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Lecture-16

FRAUDULENT TRANSFER

In this lecture discusses the fraudulent transfer. The term fraudulently has been explained by Section 25 of the Indian Penal Code. According to it, when a thing is done by a person with the intention to defraud the other, he is said to have done that thing fraudulently. The term defraud was explained by the Supreme Court in ***Dr. Vimla V. Delhi Administration AIR 1963 SC 1572: 1963 Supp (1) CR 585***. Supreme Court observed that the term defraud involves two elements:

1. Deceit and
2. Injury to the person deceived. The injury doesn't only mean economic loss. It includes deprivation of property or money and includes any harm caused to any person in body, mind, reputation or such others.

Example: A took a loan from B and mortgaged the property X as security. Later on, A realized that he was not able to pay back the loan and it would be paid out of the property X now. In order to prevent that, he sold the property to C. Here A's intention was to defraud B, hence the transfer was a fraudulent transfer.

Fraudulent Transfer is dealt with under Section 53 of Transfer of Property Act, 1882.

This section recognizes the need to protect the interest of the creditors. The rule of equity, justice, and good conscience has been incorporated in this section. It prevents a person from defeating the legitimate claims of his creditors. Fraudulent transfer Section 53 are as follows:

(1) Every transfer of immoveable property made with intent to defeat or delay the creditors of the transferor shall be voidable at the option of any creditor so defeated or delayed.

Nothing in this sub-section shall impair the rights of a transferee in good faith and for consideration.

Nothing in this sub-section shall affect any law for the time being in force relating to insolvency.

A suit instituted by a creditor (which term includes a decree-holder whether he has or has not applied for execution of his decree) to avoid a transfer on the ground that it has been made with intent to defeat or delay the creditors of the transferor shall be instituted on behalf of, or for the benefit of, all the creditors.

(2) Every transfer of immoveable property made without consideration with intent to defraud a subsequent transferee shall be voidable at the option of such transferee. For the purposes of this sub-section, no transfer made without consideration shall be deemed to have been made with intent to defraud by reason only that a subsequent transfer for consideration was made.]

Essentials Elements of Fraudulent Transfer :

53 (1):

1. Transfer by the transferor
2. Of immovable property
3. With the intention to defeat or delay his creditors
4. The transfer is voidable at the option of the creditor defeated or delayed.

Provided that there is no subsequent transferee, who

1. acted in good faith, and
2. The transfer was for consideration.

53 (2):

1. Transfer by the transferor
2. Of immovable property
3. The transfer is done without consideration
4. The transfer is done with the intention to defraud a subsequent transferee
5. Such transfer is voidable at the option of the subsequent transferee.

Transfer

In order to attract this section, there must be a transfer. The transfer must be of immovable property. The transfer must be a real one which creates a vested title in favour of the third party. Fictitious transfers do not attract this section. The fictitious transfer is where the transferor remains the real owner of the property.

Hence, in order to set aside the transfer under section 53, it has to be proved that the transfer was a real one and not a sham one.

Example: X took a loan from Y and kept his property A as security. X then gets the property mutated in favour of his son. The mutation is done without effecting a transfer. As the father is still the owner of the property, what appears to be a transfer is merely a sham and as Y still has the claim over this property, there is no need to move under Section 53 of TPA.

Intention to defeat or delay the creditors:

A creditor here is a person to whom the transferor owes the financial liability. In order to apply Section 53 of TPA, it is necessary for a creditor to exist, and it is not necessary for the creditor to be secured. The creditor can be unsecured as well.

Even a subsequent creditor can move under this section. This means that it is not necessary for the transferor to be in debt at t he time of the transfer. If the transfer is made prior to the debt transaction, with the intention that the transferor might take a loan in the future and wanted to take the property out of reach of the future creditors, it is equally fraudulent and can be set aside at the option of the creditors. But the mere fact that the loan was taken right after the transfer of property or there was subsequent indebtedness, is not evidence of fraudulent intention towards subsequent creditors.

A Muslim wife in lieu of her dower debt amounts as a creditor.

The basic objective behind this section is to protect the creditors from being delayed or defeated by removing the possible security. In order to attract section 53, it is necessary for the intention to be fraudulent. Hence, the intention behind the transfer must be to defeat or delay the creditors.

The phrase 'creditors' doesn't mean that the intention should be to defeat or delay all the creditors. The intention to defeat some or even just one of the creditors is enough to attract Section 53.

In the case of ***Kanchanbai v. Moti Chand*** *AIR 1967 MP 145* Transferor owed the Creditor Rs. 2600. The creditor asked for the money back/recovery of money. When even after being asked for the recovery of money, the transferor didn't pay back, the creditor threatened to file a suit. After receiving the notice of the same, the transferor executed a gift deed in favour of her daughter in law. Creditor filed a suit under Section 53 of TPA against the transfer.It was contended by the transferor that Section 53 of TPA was not attracted in the present case as there was just a single creditor.

Mere preference of one creditor over the others is not sufficient to attract this section unless it's shown that it was done with the intent to defraud other creditor's claims.

It was observed by the court that: the phrase creditors would also include a single creditor. The section would be attracted even when a single creditor is defrauded or there was intention just to defraud a single creditor. Here the transfer was done with the intention to defeat and delay the creditor's claim. Hence, section 53 would be applicable.

Mere preference of one creditor over the others is not sufficient to attract this section unless it's shown that it was done with the intent to defraud other creditor's claims.

Example: A mortgaged his property X to C1, C2, and C3. While repaying the loan, he gave preference to C1. Mere this fact won't amount to intention to defraud C2 and C3.
The transfer should be defeat and delay the creditors. If the transferor transfers his property but is willing to pay the creditors back what he owes to them or if just a portion of the property is transferred and there is another property left which is sufficient in value to pay back the creditors then, the Section 53 will not apply.

Example: A took a loan from C and mortgaged the property X as security. After a few days, he sold the property X to B. Now C can question or deny the transfer under Section 53.
But in order to move under Section 53, he has to prove that he is not able to recover the money from A personally. If A is ready to pay back the money to C personally without involving the property, then Section 53 will not be attracted.

The section operates only against fraudulent transfers. There might arise a case where the transfer is done for two considerations one of which is for fraudulent intention, which is separable from each other then, the whole transaction would not be regarded as fraudulent.

Only that portion of the transaction would be regarded as fraudulent for which there was an intention to defraud. And the transfer would be given effect to the extent the transaction can't be regarded as fraudulent. But in cases where the substantial portion of the transaction is fraudulent and the fraudulent and not fraudulent portions cannot be separated, then the whole transaction would become voidable.

Framing of Suit

Privity of contract is followed which means only the parties to a contract can sue. Hence, no third party, who is not a party to the suit can sue on the creditor's behalf. The suit is instituted by the creditor on the ground that the transfer has been made with the intention to defeat or delay the creditors of the transferor.

The suit is instituted in the representative category i.e. on behalf of and for the benefit of all the creditors. It is to avoid the multiplicity of suits over the same subject against the same opposite party/parties. Dismissal of the suit of one creditor would be binding on all the creditors.

Burden of Proof

There is no presumption in law that the transfer was effected with the intention to defeat or delay the creditors. The existence of fraud would not be presumed by the court, it has to be proved. So, when the transfer of property is challenged on the grounds of fraud then the primary onus is on the petitioner to show how he was connected to the property and how has the fraud taken place.

Hence, here the primary onus is on the creditors to prove that the transfer was effected with the intention to defeat and delay the creditors. But once it has been proved then the burden shifts on the transferee to prove that he bought the property in good faith and consideration.

Proviso

A bona fide transferee who paid the consideration for the transfer has been protected under this section. A bona fide transferee would mean that the transferee is unaware or has no knowledge about the fraudulent intentions of the transferor. The knowledge includes actual and constructive notice. If the transferee has the constructive notice of the fraud then it will be presumed that he had the knowledge about the fraud.

Also, the consideration must be the essence of the transfer. The transferee of a gratuitous transfer would not be protected.

A creditor is a transferee in good faith even where he is aware of the proceedings of another creditor against the transfer as he is protecting his own interest and not defeating other creditor's interests.

Section 53 further provides that this section will not affect any law relating to insolvency, which is in effect for the time being.

MCQ

1. Fraudulent - transfer is defined in: .

(a) Section 19, Transfer of Property Act
(b) Section 21,Transfer of Property Act
(c): Section 53, Transfer of Property Act
(d) Section35, Transfer of Property Act

2. Which section of Transfer of Property Act bars fraudulent transfer?

(a) section 43
(b) section 53
(c) section 63
(d) section 71

3. A took a loan from B and mortgaged the property X as security. Later on, A realized that he was not able to pay back the loan and it would be paid out of the property X now. In order to prevent that, he sold the property to C. Here A's intention was to defraud B, hence the transfer was

(a) valid transfer
(b) Fraudulent transfer
© Can not say
(d) None of the above

4. The basic objective behind the section 53 is to protect

(a) Debtors
(b) Creditors
(c) Both (a) and (b)
(d) None of the above

5. The transferee of a gratuitous transfer under section 53 is
(a) Protected
(b) not protected
© Can not say
(d) None of the above