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## LIQUIDATOR OF AN INSOLVENT CORPORATE TRUSTEE By David W Marks QC

### Table of Contents

1	The “commercial monstrosity” .....	3
2	Rights of Indemnity .....	4
2.1	Recoupment and exoneration.....	4
2.2	Personal and proprietary rights of indemnity .....	4
2.3	Confining the creditor to its rights against trust property .....	5
2.4	Assets available to the liquidator .....	6
2.5	Trustee’s proprietary interest in fund.....	6
2.6	The rule book – whether corporate law priorities apply .....	7
2.7	Extent of subrogation.....	7
2.8	Where trustee’s position vacated on insolvency.....	8
2.9	Liquidator’s fees, liquidator’s lien.....	8
2.10	Crown priority re-asserted.....	9
3	Ability to exclude the indemnity against the fund.....	9
3.1	Statutory right of indemnity from fund - Queensland .....	10
3.2	Whether possible to exclude in any case .....	10
3.2.1	Conflict in Australia .....	10
3.2.2	Resolution in Australia – it depends.....	12
3.3	Consequences for directors of excluding the indemnity – section 197 .....	12
4	Which Rule Book Applies? .....	13
5	Liquidators’ remuneration .....	16
6	Re-assertion of Crown priority .....	17
7	Schedule – extracts from Acts .....	20
7.1	Section 197 Corporations Act.....	20
7.2	Section 254 Income Tax Assessment Act 1936 .....	21

1. The rules of equity, as administered in Commonwealth courts, have diverged. There is a special leave application pending on a fundamental point – what rule book governs priorities on distribution in a liquidation of a trading trustee’s estate.
2. The fount of Australian law, as to the trustee’s right of indemnity, is *Octavo Investments Pty Ltd v Knight*.<sup>1</sup>
3. It is also applied by the New Zealand High Court.<sup>2</sup> Thus this is a fertile area for noting Australian developments, with impact in New Zealand.
4. Australians use trusts for trading.
5. They use corporate trustees, as a first line of defence of their private assets, should a business fail.
6. Inevitably, some businesses do fail.
7. Creditors, of varying degrees, go unpaid.
8. Liquidators are appointed, but seek remuneration.
9. Assets must be administered, subject to identifiable rules. (The “rule book” is a work in progress.)
10. Frustrated trade creditors attempt subrogation to the trustee’s right of indemnity, to gain priority over non-trust creditors of the company.
11. Employees seek priority creditor status, but recently hope the priority will not be frustrated by the trust.
12. Governments, having given up Crown priority, seek priority by the backdoor.
13. And there were rumblings about whether the trustee’s security, for the indemnity, was void for want of registration under the *Personal Property Securities Act 2009* (Cth) - a piece of legislation drawn together from the best bits in Canada, the UK and New Zealand.

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<sup>1</sup> [\[1979\] HCA 61](#); (1979) 144 CLR 360; (1979) 27 ALR 129; (1979) 54 ALJR 87; 4 ACLR 575

<sup>2</sup> For example, in *LSF Trustees Limited v Footsteps Trustee Company Limited (in liquidation)* [\[2017\] NZHC 2619](#), in the passage quoted at [14].

14. The trends in the law of liquidation are more obvious, than in bankruptcy. The *quantum* involved in some corporate insolvencies spurs more litigation. I will thus leave personal insolvency cases to one side, except where a bankruptcy case illustrates a point just as well.
15. Four current topics are drawn out in this paper:
  - (a) ability to exclude the right of indemnity from trust property;
  - (b) the “rule book” applicable – whether equity or statutory priorities;
  - (c) an evergreen issue - liquidators’ remuneration; and
  - (d) re-assertion of Crown priority.
16. But first I attend to the basics.
17. I then draw out those current issues, under further headings.

## 1 The “commercial monstrosity”

18. Consider a limited liability company acting as trustee of a trading trust.
19. The starting point is the late Prof Harold Ford’s 1981 paper, “Trading trusts and creditors’ rights”. Prof Ford judged that:<sup>3</sup>

*The fruit of this union of the law of trusts and the law of limited liability companies is a commercial monstrosity. The scope for frustrating creditors is considerable.*
20. *Octavo Investments* was decided in 1979.
21. And it did not simply fall from the sky, but is based in solid precedent.
22. Surprisingly, issues continue to arise.
23. Citations of *Octavo Investments* spiked again in 2016 and 2017, in the trade and academic literature examined.
24. Under heading 2, I explain the trustee’s right of indemnity, an important aspect of the framework within which the liquidator works, when appointed to a corporate trustee.

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<sup>3</sup> [\(1981\) 13 Melbourne University Law Review 1, 1](#)

25. Having done so, I touch on 4 current issues:
- (a) ability to exclude the right of indemnity from trust property;
  - (b) the “rule book” applicable – whether equity or statutory priorities;
  - (c) an evergreen issue - liquidators’ remuneration;
  - (d) re-assertion of Crown priority,
- and relate them to current cases.

## 2 Rights of Indemnity

### 2.1 Recoupment and exoneration

26. A right of indemnity may be for exoneration, or for recoupment.<sup>4</sup>
27. The right of recoupment is “the right to recoup money from the trust assets in respect of liabilities which the trustee has previously discharged from [its] own funds”.<sup>5</sup>
28. The right of exoneration is “a right to discharge trust liabilities directly from the assets of the trust”.<sup>6</sup>

### 2.2 Personal and proprietary rights of indemnity

29. The trustee has 2 types of rights of indemnity:
- (a) As against the beneficiary, personally.
    - (i) This can and should be excluded by the deed.<sup>7</sup>
    - (ii) Since a well-drawn deed inevitably excludes this, I put it to one side.
  - (b) As against the trust property. The deed may purport to exclude this. Opinions have differed as to whether exclusion is possible.
    - (i) By statute, it may not be excluded by the deed in Queensland.

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<sup>4</sup> *Commonwealth v Byrnes* [2018] VSCA 41; (2018) 124 ACSR 246; 354 ALR 789, [96].

<sup>5</sup> *Lane v Deputy Commissioner of Taxation* [2017] FCA 953; 253 FCR 46, [5].

<sup>6</sup> *Lane v Deputy Commissioner of Taxation* [2017] FCA 953; 253 FCR 46, [5].

<sup>7</sup> *Chief Commissioner of State Revenue v CCN Holdings Trust Pty Ltd* [2014] NSWCA 42, [72].

- (ii) There has been debate as to whether it is an inherent right of a trustee that may not be excluded, apart from statute.
- (iii) An attempt to exclude it causes the directors an issue under s 197 *Corporations Act 2001* (Cth).<sup>8</sup> (I have been unable to locate an equivalent New Zealand provision.)

30. The issues that arise are:

- (a) Ability to exclude the right of indemnity against the fund; and
- (b) Consequences for the directors under s 197. That provision has evolved.

### **2.3 Confining the creditor to its rights against trust property**

- 31. The trustee is personally liable for debts contracted as trustee.
- 32. However, the creditor may agree that it has no rights against the trustee personally, beyond the trustee's ability to be recouped from the trust property.
- 33. That formula is seen in contracts with registered Trustee Companies in Australia.
- 34. Often, they are acting as custodians, not as active managers.
- 35. They are inflexible in this requirement.<sup>9</sup>
- 36. The formula is not seen much outside that context.
- 37. I am not aware of a case about how the creditor proves in the winding up, or the *quantum* of such a proof, where the creditor is confined to the trust fund, for recovery. Fortunately, registered Trustee Companies rarely become insolvent in a way causing loss, nowadays.
- 38. This paper focuses on dealings with an ordinary company, as trustee. As noted, that limitation formula is not seen much in that context.

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<sup>8</sup> Schedule of extracts, heading 7.1.

<sup>9</sup> But it is not beyond debate. Thus, we were negotiating a long-term, water-bore licence. It had on-going, mutual obligations of access and repair. It involved machinery, pipes, and earthworks. The Custodian's breach would have deprived our land of water indefinitely, causing loss. It was uncommercial for our side to be liable to our boot-straps, but for the Custodian to be able to breach with impunity (that is, if trust assets were depleted).

## 2.4 Assets available to the liquidator

39. The liquidator is appointed to the company.

*Property held by the insolvent on trust for beneficiaries is excluded from distribution to the creditors, expressly under bankruptcy legislation, and by undisputed analogy in the case of corporations. It is not property of the company.*<sup>10</sup>

40. The insolvent trustee's right of indemnity against trust property, for liabilities properly incurred, confers on the trustee a proprietary interest in the trust property. That interest passes on insolvency to the trustee in bankruptcy, or for a company is an asset to which the liquidator has access for the benefit of the trustee's creditors.<sup>11</sup>

## 2.5 Trustee's proprietary interest in fund

41. The advent of Commonwealth personal property securities legislation has caused concern about whether the trustee's proprietary right in the fund must be perfected by registration.

42. The cases speak of that right as a "lien" or "charge".

43. The true nature of the right is now being examined closely.<sup>12</sup>

44. However, the literature favours not having to register, to achieve effectiveness. This was confirmed by the Victorian Supreme Court in *Re Amerind*.<sup>13</sup>

45. The Victorian Court of Appeal did not have to address the point, so its comments are *obiter dicta*.<sup>14</sup> But the approach taken suggested complexity lies ahead. As that topic leads into peculiar rules about securities, I simply note this area remains difficult, and unsettled.

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<sup>10</sup> *Commonwealth v Byrnes*, above, [62]

<sup>11</sup> This paragraph paraphrases *Commonwealth v Byrnes*, above, [96].

<sup>12</sup> D'Angelo & Busljeta, "The trustee's lien or charge over trust assets: A PPSA security interest or not?" (2011) 22 JBFLP 251;  
Loxton, "In with the Old, Out with the New? The rights of a replaced trustee against its successor, and the characterisation of trustees' proprietary rights of indemnity" (2017) 45 ABLR 285.

<sup>13</sup> *Re Amerind Pty Ltd (In liq)* [2017] VSC 127; 320 FLR 118, [380] – [389]

<sup>14</sup> *Commonwealth v Byrnes*, above, [318]

## 2.6 The rule book – whether corporate law priorities apply

46. A recent and important conflict in Australian law has been over the “rule book”.
47. Section 555 *Corporations Act* provides a *prima facie* rule of proportional abatement. It is immediately qualified by statutory priorities in section 556. An important priority is for employee remuneration and benefits. Without needing to explore the mechanics here, it is notable that the Commonwealth will often be subrogated to the rights of the employees, to the extent it has met benefits under a Commonwealth scheme.
48. On the other hand, equity is equality. If the “rule book” applicable is, instead, that principle, statutory priorities otherwise applicable, favouring employees (or, in reality, often the Commonwealth to a large extent) will not apply.
49. There is a case awaiting hearing of an application for Special Leave to Appeal, to the High Court of Australia.

## 2.7 Extent of subrogation

50. It is wrong to speak of a right of subrogation to the trustee’s right of indemnity. Subrogation is a remedy.<sup>15</sup>
51. A creditor, asserting that the debt to that creditor has been incurred by the trustee in the course of the administration of the trust, nevertheless is some distance from being subrogated to the trustee’s right of exoneration from the trust fund, and from the lien in support of that right of indemnity. P McMurdo J said in *Lerinda Pty Ltd v Laertes Investments Pty Ltd*:

*8. The applicant’s case assumes that the equitable remedy of subrogation would be granted in its case, and on terms which would have its debt paid in full. But unless and until that remedy is granted, the applicant has no equitable interest in the trust assets or equity which appears to have priority over those of other creditors of the trustee. The question then is whether the equitable remedy of subrogation would be granted on terms which would advance one otherwise*

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<sup>15</sup> *Bodycorp Repairers Pty Ltd v Maisano* [2018] VSC 96, from [41]; *Lerinda Pty Ltd v Laertes Investments Pty Ltd* [2009] QSC 251; 74 ASCR 65; [2010] 2 QdR 312, [7].

*unsecured creditor ahead of the others and to their detriment. The fact that this creditor has applied for the remedy ... whilst other creditors have not so applied, does not indicate some conduct on the part of every other creditor in the nature of, for example, acquiescence or delay, which might disentitle that creditor to the same remedy. If the applicant's right to be subrogated is no greater than that of any other creditor, the relief which it might hope to obtain would have to be limited to ensure that the rights of the other creditors were not prejudiced.*

## **2.8 Where trustee's position vacated on insolvency**

52. The trustee might be removed by an appointor.
53. The trust deed might provide that the trusteeship is vacated on an insolvency event affecting the trustee.
54. The latter has been recognised as having force.<sup>16</sup>
55. In both cases, the liquidator of the former trustee nevertheless may have assets in the liquidator's hands, and may wish to claim against assets in the hands of a successor trustee.
56. In *Kite v Mooney*, a company ceased to be trustee, under a clause in the deed removing it upon an insolvency event. To paraphrase the reasons for judgment:
  - (a) it nevertheless remained a bare trustee and held the assets of the Trust;
  - (b) its duties, rights and powers were limited to protecting the trust assets; and
  - (c) as bare trustee, it retained its right of indemnity or exoneration and its lien over the assets of the trust.<sup>17</sup>

## **2.9 Liquidator's fees, liquidator's lien**

57. The position was stated recently in *Parker v Dengi Pty Ltd (In liq)*:<sup>18</sup>

*Where non-trust assets are available, a liquidator's remuneration and expenses in relation to work done for the purpose of winding up a company's affairs should be paid out of that property. But, where non-trust assets are not available and a*

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<sup>16</sup> *Kite v Mooney* [2017] FCA 653; 121 ACSR 158, [57].

<sup>17</sup> *Kite v Mooney* [2017] FCA 653; 121 ACSR 158, [57]. A similar situation arose in *Parker v Dengi Pty Ltd (In liq)* [2018] FCA 444, [30].

<sup>18</sup> [2018] FCA 444, [36].

*liquidator would not otherwise be required to undertake that work, it would normally be appropriate for the cost of the work to be paid from trust assets ...*

58. That simple formulation, accurate enough to dispose of a plain case, belies a difficult debate that has taken decades to work out.<sup>19</sup> Below, I refer to another passage, indicating the doubts that relatively common cases can throw up. See heading 5.
59. A liquidator has a lien for fees and expenses. That cannot rise above the right to claim such fees and expenses.<sup>20</sup>

### **2.10 Crown priority re-asserted**

60. Crown priority has been abolished, in form.
61. The Crown nevertheless uses mechanisms that give it priority over unsecured creditors, and sometimes over secured creditors.
62. In the context of tax, there have been recent cases about special obligations of a trustee to account first to the Commissioner for tax; and about garnishee notices.
63. In the broader context of insolvency - and thus not discussed below - a State government may apparently enact a law defeating corporate law priority creditors (such as employees). The case concerned clean-up costs of a mining development.<sup>21</sup>
64. This trend can only continue.

## **3 Ability to exclude the indemnity against the fund**

65. The first question for the liquidator is whether the company under administration has a right against the trust property.

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<sup>19</sup> *McPherson's Law of Company Liquidation* para [8.2490].

<sup>20</sup> As to the existence of the lien, see *Nationwide News Pty Ltd v Almona Pty Ltd* (1988) 6 ACLC 84, and authorities cited there.

<sup>21</sup> *Linc Energy Ltd (In Liq), Re; Longley v Chief Executive Dept of Environment & Heritage Protection* [2017] 2 Qd R 720 (2017) 318 FLR 262; (2017) 120 ACSR 86; [\[2017\] QSC 053](#). Reversed *Longley v. Chief Executive, Department of Environment and Heritage Protection & Anor; Longley & Ors v Chief Executive, Department of Environment and Heritage Protection* [\[2018\] QCA 32](#). Special leave application understood to be pending, to the High Court of Australia.

### 3.1 Statutory right of indemnity from fund - Queensland

66. Under Queensland statute, the trustee may reimburse itself:<sup>22</sup>

*... for or pay or discharge out of the trust property all expenses reasonably incurred in or about the execution of the trusts or powers.*

67. There has been controversy about the ability nevertheless to exclude, where Queensland law applies.

68. In any case, if concerned to avoid the Queensland statute, the drafter adopts another State's law. The proper law of the trust is determined in manner analogous to the proper law of a contract. Parties may contract for a particular system of law to apply. Thus, the deed may specify the particular system of law chosen to regulate the trust.<sup>23</sup>

69. The choice, in contract, must be *bona fide*, not contrary to public policy.<sup>24</sup> Presumably, this is also true for choice of law of a trust. Debate about application of the choice of law rule ensues.<sup>25</sup> As between the different States, the *Hague Convention on the Law Applicable to Trusts and on their Recognition* does not apply.<sup>26</sup>

### 3.2 Whether possible to exclude in any case

#### 3.2.1 Conflict in Australia

70. The Full Court of Queensland said in *Kemtron*:<sup>27</sup>

*The right of the trustee to indemnity from the assets is an incident of the office of the trustee and is inseparable from it ...*

<sup>22</sup> [Trusts Act 1973 \(Qd\), s 72](#)

<sup>23</sup> *Augustus v Permanent Trustee Co (Canberra) Ltd* [1971] HCA 25; (1971) 124 CLR 245; 45 ALJR 365; [1971] ALR 661

<sup>24</sup> *Golden Acres Ltd v Queensland Estates Pty Ltd* [1969] Qd R 378 (Hoare J), upheld on other grounds in *Freehold Land Investments Ltd v Queensland Estates Pty Ltd* [1970] HCA 31; (1970) 123 CLR 418; 44 ALJR 329

<sup>25</sup> The main context of the debate at present is, however, not insolvency, but choice in favour of South Australian law for the purposes of avoiding the rules against perpetuities and accumulations.

<sup>26</sup> As between Australia, and other signatories to that Convention, see the Commonwealth legislation, [Trusts \(Hague Convention\) Act 1991 \(Cth\)](#).

<sup>27</sup> *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (Qld)* [1984] 1 Qd R 576, 585; 84 ATC 4380; (1984) 15 ATR 627 (Andrews SPJ, DM Campbell & McPherson JJ). This proposition is in the judgment of McPherson J, Andrews SPJ concurring.

71. The Victorian Supreme Court, in *RWG Management*, decided that it was possible to exclude the right.<sup>28</sup>
72. The New South Wales Supreme Court, in *JA v Jonco*, thought not.<sup>29</sup> But Santow J did not refer to the Victorian decision.<sup>30</sup>
73. The Western Australian Court of Appeal said that the indemnity could be excluded.<sup>31</sup>
74. That Court relied, in part, on the statutory context in Western Australia.<sup>32</sup>
75. And that Court pointed to the similar statutory context in Victoria, in discussing the Victorian decision.<sup>33</sup>
76. But that Court did not confine its reasoning by reference to a particular statutory regime.<sup>34</sup>
77. The only reservation by that Court was:<sup>35</sup>
- ... if the purpose of excluding or releasing the trustee's right of indemnity is fraudulently to defeat creditors' rights, the exclusion or release may be set aside on their application.*
78. The mechanism for setting aside the exclusion or release is unexplained.<sup>36</sup> Western Australia has the equivalent of the Statute 13 Eliz. c.5, dealing with an alienation made with intent to defraud creditors.<sup>37</sup>

<sup>28</sup> *RWG Management Ltd v Commissioner for Corporate Affairs* [1985] VR 385, 395; (1984) 9 ACLR 739; [1985] VicRp 42 (Brooking J)

<sup>29</sup> *JA Pty Ltd v Jonco Holdings Pty Ltd* [2000] NSWSC 147; (2000) 33 ACSR 691, 706 (Santow J)

<sup>30</sup> *Franknelly*, below, at [226]

<sup>31</sup> *Franknelly Nominees Pty Ltd v Abrugiato* [2013] WASCA 285; (2013) 10 ASTLR 558, [235]-[242] (McLure P, Buss & Newnes JJA)

<sup>32</sup> *Franknelly Nominees Pty Ltd v Abrugiato* [2013] WASCA 285; (2013) 10 ASTLR 558, [240]

<sup>33</sup> *Franknelly Nominees Pty Ltd v Abrugiato* [2013] WASCA 285; (2013) 10 ASTLR 558, [223]-[224]

<sup>34</sup> Reference fn 31

<sup>35</sup> *Franknelly Nominees Pty Ltd v Abrugiato* [2013] WASCA 285; (2013) 10 ASTLR 558, [241]

<sup>36</sup> WA has the common provision, making a voluntary conveyance made with the intent to defraud creditors, void

<sup>37</sup> *Property Law Act 1969* (WA), s 89; and see for example s 228 *Property Law Act 1974* (Qd). The Queensland Law Reform Commission noted in 1973 that such a provision was largely overtaken by bankruptcy laws (the province of the Commonwealth), but recommended insertion to cover a few identified kinds of transactions: [16 QLRC Report](#) p.111, commenting on then clause 227. Thus see [Part 3 Sub-Part 7 Insolvency Act 2006](#) (NZ)

### 3.2.2 Resolution in Australia – it depends

79. The decision of the Western Australian Court of Appeal will be applied in other States' trial and intermediate appellate courts, at least where there is a similar statutory context, subject to later consideration by the High Court of Australia.<sup>38</sup>
80. Whether *Franknelly* is good law, beyond the statutory context of Western Australia, depends on whether there is truly a conflict between the Full Court of Queensland (*Kemtron*) and the Western Australian Court of Appeal (*Franknelly*).
81. The Western Australian Court said there was no conflict, confining the Queensland decision to its particular statutory context.<sup>39</sup>
82. The Australian controversy was noted in 2017, by the New Zealand High Court.<sup>40</sup> Heath J did not have to resolve the point.

### 3.3 Consequences for directors of excluding the indemnity – section 197<sup>41</sup>

83. The precise consequences of section 197 are yet to be worked out. The position is not assisted by the statutory history, since an amendment more than a decade ago was required to overcome a decision that a director remained liable where the trust had no assets, even if there was a full right of indemnity. The better view, in light of *obiter dicta* to the effect that the former (and perforce the current) section 197 is “only concerned with a liability incurred by the trustee in breach of trust and its operation is confined to

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<sup>38</sup> *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89; (2007) 236 ALR 209; (2007) 81 ALJR 1107; 2 BFRA 85; [\[2007\] HCA 22](#), [135]

<sup>39</sup> *Franknelly Nominees Pty Ltd v Abrugiato* [\[2013\] WASCA 285](#); (2013) 10 ASTLR 558, [242]

<sup>40</sup> *Burgess v Monk* [\[2017\] NZHC 2424](#), fn 66 (Heath J)

<sup>41</sup> [Section 197 Corporations Act 2001 \(Cth\)](#) is set out in the Schedule of extracts, heading 7.1

creditors of a trust”;<sup>42</sup> or possibly where some other deliberate step has been taken to deny a right of indemnity, such as writing it out of the trust deed.<sup>43</sup>

## 4 Which Rule Book Applies?

84. The question here is statutory priorities under the *Corporations Act* as against the principle that equity is equality.
85. Decisions of the New South Wales and Victorian Supreme Courts, in 2016 and 2017, concluded that the liquidator of the trustee, having a right of indemnity from, and a lien over, trust assets (in priority over the interests of the beneficiaries) for liabilities incurred by the trustee acting as such nevertheless had to administer those assets in disregard of the statutory priority under section 556 (for example in favour of employee liabilities). The creditors shared equally in the trust assets, after providing for the costs of administration.<sup>44</sup>
86. Those single judge decisions have not been followed by two Full Courts.
87. In *Re Amerind*, Robson J reasoned (underlining added):

*53. The Commonwealth, liquidator, and the receivers claim that the trustee's right of indemnity is “property of the company.” As the cases below establish, the trust assets, at all times, remain trust assets. The trust assets may be used to indemnify creditors for liabilities incurred on behalf of the trust. The trust creditors themselves have equitable rights to be subrogated to the rights of the trustee to be indemnified from the trust assets. The trustee's right of indemnity and related lien do not become “property of the company” and are not available to meet other liabilities of the company. Rather, the right of indemnity and lien may only be used to satisfy liabilities incurred on behalf of the trust.*

*54 In the case of a company that acts solely as a trustee (such as Amerind), liabilities could be incurred by the trustee personally, for which the trustee would not be entitled to an indemnity from the trust assets, if, for example, the trustee*

<sup>42</sup> *Edwards v Attorney-General* (2004) 208 ALR 605; 60 NSWLR 667; 50 ACSR 122; 22 ACLC 1177; [2004] NSWCA 272, [145].

<sup>43</sup> [Section 197\(1\)\(b\)\(iii\)](#).

<sup>44</sup> *Re Independent Contractor Services (Aust) Pty Ltd (In liq) (No. 2)* [2016] NSWSC 106; 305 FLR 222, [25]. Also see *Re Amerind Pty Ltd (In liq)* [2017] VSC 127; 320 FLR 118. The latter case became *Commonwealth v Byrnes*, above. *Re Independent Contractor Services* was followed in 2 Federal Court decisions, as well. See the history in the Honourable Justice Black’s [paper](#), presented to the NSW Bar Association on 11 April 2018 on “Recent developments in Corporations and Insolvency Law”, p 5 fn 8. His Honour mentions *Woodgate, in the matter of Bell Hire Services Pty Ltd (in liq)* [2016] FCA 1583; *Kite v Mooney, in the matter of Mooney’s Contractors Pty Ltd (in liq) (No 2)* [2017] FCA 653.

*acted improperly beyond its powers as a trustee. Such creditors would not be entitled to be subrogated to the trustee's right of indemnity over the trust assets that it may otherwise have had. A trustee's right of indemnity is conditional on the trustee's account with the beneficiaries being clear, thus if a trustee is under an obligation to make good some loss or damage arising from a breach to the trust, such obligation would be deducted from the right of indemnity (and the related right of subrogation).*

...

*79 ...the issue of whether the right of indemnity of the trustee may constitute property of the company, has been subject to considerable judicial consideration and differing views. As discussed below, the better view is that where a company acts solely as a trustee and has no assets of its own, it does not.*

88. For the appeal from that decision, the Victorian Supreme Court constituted a panel of 5.<sup>45</sup> *Commonwealth v Byrnes* (as *Amerind* became) overturned Robson J's decision (on priorities).
89. Essentially, the unanimous decision says that the right of indemnity was, relevantly, property of the company.<sup>46</sup> Being property of the company, the statutory priorities regime applies.<sup>47</sup>
90. Separately, there had been a question reserved by a judge of the Federal Court of Australia, to a Full Court, about similar issues.<sup>48</sup> The Full Federal Court followed *Commonwealth v Byrnes* in essentials: *Killarnee*.<sup>49</sup>
91. There are divergences. I come back to that.
92. Special leave to appeal from the decision of the Victorian Court of Appeal has been sought. It is thought that other matters, including the appeal in the bankruptcy matter,

<sup>45</sup> There was no appeal from the NSW Supreme Court decision.

<sup>46</sup> *Commonwealth v Byrnes* [2018] VSCA 41; 124 ACSR 246, [96]

<sup>47</sup> *Commonwealth v Byrnes* [2018] VSCA 41; 124 ACSR 246, [276]

<sup>48</sup> A curiosity of that procedure was that the Full Federal Court, exercising original jurisdiction, was – on one view – essentially bound by the decision of an intermediate appellate court, the Victorian Court of Appeal, in *Commonwealth v Byrnes*.

<sup>49</sup> *Jones v Matrix Partners Pty Ltd; in the matter of Killarnee Civil & Concrete Contractors Pty Ltd (in liq)* [2018] FCAFC 40; 124 ASCR 568

*Lane v Deputy Commissioner of Taxation*,<sup>50</sup> are held up waiting for the High Court of Australia's decision on special leave (initially).

93. The remaining divergences centre around treatment of two older, Full Court decisions, *Re Enhill*<sup>51</sup> and *Re Suco Gold*.<sup>52</sup> The Honourable Justice Black, of the New South Wales Supreme Court, has said, extra-judicially:<sup>53</sup>

*An understanding of the controversy requires reference to differing approaches taken in earlier case law. In Re Enhill Pty Ltd ..., a liquidator sought an order that he could utilise trust assets in discharging his remuneration costs and expenses. The Full Court of the Supreme Court of Victoria made that order, holding that the trustee's right of indemnity was property of the company for the purposes of a predecessor to s 556 of the Corporations Act (which specifies the statutory order of priorities for distribution of property in a winding up) and also that the proceeds could be divided between the trustee's creditors generally. A different view was then taken in Re Suco Gold Pty Ltd (in liq) ..., where King CJ accepted that, in a winding up, the debts of a trust could be paid in accordance with the provisions of the then Companies Act 1962 (SA). The Chief Justice also distinguished between the right of recoupment (or reimbursement for trust debts previously paid by the trustee) and its right of exoneration (in relation to trust debts not yet paid) and held that the proceeds of the exercise of a right of recoupment would be available for division among creditors generally, but the proceeds of a right of exoneration could only be distributed among trust creditors. The former proposition appears to be settled and the latter has been controversial. Jacobs J also held that the relevant provisions of the Companies Act apply to trust debts and Mathieson J agreed with both King CJ and Jacobs J.*

94. Before discussing that divergence, it is also necessary to say that Derrington J, in *Lane v Deputy Commissioner of Taxation*,<sup>54</sup> has favoured the approach in *Suco*, that proceeds of a right of exoneration could only be distributed to trust creditors.<sup>55</sup>

<sup>50</sup> [2017] FCA 953; 253 FCR 46. The last order in the pending appeal, QUD514/2017, on 9 May 2018, stood it over for case management on 27 August 2018. It is not known how widespread the effects are. At least one matter in my chambers is being stood over from time to time (and has been for months) awaiting resolution of the appeal, first to the Victorian Court of Appeal, and now from the Victorian Court of Appeal, by the High Court of Australia.

<sup>51</sup> [1983] VicRp 52; [1983] 1 VR 561; (1982) 7 ACLR 8; (1982) 1 ACLC 415 (FC)

<sup>52</sup> (1983) 33 SASR 99; (1983) 7 ACLR 873; (1983) 1 ACLC 895 (FC)

<sup>53</sup> The Honourable Justice Black's [paper](#), presented to the NSW Bar Association on 11 April 2018, "Recent developments in Corporations and Insolvency Law", p 4

<sup>54</sup> [2017] FCA 953; 253 FCR 46. The last order in the pending appeal, QUD514/2017, on 9 May 2018, stood it over for case management on 27 August 2018. It is not known how widespread the effects are. At least one matter in my chambers is being stood over from time to time (and has been for months) awaiting resolution of the appeal, first to the Victorian Court of Appeal, and now from the Victorian Court of Appeal, by the High Court of Australia.

<sup>55</sup> [2017] FCA 953; 253 FCR 46, [98], [121]

95. *Suco*, a decision of the Full Court of South Australia, was considered by the Victorian Court of Appeal, in *Commonwealth v Byrnes*.<sup>56</sup> But the Full Federal Court, in *Killarnee* appears to favour Derrington J's approach. Farrell J said:

*I would emphasise Allsop CJ's conclusion at [69]: trust assets are not property of the company, but the trustee's right of exoneration supported by the lien in the character of a proprietary interest is. It is, however, property of a particular character, with its content and shape determined by the purpose for which it came into existence — the payment of creditors the liability to whom was incurred in executing the trust. The reasoning of Derrington J in Lane v Deputy Commissioner of Taxation [2017] FCA 953 is consistent with this reasoning. I prefer Derrington J's approach to that adopted by the Victorian Court of Appeal in ... [Commonwealth v Byrnes] at [274]–[281].*

96. This leaves the position open to further argument. A peculiarity of the Full Federal Court having exercised original jurisdiction in *Killarnee* is that they were arguably bound by the marginally earlier decision in *Commonwealth v Byrnes* (as the Victorian Court of Appeal was exercising appellate jurisdiction).

## 5 Liquidators' remuneration

97. It is possible to give a flavour of the position in relation to liquidators' remuneration, by quoting a passage from the bankruptcy case, *Lane v Deputy Commissioner of Taxation* [paragraphing added]:<sup>57</sup>

*The parallel principles found in Berkeley Applegate and Re Universal Distributing provide a much surer foundation to support an order that an insolvency administrator have recourse to trust assets or to the right of exoneration to meet the costs, expenses and remuneration of their administration.*

*Generally, there will be no need to distinguish between the two principles as they each cover the relevant expenses under consideration.*

*It should, however, be kept in mind that much will depend upon the circumstances of the case.*

*In most cases where the trust, itself, is insolvent in the sense that the right of exoneration overwhelms the beneficiaries' interests in the assets held on trust, no great difficulty arises.*

*The insolvency regimes require that the trust creditors be paid in the course of the liquidation or administration and, for that to occur, the trust itself needs to be wound up.*

<sup>56</sup> [\[2018\] VSCA 41](#); 124 ACSR 246

<sup>57</sup> [\[2017\] FCA 953](#); 253 FCR 46, [187]

*Consequently, the insolvency administrators are entitled to be paid from the fund they create for the purposes of applying the right of exoneration.*

*Where, in such a case, the only business of the trustee was to operate the trust, there are good arguments in favour of the view that all the costs of the administration can be paid out of the fund created to meet the right of exoneration (Re Reehal Holdings Pty Ltd (in liq) [2017] FCA 793 at [29]).*

*Where, however, the insolvent trustee has other non-trust creditors, only those amounts referable to the creation of a fund and the payment of trust creditors might be met from the fund so created.*

*Further, where a right of exoneration does not exist at all, there are likely to be strong arguments to the effect that the liquidators will not be entitled to access any trust funds to meet their costs, expenses and remuneration of the administration.*

98. Therefore, liquidators are making special applications for directions, as to remuneration, still.

## 6 Re-assertion of Crown priority

99. Crown priority has disappeared, formally, in most respects.
100. It re-emerges through the backdoor.
101. A few recent instances may strike a resonance, or at least put us on guard against unwarranted Crown claims to stand ahead of ordinary creditors.
102. Thus, the *Linc Energy* litigation, which would have placed mining make-good expenses ahead of the Commonwealth's statutory priorities, emerged through a hole in Queensland's referral, to the Commonwealth, of powers over corporations.
103. In the tax sphere, the Commonwealth Commissioner has rediscovered priorities such as the requirement<sup>58</sup> for a *trustee* (which, as defined, includes a liquidator) to retain monies coming to his or her hands:<sup>59</sup>

*He or she is hereby authorized and required to retain from time to time out of any money which comes to him or her in his or her representative capacity so much as is sufficient to pay tax which is or will become due in respect of the income, profits or gains.*

<sup>58</sup> [Section 254\(1\)\(d\) Income Tax Assessment Act 1936 \(Cth\)](#). See attached extract.

<sup>59</sup> *Commissioner of Taxation v Australian Building Systems Pty Ltd (in liq)* [2015] HCA 48; (2015) 257 CLR 544; (2015) 326 ALR 590; (2015) 90 ALJR 151; (2015) 102 ATR 359; (2015) 110 ACSR 228

104. Recently the Commonwealth rediscovered<sup>60</sup> priority and compliance provisions applicable to executors and administrators,<sup>61</sup> which has been rejuvenated in modern drafting in the Schedule to the *Taxation Administration Act 1953* (Cth).
105. These two sets of provisions introduce uncertainty into the administration of trusts, estates, and (given the statutory definition of *trustee*) all liquidations where there is a gain or income. Despite section 254 having been to the High Court in 2015, the case left as many questions unanswered as were answered.
106. But, apart from section 254, the developments highlighted under this heading, thus far, have no peculiar operation only in corporate insolvency. (Section 254 does have such potential operation, but causes intractable problems.)
107. Tax collection from corporate trustees can give rise to nice questions, where the authority uses a garnishee notice. There appears to be some conflict between State and Federal jurisprudence now. The Queensland Court of Appeal, in *Can Barz*, considered that a garnishee (issued under State tax laws) could not defeat the interests of beneficiaries, where the garnishee notice was in respect of tax owed<sup>62</sup> by trustees (but not in respect of anything done on account of the trust):<sup>63</sup>

*It is clear that the proceeds of the sale of the real property, if now in the hands of Ms Bird and Mr Scott, could not be seized in the enforcement of a judgment against them for the unpaid tax and nor would those moneys be available to their creditors if they were made bankrupt. Further and importantly, they could not choose to pay those moneys to the Commissioner because such a payment would contravene s 62 of the SIS Act as well as the terms of the deed. In no sense therefore would these moneys in the taxpayers' hands be available in any lawful way for payment of their tax debt. Just as these moneys would not have been accessible to the Commissioner under the garnishee process, so are they unavailable by means of s 50.*

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<sup>60</sup> See the practical compliance guideline, in draft at time of writing, [PCG 2017/D12](#).

<sup>61</sup> Sections 260-145 and 260-150 of Schedule 1 to the *Taxation Administration Act 1953* (TAA)

<sup>62</sup> The tax was, it was said, owed by 2 individuals as trustees, by way of a very extended means of collection of payroll tax from all members of a "group".

<sup>63</sup> *Commissioner of State Revenue v Can Barz Pty Ltd (No 2)* [\[2017\] 2 Qd R 537](#), [82]

108. But to get there, the Queensland Court of Appeal had to explain a difficult passage in an earlier decision of the Federal Court of Australia, *Ultra Thoroughbred Racing Pty Ltd v Federal Commissioner of Taxation*.<sup>64</sup>
109. In the Federal Court, Pagone J had said that the garnishee notice, issued to the racing authority (in respect of the winning manager's tax debts) was ineffective. This was so since, contractually, the prize-money never belonged to the manager, Mr Buckley. It belonged to the owner of the horse, Ultra.
110. But Pagone J had gone on to comment that the situation may be different if the contract (relating to the prize-money) conferred "a direct benefit" upon Mr Buckley "with an interest to protect".<sup>65</sup> Precisely what that means still needs to be worked out.
111. I argued this for the Revenue, in *Can Barz* on an urgent, preliminary hearing.<sup>66</sup> At that stage, the trustees seemed to be saying that they evaded Pagone J's *dictum* as they, like Mr Buckley in *Ultra*, were bare trustees. I ran a case that they did benefit from ownership of the custodial property, as they had access to a right of indemnity; and were no mere bare trustees, but had some active duties.<sup>67</sup>
112. These developments in relation to trust property, which tend to arise in financial distress and in insolvency administration, look like re-assertion of foresworn Crown priority.
113. It remains to be seen whether that becomes a trend beyond Australia.

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9 June 2018

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<sup>64</sup> [\[2013\] FCA 1300](#); [2013] FCR 1300; (2013) 96 ATR 117; 2013 ATC 20-428

<sup>65</sup> [\[2013\] FCA 1300](#); [2013] FCR 1300; (2013) 96 ATR 117; 2013 ATC 20-428, [11]

<sup>66</sup> That hearing did not proceed to judgment on the merits.

<sup>67</sup> *ISPT Nominees Chief Commissioner of State Revenue* (2003) 59 NSWLR 196; (2003) 12 BPR 22,941; 2003 ATC 4697; (2003) 53 ATR 527; [\[2003\] NSWSC 697](#), [278], [280], [281]. Those passages are omitted from the authorised report.

## 7 Schedule – extracts from Acts

### 7.1 Section 197 Corporations Act

#### 197 Directors liable for debts and other obligations incurred by corporation as trustee

- (1) A person who is a director of a corporation when it incurs a liability while acting, or purporting to act, as trustee, is liable to discharge the whole or a part of the liability if the corporation:
- (a) has not discharged, and cannot discharge, the liability or that part of it; and
  - (b) is not entitled to be fully indemnified against the liability out of trust assets solely because of one or more of the following:
    - (i) a breach of trust by the corporation;
    - (ii) the corporation's acting outside the scope of its powers as trustee;
    - (iii) a term of the trust denying, or limiting, the corporation's right to be indemnified against the liability.

The person is liable both individually and jointly with the corporation and anyone else who is liable under this subsection.

Note: The person will not be liable under this subsection merely because there are insufficient trust assets out of which the corporation can be indemnified.

- (2) The person is not liable under subsection (1) if the person would be entitled to have been fully indemnified by 1 of the other directors against the liability had all the directors of the corporation been trustees when the liability was incurred.
- (3) This section does not apply to a liability incurred outside Australia by a foreign company.
- (4) This section does not apply to a liability incurred by a registrable Australian body outside its place of origin.
- (5) This section does not apply to a corporation that is an Aboriginal and Torres Strait Islander corporation.

Note: Section 271-1 of the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* deals with the liability of directors of Aboriginal and Torres Strait Islander corporations for debts and other liabilities incurred by those corporations as trustee.

## 7.2 Section 254 Income Tax Assessment Act 1936

### 254 Agents and trustees

- (1) With respect to every agent and with respect also to every trustee, the following provisions shall apply:
- (a) He or she shall be answerable as taxpayer for the doing of all such things as are required to be done by virtue of this Act in respect of the income, or any profits or gains of a capital nature, derived by him or her in his or her representative capacity, or derived by the principal by virtue of his or her agency, and for the payment of tax thereon.
  - (b) He or she shall in respect of that income, or those profits or gains, make the returns and be assessed thereon, but in his or her representative capacity only, and each return and assessment shall, except as otherwise provided by this Act, be separate and distinct from any other.
  - (c) If he or she is a trustee of the estate of a deceased person, the returns shall be the same as far as practicable as the deceased person, if living, would have been liable to make.
  - (d) He or she is hereby authorized and required to retain from time to time out of any money which comes to him or her in his or her representative capacity so much as is sufficient to pay tax which is or will become due in respect of the income, profits or gains.
  - (e) He or she is hereby made personally liable for the tax payable in respect of the income, profits or gains to the extent of any amount that he or she has retained, or should have retained, under paragraph (d); but he or she shall not be otherwise personally liable for the tax.
  - (f) He or she is hereby indemnified for all payments which he or she makes in pursuance of this Act or of any requirement of the Commissioner.
  - (g) Where as one of 2 or more joint agents or trustees he or she pays any amount for which they are jointly liable, each other one is liable to pay him or her an equal share of the amount so paid.
  - (h) For the purpose of insuring the payment of tax the Commissioner shall have the same remedies against attachable property of any kind vested in or under the control or management or in the possession of any agent or trustee, as the Commissioner would have against the property of any other taxpayer in respect of tax.
- (2) Subsection (1) applies to the following in the same way as it applies to tax:
- (a) the general interest charge under:
    - (i) section 163AA, former section 170AA, former subsection 204(3), former subsection 221AZMAA(1), former subsection 221AZP(1), former subsection 221YD(3) or former section 221YDB of this Act;
    - (ii) section 5-15 of the *Income Tax Assessment Act 1997*;
  - (b) additional tax under former Part VII of this Act;
  - (c) shortfall interest charge.
- Note 1: The general interest charge is worked out under Part IIA of the *Taxation Administration Act 1953* and shortfall interest charge is worked out under Division 280 in Schedule 1 to that Act.
- Note 2: Subsection 8AAB(4) of that Act lists the provisions that apply the general interest charge.
- (3) In paragraphs (1)(d) and (e), and in its first occurrence in paragraph (1)(h), **tax** includes, in addition to the things mentioned in subsection (2):
- (a) trustee beneficiary non-disclosure tax within the meaning of Division 6D of Part III; and
  - (b) general interest charge payable under section 102UP in respect of such tax.