

Transfers at undervalue: A risk to lenders and purchasers

Laura O'Neill from First Title explains how a transfer at undervalue takes on a new meaning and triggers other implications when it is read in light of the Bankruptcy (Scotland) Act 1985.

A transfer at undervalue means, in its simplest form, to transfer a property to another person or entity for less money than it is worth, or for no consideration at all.

However, the phrase takes on a new meaning and triggers other implications when it is read in light of the Bankruptcy (Scotland) Act 1985. To a property practitioner in the middle of a transaction in Scotland, it can signal trouble ahead and requires further investigation.

The legislation: Bankruptcy (Scotland) Act 1985

Section 34 of the Bankruptcy (Scotland) Act 1985 (the Act) sets out the basis for challenging a gratuitous alienation by a debtor. An alienation may be gratuitous if it involves the voluntary transfer by the debtor of any property, or right, to another person for no valuable consideration, or for a consideration that was significantly less than the real value of the transferred asset. The aim is to deter people from alienating their property to protect their assets from the risk of repossession.

There could be a range of reasons why someone wants to sell their property for less than it is worth, especially in today's

economic climate. A Parent may wish to offer a helping hand to their children who are struggling to get onto the property ladder by gifting them a home. Or a seller whose property has been on the market for many months may grow increasingly impatient and be more willing to accept an offer for less than the property is worth.

Gratuitous alienations may seem like a convenient way to navigate the current property market, for eager first time homeowners or sellers desperate to rid themselves of a property. But a transfer at undervalue can be a tricky area for property practitioners, as they have to be aware of section 34 of the Act and pay close attention to the timing of the gratuitous alienation.

Timing is of vital importance in these cases, as a section 34 challenge is only available within five years of the date of sequestration, or of the date of the granting of a trust deed by the debtor. This time limit is reduced to two years if the gratuitous alienation was to a person who is not an associate of the debtor, i.e. not a family member, for example. Section 34 of the Act is therefore like an hourglass that is turned when a property is transferred at undervalue, with the sand running out after either two or five years.

During this time the threat of the transaction being reduced, or 'set aside', is ever present.

Defences to a section 34 challenge

There are defences to a statutory challenge of a gratuitous alienation, but they are relatively limited, and the burden of proof rests on the person seeking to uphold the transaction. Defences include:

- That immediately, or at any time since the date of the alienation, the debtor was absolutely solvent
- That the alienation was for adequate consideration
- That the alienation was a reasonable birthday, Christmas or another conventional gift
- That the alienation was a reasonable charitable donation made to a person who was not an associate of the debtor.

However, even if one or more of these defences is legitimate, the practitioner acting in the transaction may not wish to depend solely on it. Or better still, may wish to avoid ever having to defend against a challenge in the first place.

Cover for both lender and purchaser

First Title has developed a policy that is designed to protect lenders and purchasers in a transaction where there has been, either currently or in the past, a transfer at undervalue or 'gratuitous alienation'. With this policy, either the lender or the purchaser would be protected against any loss sustained as a result of a third party seeking to challenge the title to the property, by reason of the sequestration of the party transferring at undervalue pursuant to section 34 of the Act.

A common obstacle in these transactions is the caution shown by lenders. Lenders may be unwilling to lend unless they are assured of the solvency of the transferor, or they may request that a title indemnity policy is put in place as an extra safeguard. This is one situation where the choice can be dictated by the lender: Section 5.16 of the CML Handbook recommends obtaining a clear bankruptcy search against the seller and also obtaining title indemnity insurance.

Title insurance can provide invaluable comfort where there is a risk or uncertainty over the title to a property being challenged. Our Bankruptcy Policy may therefore be helpful in easing the concerns of the solicitor and the lender, ensuring that the lender does not suffer loss as a result of a transfer at undervalue under section 34 of the Act.

First Title also offers cover for the purchaser of a property as well as the lender, in cases where the transfer at undervalue has already occurred and the property is being sold on to an unrelated third party.

A purchaser buying a property from the recipient of a gratuitous alienation is offered a degree of statutory protection from any challenge, provided that they acquired the property in good faith and for value.

However, the criteria of good faith and for value are open to interpretation, and the transfer is likely to be scrutinised closely by any party seeking to challenge the title. It will be expected that the previous titles should have been examined closely by the purchaser, and any risk of insolvency of a transferor should have been noticed and checked.

Providing valuable comfort and reassurance

Whenever a property is transferred, at undervalue or for no consideration, for whatever reason, there is the threat of a section 34 challenge. The transferor may be completely solvent and have innocent, justifiable reasons for this transfer, but a lender or a future unrelated purchaser may not want to rely on faith alone, and may wish to protect themselves from any losses if the transferor is declared bankrupt.

This is where title insurance can come in, providing comfort to both lenders and purchasers, and allowing property practitioners to proceed with the transaction with confidence and reassurance. A title indemnity policy may be the most practical solution for a smooth, lower risk property transfer.

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