INTRICACY OF PF CLAIM AND ITS EFFECT ON RESOLUTION PLAN

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Introduction

Refusal of Hon'ble Supreme Court to interfere in NCLAT order dated 21.10.2022 pronounced in the matter of **Jet Aircraft Maintenance Engineers Welfare Association vs. Ashish Chhawchharia, Resolution Professional of Jet Airways**, will have far-reaching implications on approval of resolution plan(s) and recovery of financial creditors through resolution plan or liquidation proceedings. Partial reversal of its own order by NCLAT, earlier pronounced in the above referred matter, in the case of **Regional Provident Fund Commissioner Vs Manish Kumar Bhagat, RP of Perfect Boring Pvt Ltd**, confirms that issues relating to treatment of provident fund dues during corporate insolvency resolution process / liquidation process are far from fully settled and may have more further examination in future.

In Jet Airways case, NCLAT held that EPF dues do not fall under the scope of the term 'assets' even during the CIRP and, therefore, the IRP / RP cannot alienate or transfer such assets. The NCLAT observed *"...the said funds i.e.,* provident fund, pension fund and gratuity fund maintained by the corporate debtor, have to be utilized fully for payment of provident fund, pension fund and gratuity of the workmen and employees and thus, these assets cannot be included in the information memorandum as the assets of the corporate debtor, while inviting the resolution plan and claims have to be settled against the assets of the corporate debtor. It was further held that EPF dues have to be paid in full calculated till the Insolvency Commencement Date ("ICD"), along with any damages and interest as levied, as per the provisions of the EPF Act, since they do not form part of the assets of the Corporate Debtor by virtue of Section 18 and Section 36 of the Code. It was further clarified that EPF dues have to paid irrespective of whether or not the Corporate Debtor has maintained a separate fund for provident fund contributions.
In the aforesaid case, NCLAT examined and upheld following two issues relating to employee provident fund:

a) Whether the workers and employees are entitled to receive the payment of provident fund, gratuity, and other retirement benefits in full since they are not part of the liquidation estate under Section 36(4)(b)(iii) of the Code?

NCLAT held that workers and employees are entitled to receive the amount of provident fund and gratuity in full since they are not part of the liquidation estate under Section 36(4)(b)(iii).

b)Whether verified & admitted claim of Regional Provident Fund Commissioner for the amount related to Section 14B of Employees' Provident Funds & Miscellaneous Provisions Act 1952 (PF Act 1952), can be treated as secured debt and the Appellant was entitled to receive the amount as secured creditors?
Relying on its earlier judgement in the case of "Tourism Finance Corporation of India Ltd. vs. Rainbow Papers Ltd. & Ors., NCLAT held that Section 11 of Provident Funds & Miscellaneous Provisions Act 1952 provides for priority of payment of full claim over other debts and therefore. any partial payment of Provident fund dues would lead to breach of provision of Section 30(2)(e) of the Code.

Earlier, NCLAT in the case of ***Tourism Finance Corporation of India Ltd. vs Rainbow Papers Ltd.*** held that since no provisions of the Code and the EPF Act are in conflict, the application of Section 238 of the Code does not arise in respect PF claim filed pursuant to section 7Q and 14B of PF Act. Section 17B of the EPF Act creates an obligation on the transferee to pay the contribution and other sums due from the employer whenever an establishment is transferred. Therefore, by operation of Section 17B of the EPF Act, the successful resolution applicant was made liable to pay the provident fund dues arising pursuant to section 7Q and 14B of PF Act which the corporate debtor owes to its employees.

NCLAT followed its judgement given *in* Jet Airways case, subsequently in the *case of* **Assam Tea Employees Provident Fund Organization Vs, Mr. Madhur Agarwal, Resolution Professional of Hail Tea Limited.** In this case**,** NCLAT also relied on Hon'ble Supreme judgement given in the case of **"Maharashtra State Cooperative Bank Limited vs. Assistant Provident Fund Commissioner & Others**, wherein Apex observed that. *The expression "any amount due from an employer" appearing in sub-section (2) of Section 11 has to be interpreted keeping in view the object of the Act and other provisions contained therein including sub-section (1) of Section 11 and Sections 7A, 7Q, 14B and 15(2) which provide for determination of the dues payable by the employer, liability of the employer to pay interest in case the payment of the amount due is delayed and also pay damages, if there is default in making contribution to the Fund. If any amount payable by the employer becomes due and the same is not paid within the stipulated time, then the employer is required to pay interest in terms of the mandate of Section 7Q. Likewise, default on the employer's part to pay any contribution to the Fund can visit him with the consequence of levy of damages."*

NCLAT observed that the above judgment lays down that any amount due from employer appearing in sub-section (2) of Section 11 also covers the amount determined under Section 14B and there cannot be any quarrel to the preposition as laid down by the Hon'ble Supreme Court in the above case. The priority for payment of debt under Section 11 of the PF Act has to be looked into in view of the mechanism which is specifically provided under Section 53(1) of the Code. It further stated that they had already dealt the provision of Section 36(4)(a)(iii) of the Code and held that provident fund dues are not subject to distribution under Section 53(1) of the Code.

In the case of **State Bank of India v. Moser Baer Karamchari Union** the question of whether provident fund, pension fund, and gratuity fund dues could be included in section 53 of the IBC was considered. The Adjudicating Authority allowed the application on the grounds that these dues could not be part of Section 53 of the IBC. NCLAT upheld the decision of the Adjudicating Authority, which held that provident fund, pension fund, and gratuity fund do not come within the meaning of liquidation estate. This means that these funds are not part of the assets available for distribution to the creditors of the company in liquidation.

However, NCALT in the case of **Regional Provident Fund Commissioner, Vatwa Vs Shri Manish Kumar Bhagat, Resolution Professional of M/s. Perfect Boring Pvt. Ltd. (**Judgement pronounced on 11.10.2023) partially reversed its earlier orders by examining afresh nature of section 17 B and discretionary power vested with the concerned authority for waiver of penalty under section 32 B of Provident Fund Scheme. NCLAT observed that *Central Board is empowered to waive the damages under Section 14B of the Act. The Para 32B of the Scheme provides that Board for Industrial and Financial Reconstruction for reasons to be recorded in its schemes, in this behalf recommends, waiver of damages up to 100 per cent may be allowed. After enforcement of IBC, the provisions of Board for Industrial and Financial*

statutory regime for rehabilitation is now substituted by Insolvency Regime as contained in IBC. Thus, when Insolvency Resolution Process has been initiated against a Corporate Debtor and Resolution plan has been approved under IBC, power of Central Board to reduce or waive the damages can be exercised with regard to the damages imposed under Section 14B. The power of recommendation as contemplated in paragraph 32B of the scheme can very well be exercised by the NCLT.

Accordingly, NCLAT asked Successful Resolution Applicant to pray to the Central Board to waive 100 percent damages imposed under Section 14B of the PF Act 1952 and no direction was issued for payment of damages of imposed under Section 14B. Successful resolution applicant was directed to pay remaining amount as determined to be payable under section 7A & 7Q of EPF Act 1952.

From above judicial pronouncements, it is amply clear that a Resolution Plan will have to provide for payment of entire outstanding EPF dues, calculated as on ICD. Claim for such outstanding EPF amount can be filed either by workers/ employees or by Provident fund organisation. Such provisioning in the Resolution Plan is essential to make it compliant with Section 30(2)(e) of the IBC which stipulates that the Resolution Plan must not contravene any of the provisions of the law for the time being in force. Further, in liquidation, *a*ll sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund be excluded from liquidation estate as well as from the purview of the waterfall mechanism, as enshrined under Section 53 of the IBC, which enumerates the order of priority in which the payment during liquidation is to be made.

While it is laudable to accord priority to the payment of workers / employees dues, a cause espoused by the Apex Court, but in none of the above referred judgements, the Apex Court / NCLAT examined rationale and purpose of section 7Q and 14 B of PF 1952 and how amount collected pursuant to said sections are utilised by PF organisation.

Section 7Q and 14 B of PF Act 1952

7 Q: *Interest payable by the employer. —The employer shall be liable to pay simple interest at the rate of twelve per cent. per annum or at such higher rate as may be specified in the Scheme on any amount due from him under this Act from the date on which the amount has become so due till the date of its actual payment: Provided that higher rate of interest specified in the Scheme shall not exceed the lending rate of interest charged by any scheduled bank.]*

14B. Power to recover damages.—Where an employer makes default in the payment of any contribution to the Fund , Pension Fund or the Insurance Fund or in the transfer of accumulations required to be transferred by him under sub-section (2) of section 15 or sub-section (5) of section 17 or in the payment of any charges payable under any other provision of this Act or of 5 any Scheme or Insurance Scheme or under any of the conditions specified under section 17, the Central Provident Fund Commissioner or such other officer as may be authorised by the Central Government, by notification in the Official Gazette, in this behalf may recover from the employer by way of penalty such damages, not exceeding the amount of arrears, as may be specified in the Scheme Provided that before levying and recovering such damages, the employer shall be given a reasonable opportunity of being heard Provided further that the Central Board may reduce or waive the damages levied under this section in relation to an establishment which is a sick industrial company and in respect of which a scheme for rehabilitation has been sanctioned by the Board for Industrial and Financial Reconstruction established under section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985,subject to such terms and conditions as may be specified in the Scheme.

Section 14 B is a deterrent provision to prevent default in payment of EPF dues and any recovery pursuant to said provision is never paid to employees of concerned organisation. Further, since the section prescribes stiff penalty, the section itself empowers Central Board to reduce / waive penalty levied in the case of sick unit. Corporate debtor undergoing CIRP, or liquidation process is certainly a distressed unit and therefore, deserves waiver of penalty levied u/s 14 B. Similarly, pursuant to section 7 Q, PF department normally charges interest @ 12% while it pays interest between 7-8 percent to employees on outstanding PF balances. In view of this, payment of full amount of claim including for interest and damages charged pursuant to section 7Q and 14 B may be considered as enrichment of PF organisation at the cost of other creditors.

Further, section 36(4)(a)(iii) of the Code excludes all sums due to any worker or employee from the provident fund, pension fund and the gratuity fund from liquidation estate. Sub section (3) of section 36, prescribe list of assets which shall form part of liquidation estate. Generally, organisation deposit contribution (both employer and employees) with Employees' Provident Fund Organisation ("EPFO") and only handful of organisations are having their Provident Fund Trust. In financial statements, there are generally no assets named as provident fund, even if contribution amount is deposited with its own trusts. On retirement / retrenchment / otherwise, EPFO or PF trust, as the case may be, directly settles PF claims, without routing funds through the concerned organisation. Similarly, in liabilities side of the financial statement, only contribution amount, which are yet to deposited, are shown. In view of the above, in Author's view, no adjustment is needed in the liquidation estate, created pursuant to section 36(3) of the Code, even if there are outstanding PF dues unless Regulatory authorities allows deduction of outstanding PF amount reflected as liability in the books of corporate debtor / Admitted amount of PF department or employees claim towards PF from assets value representing immovable properties, plant & machinery, investment and monetary assets.

In author's views, even considering NCLAT and Apex Court judgements that there is no conflict between section 11 of EPF Act 1952 and provisions of the Code, priority can be given and amount can be excluded from liquidation estate *under Section 36(4)(b)(iii) of the Code,* only to the extent of contribution (both employer and employee) and accrued interest to the extent payable to workmen / employee only and not for any additional interest, penalty and damages as claimed EPFO.

Further, Invariably, EPFO files claim during CIRP / liquidation based on ex-parte order issued by its own officers on the basis of salary & wages amount disclosed in audited financial statements. Seldom only, claims are substantiated with employee wise claim detail or based on PF returns filed by the concerned organisation. As per Regulation 12 of CIRP Regulation, it is responsibility of creditor to submit claim with proof. IRP / RP may call for such other evidence or clarification as he deems fit from creditor to substantiate the whole or part of its claim. In Author's view, filing of any claim by EPFO on estimate / best judgement basis, cannot be termed as substantiated.

In all cases, referred in earlier paragraphs, workers and EPFO had filed their claims with the RP before approval of resolution plan and the dispute was only over the amount allocated towards their claims under the Resolution Plan. The law is still unclear on what were to unfold if EPF claims are lodged based on assessments/ inspections carried out at belated stages where the Resolution Plan is already approved. Despite multiple legal pronouncements, there are still many unresolved issues, and therefore, Payment of EPF dues during CIRP or liquidation is far from fully settled. Further, payment of full amount of EPF dues including interest under section 7Q of PF 1952, and gratuity dues during CIRP / Liquidation may affect

under section 53 of Code also. Therefore, according to priority in payment of entire EPF and gratuity dues, irrespective of category or number of dues may disincentivise financial creditors to support resolution. Appellate courts normally examine legal issues which are espoused in appeal and does not look into nitty gritty of entire issue. Hence, there is a need for examination of entire PF claim issue afresh to resolve unsettled issues and to balance out interest of all stakeholders.