (“**EPF and MP Act**”) mandates the employers to compulsorily make contributions under the Act, and the rights of the employees has

---

<sup>1</sup> Constitution of India 1950, art 38.

<sup>2</sup> Constitution of India 1950, art 43.

statutory protection in case of non-compliance by employer fails to fulfill his obligation. *Illustratively*, if the contribution has been deducted from the salaries of the employees but the employee fails to pay to the EPF, then the Employees Provident Fund Organization (“**EPFO**”) can lodge a complaint with Police under Section 316 of the BNS.<sup>3</sup> However, when CIRP is initiated in any company, the EPF dues of the workmen and employees are treated differently. Therefore, on one side, the EPF and MP Act protected the rights of employees, and on the other, the dues owed to workmen and employees were treated in a complicated manner under the IBC, 2016.

The EPF and MP Act provide that, for safeguarding the interests of employees, separate funds for provident dues, pension dues, and deposit-link insurance dues shall be created. The contribution to the Provident Fund (“**PF**”) is compulsory for employers as well as employees. The proportion of these contributions is decided by the central government.

Provident Fund dues mean those dues that the employer is mandated to pay into the PF account of his employees. It is a retirement beneficial scheme for all employees who are earning up to a particular amount. The employer is required to submit these dues to the EPFO within a certain period.

---

<sup>3</sup> Bharatiya Nyaya Sanhita 2023, s 316.

Gratuity is a benefit that is received by the employees in gratitude for their contributions to the development of the company. Therefore, Gratuity dues are those dues that employees receive from their employer at the time of their resignation or retirement from their services. Gratuity is determined by calculating the fifteen (15) day salary of an employee for every completed year of his service, with a maximum limit of up to Rs. twenty (20) lakhs.

## **II. EXCLUSION OF PF AND GRATUITY DUES FROM THE LIQUIDATION ESTATE OF THE CD**

Section 36 of the IBC, 2016 provides that liquidation estate is formed by the liquidator comprising of the assets (mentioned under sub-section 3) and it shall be called the liquidation estate in relation to the CD.<sup>4</sup> It is provided under Section 36 of the IBC, 2016 that the liquidation estate of the CD does not include certain assets, and these cannot be utilized for the purpose of recovery during the liquidation process.<sup>5</sup> Certain assets excluded from the liquidation estate are the dues owed to employees and workers by the employer, including PF and Gratuity. Section 36(4)(a)(iii) explicitly provides that the assets undergoing liquidation estate do not include PF, Pension Fund and Gratuity owed by the employer to his workmen and employees, and this amount cannot be used for the process of recovery during the liquidation process.<sup>6</sup>

---

<sup>4</sup> Insolvency and Bankruptcy Code 2016 (IBC 2016) s 36.

<sup>5</sup> *ibid.*

<sup>6</sup> IBC 2016, s 36(4)(a)(iii).

Funds like PF, Pension Fund, and Gratuity are created to promote the welfare and rights of employees. Therefore, these sums are considered sacred and are kept outside the process of liquidation. This is done solely to make sure that the employees get their hard-earned money even during the liquidation of the company. In the important case of *State Bank of India v. Moser Baer Karamchari Union*,<sup>7</sup> NCLAT considered whether the sum consisting of PF, Pension Fund, and Gratuity shall be included under Section 53 of the IBC or not.<sup>8</sup> The instant case involved a liquidation proceeding, and the Adjudicatory Authority order the Liquidator to pay PF, Pension Fund and Gratuities due to workers and employees as per Section 36(4)(a)(iii) of the Code.<sup>9</sup> This decision was later upheld by the NCLAT on the ground that the term 'liquidation estate' does not include PF, Pension Fund, and Gratuity fund within its definition. Therefore, these sums are not included in those assets that are used for distribution among the creditors of the CD during liquidation.

i. Overriding conflict

It is provided under Section 238 of the IBC, 2016 that the IBC shall have overriding power over all the other statutes that are inconsistent with the provisions of this Code and are enforced in India.<sup>10</sup> Therefore, if there exists any provision under any other that is in conflict with the provisions of the IBC, then in that case, it is the provision mentioned under the IBC

---

<sup>7</sup>*State Bank of India v Moser Baer Karamchari Union*, [2019] SCC OnLine NCLAT 447.

<sup>8</sup> IBC 2016, s 53.

<sup>9</sup> IBC 2016, s 36(4)(a)(iii).

<sup>10</sup> IBC 2016, s 238.

that will have the force of law. This section makes sure that the IBC takes precedence if there is a situation of disagreement with the provisions of other legislation. However, the provisions of EPF and MP Act, and IBC are not inconsistent with each other.

The NCLAT held in *Sikander Singh Jamuwal v. Vinay Talwar Resolution Professional* that the requirements of Section 17B of the Employees Provident Fund and Miscellaneous Requirements Act,<sup>11</sup> do not conflict with the IBC.<sup>12</sup> The Appellate Tribunal ordered the Successful Resolution Applicant (“SRA”) to pay the amount of PF owed to the employees. Furthermore, the Tribunal held that the question regarding the application of Section 238 did not arise in the instant case as the provisions of the EPF and MP Act and the IBC Code are not inconsistent with each other.<sup>13</sup>

In deciding the above-mentioned case, the Tribunal referred to its earlier decision in *Tourism Finance Corporation of India Ltd. v. Rainbow Papers Ltd.*<sup>14</sup> In this case, the tribunal held that PF dues are not the assets of the CD as per Section 36(4)(a)(iii) of the Code.<sup>15</sup>

ii. Constitutional effect

---

<sup>11</sup>Employees Provident Fund and Miscellaneous Provisions Act 1952 (EPF & MP Act) s 17B.

<sup>12</sup>*Sikander Singh Jamuwal v Vinay Talwar*, [2022] SCC OnLine NCLAT 125.

<sup>13</sup>IBC 2016, s 238.

<sup>14</sup>*Tourism Finance Corporation of India Ltd. v Rainbow Papers Ltd.*, [2019] SCC OnLine NCLAT 910.

<sup>15</sup>IBC 2016, s 36(4)(a)(iii).

The NCLT held in *Precision Fasteners Ltd. v. EPFO* that the sums owed to workmen and employees by the CD shall be treated as the first charge on the assets.<sup>16</sup> The EPF Act was enacted by the Indian Parliament to safeguard the interests of vulnerable sections of society, which is also mentioned in the DPSP enshrined under the Indian Constitution. An employee saves a part of his remuneration, which is earned after putting in his hard work, for later use in old age. Hence, the rights of workmen and employees, including the right to their PF dues, are interlinked with the right to life enshrined under Article 21 of the Constitution.<sup>17</sup> If these dues are treated at par with the amount owed to financial creditors is treated, it shall disbalance the right to life and right to property, which is inferior to the right to life provided under Article 21 of the Constitution.

The provisions of the EPF Act have been made stringent with the later amendments. Moreover, it has been expressly held under the IBC, 2016 that PF, Pension Fund, and Gratuity are not included under the assets of a liquidation estate. Furthermore, it has also been held that the employees are the owners of these fund, even though they may be in possession of the CD. Therefore, these dues should not be treated in the same manner in which the other dues are treated.

In the interesting case of *SAS Autocom Engineers India (P.) Ltd. v. Office of the Recovery Officer*,<sup>18</sup> the EPFO released a sale notice for selling a

---

<sup>16</sup>*Precision Fasteners Ltd. v Employees Provident Fund Organization*, [2018] SCC OnLine NCLT 27284.

<sup>17</sup> Constitution of India 1950, art 21.

<sup>18</sup>*SAS Autocom Engineers India Private Limited, In re*, [2019] SCC OnLine NCLT 516.

movable property that belonged to the CD for payment of dues amounting to Rs. 38,89,229. Due to this, the Liquidator filed an application in the NCLT contending that no claim was filed by the EPFO during the CIRP process or after the order allowing liquidation of the CD was passed by the Tribunal. The land, buildings, plants, and machinery belonging to the CD were auctioned by the Liquidator through e-auction, and certain money was also collected through this process. The sale of plant and machinery, however, was unable to be completed due to the status quo order issued by the Tribunal.

The Tribunal deeply analysed the meaning of the term ‘claim’ with respect to the CIRP and concluded that it has a broad definition and includes all claims to those individuals who have a right to receive payment from the CD, and similarly, the CD has a duty to pay the claimants. The Adjudicating Authority (“AA”) also analysed that an IRP has the power to compile all the dues owed to the claimants, and it becomes aware of a claim when a claimant files his claim in furtherance of a notice published by the IRP. These compiled claims are then given to the CoC and are also kept for reconsideration during the resolution procedure.

However, the AA concluded that nothing in Section 11 of the EPF and MP Act,<sup>19</sup> and Section 36(4)(a)(iii) of the IBC exempts the EPF authorities from filing a claim before the Resolution Professional/ Liquidator with

---

<sup>19</sup>EPF & MP Act 1952, s 11.

respect to the CD who is going through an insolvency or liquidation process.<sup>20</sup>

Therefore, it means that the EPF authorities have to first lodge a claim with the Resolution Professional, or Liquidator, who will then settle the liability of the CD by paying off these dues through money received by selling the property of the CD. This will be done in priority to settling the claims of other creditors.

iii. The landmark case of Jet Airways Ltd.

In the landmark case of Jet Aircraft Maintenance Engineers Welfare Association v. Ashish Chhawchharia, Resolution Professional of Jet Airways (India) Ltd.,<sup>21</sup> the Committee of Creditors (“CoC”) had approved the Resolution Plan, and the facts of the case did not deal with liquidation proceedings. It is mandatory for the CD to deposit the PF of its workmen with the EPFO under the EPF and MP Act, 1952. However, in the concerned case, the CD did not fulfill this obligation after February, 2019. The date of initiation of the CIRP was June 20th, 2019, and it was compulsory for the CD to deposit his PF contributions to the EPFO. The claim of the workers for a total of 24 months, including the PF and Gratuity amount, was accepted by the Resolution Professional.

The issues that arose in this case were whether the resolution plan shall provide for full payment of PF, Gratuity, and other allied benefits to the

---

<sup>20</sup>IBC 2016, s 36(4)(a)(iii).

<sup>21</sup>*Jet Aircraft Maintenance Engineers Welfare Assn. v Ashish Chhawchharia*, [2021] SCC OnLine NCLAT 5202.

employees and workmen, as these sums are not included within the liquidation estate under Section 36(4)(b)(iii)<sup>22</sup> of the IBC, and whether their dues shall be paid as per the minimum liquidation value provided under Section 30(2)(b) of the IBC,<sup>23</sup> read with the waterfall mechanism mentioned under Section 53(1) of the Code.<sup>24</sup>

It was held by the NCLT that the workmen as well as employees are entitled to full payment of PF and Gratuity dues till the date of commencement of CIRP. As the CD had failed to fulfill his obligations under the EPF and MP Act of 1952, the SRA must make provision for fulfilling these liabilities.

Section 36(4)(a)(iii) of the IBC mostly deals with the liquidation proceedings.<sup>25</sup> If any fund is maintained by the CD for paying his dues to employees, including PF, Gratuity, and other allied benefits, the Interim Resolution Professional is required to take this fund into its possession. Therefore, the Information Memorandum of the Resolution Plan does not include these funds under the category of assets of the CD. Furthermore, the CD is under the obligation to make full use of these funds for paying PF, Gratuity, and other allied benefits to his employees and workmen.

### III. CONCLUSION

---

<sup>22</sup>IBC 2016, s 36(4)(a)(iii).

<sup>23</sup> IBC 2016, s 30(2)(b).

<sup>24</sup> IBC 2016, s 53(1).

<sup>25</sup> IBC 2016, s 36(4)(a)(iii).

The decision of the Adjudicating Authority in *State Bank of India v. Moser Baer Karamchari Union* has helped to clear a confusion regarding how PF, Gratuity, and other allied dues of the workmen and employees should be dealt with during the CIRP under the IBC, 2016. Now, it is a settled principle that PF and Gratuity dues are not included under the liquidation estate assets, and these cannot be utilized for the purpose of recovery under Section 36(4)(a)(iii) of the IBC.<sup>26</sup>

Furthermore, the NCLT has also provided more clarity in two different judgments. Firstly, it has held that PF, pension, and Gratuity dues shall be given priority and must be paid in full before making any other payment under the Waterfall Mechanism as provided under Section 53 of the Code.<sup>27</sup> Section 53 provides a priority order under which the payment is to be distributed during the liquidation process. Such order is termed as the Waterfall Mechanism. The fact that the CD failed to maintain any separate fund for the fulfilment of these dues is irrelevant. Therefore, it can be explicitly said that the statutory dues shall be settled in priority to the other dues of the CD.

Secondly, if there are insufficient funds for fulfilling the statutory dues owed by the CD, then the Liquidator or Resolution Professional is obliged to provide more funds to remove this insufficiency before paying any other creditor as per the waterfall mechanism mentioned under Section 53 of the Code.<sup>28</sup> Therefore, the Liquidator cannot deny paying the dues

---

<sup>26</sup> *ibid.*

<sup>27</sup> IBC 2016, s 53.

<sup>28</sup> *ibid.*

owed to workmen and employees on the pretext of insufficiency in the separate funds maintained by the CD.

Employees will greatly benefit from this ruling, which also guarantees that they will be treated properly during the insolvency processes of the CD. The choice is a positive step towards attaining the goals of the IBC, which seeks to guarantee that insolvency and bankruptcy processes are resolved fairly and effectively for all parties.

However, at the same time, it is also necessary to remove inconsistencies in the statutory laws which undermine the protection of the rights of the employees in connection with their EPF dues. For Instance, on one hand, the courts have upheld that EPF, and other related dues of the employees are required to be paid in priority under IBC; whereas, on the other hand, Section 17B of the EPF Act allows a successful resolution applicant to carry on the business of the CD on a clean slate basis, wiping out any of the CD's previous encumbrances, if any.<sup>29</sup> Therefore, in order to address this issue, a harmonious construction of the statutes and a legislative clarification in this regard is necessary.

---

<sup>29</sup> EPF & MP Act 1952, s 17B.