PS LA 2012/2 - Change of trustee

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Law Administration Practice Statement

PS LA 2012/2

This Practice Statement is an internal ATO document and an instruction to ATO staff.

Taxpayers can rely on this Practice Statement to provide them with protection from interest and penalties in the following way. If a statement turns out to be incorrect and taxpayers underpay their tax as a result, they will not have to pay a penalty, nor will they have to pay interest on the underpayment provided they reasonably relied on this Practice Statement in good faith. However, even if they do not have to pay a penalty or interest, taxpayers will have to pay the correct amount of tax provided the time limits under the law allow it.

SUBJECT: **Change of trustee**

PURPOSE: **To advise ATO staff of the approach to be taken in the raising and recovery of income tax and goods and services tax liabilities of a trust where there is a change of trustee during or following an income year or a tax period.**

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BACKGROUND

1. Under trust law, all trustees, corporate or otherwise, are:

   - personally liable for the debts of the trusts they administer[1], and

[1] *Vacuum Oil Company Pty Ltd v Wiltshire* [1945] HCA 37 (*Vacuum Oil*); *Octavo Investments Pty Ltd v Knight* [1979] HCA 61.

- entitled to be indemnified out of the trust property for liabilities incurred in the proper exercise of the trustee's powers (except where a breach of trust has occurred).

2. Similarly, for tax purposes, trustees are personally liable for tax debts assessed to them on behalf of a trust.[2] However, a question arises as to which trustee of a trust has a tax-related liability when a change of trustee occurs before or after the time at which the tax-related liability arose.

3. This issue has practical implications in terms of identifying the trustee to whom a notice of assessment should be issued and the form that the notice should take. It also affects the way in which we should seek to recover debts, including how litigation procedures are to apply.

SCOPE

4. Although the definitions of 'trustee' in various taxing Acts are broad enough to include a trustee appointed over the estate of an entity under the *Bankruptcy Act 1966* or an external administrator under the *Corporations Act 2001*, this Practice Statement does not apply where such a trustee or external administrator is replaced due to death, disqualification or for any other reason.

5. In some instances, a former or successor trustee or external administrator may wish to seek our guidance on whether they are liable for a particular tax-related liability as a result of their appointment or otherwise.

6. Given the range of situations that can arise in practice, you should escalate enquiries of this nature to your business line's Technical Leadership and Advice (TLA) area in the first instance.

STATEMENT

7. The trustee at the end of the income year or tax period is the entity that has the tax-related liability (as defined in section 255-1 of Schedule 1 to the *Taxation Administration Act 1953*) for income tax or goods and services tax (GST) for that period. This is the case even if there has been a change of trustee during, or after, the relevant income year or tax period.

8. All legislative references in this Practice Statement are to Schedule 1 to the *Taxation Administration Act 1953*, unless otherwise indicated.

9. Any notice of assessment should be served on that trustee.

Example 1 – income tax – change of trustee after the end of an income year

10. *Joan Jones is the trustee of the Jones Family Trust (a discretionary trust). During the 2010–11 income year, as trustee she derives interest income. Joan does not appoint any of the income to any objects of the trust (and there are no beneficiaries who benefit as takers in default of appointment). As there are no beneficiaries presently entitled to the income of the trust for the 2010–11 income year, the net income of the trust will be assessed to the trustee.*

11. *On 2 July 2011, after the end of the 2010–11 income year, Joan retires as trustee and Jones Co becomes the trustee of the trust. The liability for tax in respect of the net income of the trust estate for the 2010–11 income year rests with Joan, although it only becomes payable at a time when she is no longer trustee.*

[2] Section 254 of the *Income Tax Assessment Act 1936*.

Example 2 – income tax – change of trustee during an income year

12. *Assume the same facts as in Example 1 of this Practice Statement, except that Joan retires as trustee and is replaced by Jones Co on 29 June 2011, before the end of the 2010–11 income year. Neither Joan nor Jones Co is required to pay, pay as you go (PAYG) instalments under Division 45 in relation to the 2010–11 income year.*

13. *Jones Pty Ltd has the liability for tax in respect of the net income of the trust estate because it is the trustee at the end of the 2010–11 income year, notwithstanding that it was not the trustee when most of the interest income was derived. Jones Co has a tax-related liability in respect of the net income of the trust for the 2010–11 income year, because it was the trustee at the end of that year and no beneficiary was presently entitled to the income of the trust by that time.*

Example 3 – GST

14. *The Arnold Family Trust accounts for GST on a quarterly basis. For the tax period ending 30 June 2011, it has a net amount payable and accordingly a tax-related liability arises at that time. Ants Co is the trustee of the trust at the end of the tax period but retires on 1 July 2011 and is replaced by Aardvark Co. Ants Co is the trustee liable for the net amount for the tax period ending 30 June 2011, even though the net amount is not due and payable until 28 July 2011.*

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15. The time at which any tax-related liability (other than income tax and GST) arises varies according to the legislative provision that imposes the particular liability, which may not be at the end of an income year or a tax period. The entity that is the trustee at the time the particular tax-related liability arises will have that liability.

Example 4 – PAYG withholding

16. *Assume the same facts as in Example 3 of this Practice Statement. Ants Co, in its capacity as trustee of the Arnold Family Trust, makes payments up to 30 June 2011 from which it is required to withhold PAYG amounts under Division 12. Ants Co is liable to pay the withheld amounts to us and is liable for any related penalty for failure to do so, even though the amount is not due to be paid until Aardvark Co has become trustee of the Arnold Family Trust.*

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17. You must follow the principles and guidelines outlined in this Practice Statement to ensure that a consistent approach is applied in the assessment and recovery of liabilities attributable to trustees. The advice set out in this Practice Statement should be applied in respect of income years and tax periods commencing both before and after its date of issue.

18. However, in cases where a former trustee contests its liability to pay tax on the grounds that its successor as trustee is liable and a time limit of some kind (whether or not it is in the tax law) might inhibit recovery from the succeeding trustee if no further action is taken until that contest is resolved, consideration

should be given to joining the successor trustee or taking such other action as is necessary to protect the position of the revenue.

19. If you are uncertain about which trustee should be assessed in relation to tax-related liabilities (other than income tax, GST and PAYG withholding) or have other questions relating to the advice in this Practice Statement, you should escalate the issue to their business line's TLA area in the first instance.

EXPLANATION

Liability to income tax

20. Only a legal person can owe a debt and be sued for it. A trust is not a legal person; it is a fiduciary relationship subject to which property is held.[3] It is the trustee of a trust, being a legal person that can incur legal obligations such as debts and other liabilities for the purposes of the trust.[4]

21. Section 255-1 provides that a tax-related liability is a pecuniary liability to the Commonwealth arising directly under a taxation law (including a liability the amount of which is yet to be determined).

22. In situations where a tax-related liability has arisen in respect of a trust but there has been a change of trustee during the year or period to which the liability relates, or following that year or period (before or after the liability becoming payable), a question arises as to which trustee or trustees have the particular tax-related liability.

23. Division 6 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) (Division 6) contains specific rules for the taxation of the income of trusts. The scheme of Division 6 is that 'net income' (which is broadly the taxable income of the trust) is calculated in respect of a trust estate for a year of income. Liability for income tax in respect of the net income may fall on either the trustee or the beneficiary depending on the extent to which there are beneficiaries presently entitled to the income of the trust estate at the end of the relevant income year.[5]

24. Under Division 6[6], a trustee is only liable to pay tax in respect of the net income of a trust estate if:

- it is not assessed to a beneficiary (sections 99 and 99A of the ITAA 1936)[7]
- a beneficiary who is otherwise assessable is under a legal disability or is a non-resident at the end of the income year (section 98 of the ITAA 1936), or
- the trust can be revoked or altered or the trust is for an unmarried minor (section 102 of the ITAA 1936).

25. 'Net income' is a central concept in Division 6 and is the foundation for determining the liability to tax of either a beneficiary or the trustee. Net income

[3] See Hayton, D, Matthews, P, Mitchell, C (2007) *Underhill and Hayton Law relating to trusts*, LexisNexis Butterworths, Australia p. 2; *Commissioner of State Taxation v Merifield Cooksey Holdings Pty Ltd & Anor* [1994] WASC 600 at [26]; *David Christie as Trustee for the Moreton Bay Trading Company and Commissioner of Taxation* [2004] AATA 1396 at [22–23].

[4] See, for example, *Labouchere v Tupper* (1857) 14 ER 670, *Deancrest Nominees Pty Ltd v Nixon* [2007] WASC 304 in particular at [5] and [36], per Newnes J.

[5] See *Colonial First State Investments Limited v Commissioner of Taxation* [2011] FCA 16 at [32], together with sections 95A and 101 of the ITAA 1936.

[6] Subject to Division 6E of Part III of the ITAA 1936.

[7] With appropriate modifications for so much of the net income as is not attributable to sources in Australia in respect of which a non-resident beneficiary (or the trustee in respect of a non-resident beneficiary) would otherwise be assessed.

as defined in subsection 95(1) of the ITAA 1936 is the total assessable income of the trust estate calculated as if the trustee were a resident taxpayer in respect of that income less (with some exceptions) all allowable deductions.

26. The net income of a trust estate as defined in section 95 of the ITAA 1936 can only be calculated as at the end of an income year, as it is only at that point in time that it is possible to determine all the assessable income and allowable deductions of the trust for that year. As Barwick CJ observed in *Union Fidelity Trustee Co (Aust) Ltd v Commissioner of Taxation* [1969] HCA 36[8]:

> The time as at which to determine the assessable income of a taxpayer is in general the concluding day of the taxation year. There is no provision which takes the calculation under s. 95 in that respect out of the general scheme of the Act.

27. It is at that time, the close of the income year, when the net income of the trust estate can be assessed to beneficiaries, or to the trustee as described in paragraph 24 of this Practice Statement.[9] Not only is this consistent with the legislative scheme of Division 6, but also with the basic position under the income tax law that a taxpayer's obligation to pay tax comes into existence on 30 June of the year of income in which the income was derived – even though no amount is due and payable and enforceable as a debt until an assessment issues.[10]

28. Consistent with this legislative scheme and basic proposition, where Division 6 operates to impose a liability to tax on the trustee of a trust estate, it is the entity which held the office of trustee at the end of the relevant income year which is the entity to be assessed and liable to pay tax.

Liability to GST

29. For GST purposes, every entity that is registered (or required to be registered) under the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) has a tax period that applies to it. The trustee of a trust is taken to be an entity consisting of the person or persons who are the trustees at any given time.[11] The general rule set out in section 27-5 of the GST Act is that an entity has 3-month tax periods ending on 31 March, 30 June, 30 September and 31 December in any year.

30. Although GST is payable by an entity on its taxable supplies[12], this does not create or fix a discrete liability at the time each supply is made. Rather, the sum of the GST payable on all taxable supplies attributable to a tax period is a component in the formula for working out the net amount for the tax period under section 17-5 of the GST Act. It is only at the close of the relevant tax

[8] This observation is also consistent with the High Court's reasoning in *Commissioner of Taxation v Galland* [1986] HCA 83.

[9] An obligation generally arises under Division 6 at this time, even though in some cases the quantification of that obligation may be altered by the operation of Division 6E of Part III of the ITAA 1936. However, in some cases, whether or not the trustee has a liability at all cannot be determined until after the end of the income year. For example, where the net income of the trust estate for an income year is less than or equal to the net capital gain of the trust estate in that year, the operation of Division 6E and paragraph (c) of the definition of 'share of net financial benefit' in subsection 115-228(1) of the *Income Tax Assessment Act 1997* may mean that whether or not the trustee has a liability at all cannot be determined until 2 months after the end of the income year. Such cases should be escalated to the relevant business line's TLA area in the first instance.

[10] In *Commissioner of Taxation v H* [2010] FCAFC 128, the Full Federal Court found that an obligation to pay tax is a present legal obligation as at the end of the financial year and arises independently of the issue of a notice of assessment (see [39–41]).

[11] Subsection 184-1(2) of the GST Act.

[12] See section 7-1 of the GST Act.

period that amounts of GST on taxable supplies and input tax credits can be netted off so as to determine what the net amount for that period is.

31. Section 7-15 of the GST Act provides that the 'net amount' (generally being the difference between the sum of GST payable and any entitlements to input tax credits)[13] or, in the case of tax periods commencing on or after 1 July 2012, the assessed net amount which an entity has for a tax period is the amount that the entity must pay to the Commonwealth or the Commonwealth must refund to the entity in respect of that period.

32. It is also the net amount or (in the case of tax periods commencing on or after 1 July 2012) the amount assessed as being the net amount, and not whatever GST is payable on individual taxable supplies, which is listed in table item 5 of subsection 250-10(2) as being a tax-related liability arising under the GST Act.

33. It follows from this legislative scheme that a liability in respect of a net amount arises at the end of the relevant tax period and, consistent with the position that applies for income tax purposes, it is this liability which attaches to the trustee who was the trustee at that time.[14]

The indirect tax self-assessment regime

34. The indirect tax self-assessment regime commenced on 1 July 2012. Under this regime, the Commissioner of Taxation is treated as having made an assessment of the net amount for a tax period when the GST return for that tax period is lodged.[15]

35. Section 31-5 of the GST Act requires that, if an entity is registered or required to be registered for GST purposes, it must give to us a GST return for each tax period. This provision imposes a lodgment obligation on each 'entity' as defined in section 184-1 of the GST Act, including each 'trust'. The legal obligation imposed on a trust to lodge GST returns falls to be performed by the person who is trustee of the trust at any given time.

36. It is the trustee who is in office at the end of the relevant tax period which is required to lodge the GST return for that period. It follows that it is that same trustee who is treated as having been given a notice of assessment of the net amount for that tax period.[16] It is that same trustee who becomes liable to pay the 'assessed net amount' for that tax period by the due date.

Summary of position for income tax and GST

37. There is no basis to impose liability for income tax or GST on the person who is the trustee at some later time, including at the time when an assessment is issued or an amount becomes payable. Section 250-5 makes it clear that a tax-related liability may arise for an entity before it becomes due and payable. In an income tax context, the issue and service of a notice of assessment does not give rise to the obligation to pay income tax. A notice of assessment simply makes the obligation to pay income tax a debt due to the Commonwealth and payable to the Commissioner. For GST purposes, a liability arises at the end of a tax period notwithstanding that payment of a net amount becomes due and payable at a later time (generally on the 21st day of the month following the end of a tax period).

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[13] Subsection 17-5(1) of the GST Act.

[14] See also *Eskdale South Cattle Company Pty Ltd v Deputy Commissioner of Taxation* [2013] FCA 1125 at [21], where Logan J said that a trustee's GST liability for tax a period crystallised at the end of that period.

[15] Subsection 155-15(1).

[16] Subsection 155-15(4).

38. This approach is also generally consistent with the equitable principles that apply where there has been a change of trustee. As a matter of general trust law, the authorities establish that a trustee's right of indemnity does not cease upon retirement.[17] Accordingly, where a trustee retires and a new trustee is appointed (and holds all trust assets), except in cases where a breach of trust is concerned, the former trustee is entitled to be indemnified out of the assets of the trust fund in respect of liabilities it incurred as trustee.[18] In practice, a new trustee will often be required to acknowledge this indemnity as a condition of the transfer of the trust assets to itself as the new trustee.

39. A change in the trustee of a trust does not give rise to an assumption by the new trustee of outstanding liabilities that have arisen in relation to the trust. In the ordinary case, a new trustee is not personally subject to the liabilities incurred by the former trustee.[19] Even if a new trustee did become personally liable to pay an amount to the former trustee as a result of the way in which the new trustee dealt with the trust property that would not provide a statutory basis for us to impose a liability on the new trustee directly. Our rights are against the trustee who is liable and any rights against the new trustee will be only by way of enforcement of or subrogation to the rights of the liable trustee.

40. While the matter is not free from doubt, we do not consider that the trust entity provisions in the *Income Tax Assessment Act 1997*[20] and the GST law[21] confer rights against a new trustee who has replaced a liable trustee. Those provisions are intended to ensure that a trust is treated as a continuous economic entity for the purpose of calculating the amount of tax payable in respect of that trust, and attributing it to the liable trustee, notwithstanding that there may have been a change of trustee.[22] We do not consider that those provisions change the incidence of any tax-related liability of a liable trustee or make a later trustee concurrently liable.[23]

Liability to PAYG withholding

41. Where there is a change of trustee during a tax period, it will also be necessary to establish which trustee is liable for any PAYG withholding debt or any estimates of the amounts not remitted that we may have made.

42. Section 16-70 states that an entity that withholds an amount under Division 12 must pay the amount to us in accordance with Subdivision 16-B. Division 268 enables us to make estimates of amounts not remitted as required under the PAYG withholding provisions in Part 2-5 and to recover on the basis of the estimates. Section 268-20 states that an entity must pay us the amount of the estimate if we give a notice of the estimate in accordance with section 268-15. The amount of the estimate is due and payable when we give notice of the estimate to an entity.

43. Section 16-75 sets out the due date for payment of PAYG withholding. The due date differs depending on whether the entity is a large, medium or small withholder. However, for all classifications of withholders, the due date is

[17] Heerey J in *Leo Dimos trading as Leo Dimos & Associates v Dikeakos Nominees Pty Ltd* [1996] FCA 590; 68 FCR 39 at [43].
[18] See, for example, *Re Indopal Pty Ltd* (1987) 12 ACLR 54 at [58]; 5 ACLC 278 at [280–281].
[19] McMurdo J in *Arkmill Pty Ltd v Tippers & Co Pty Ltd* [2006] QSC 248.
[20] Subsection 960-100(2) of the *Income Tax Assessment Act 1997.*
[21] Subsection 184-1(2) of the GST Act.
[22] See, for example, *AXA Asia Pacific Holdings Limited v Commissioner of Taxation* [2008] FCA 1834 at [110].
[23] However, compare *Keenhilt Pty Ltd as trustee for the CHC Services Trust and Commissioner of Taxation* [2007] AATA 2095 at [5].

determined by reference to an amount the entity withholds during a particular month.

44. It is the trustee who withheld an amount applicable to any particular withholding event during any month who has a liability in respect of the unremitted PAYG withholding. Any liability for amounts due under an estimate falls on the trustee who is believed to have withheld the unremitted PAYG withholding.

45. Notwithstanding that the liability for PAYG withholding is not imposed by the giving of a notice of assessment, it may be useful to serve a demand letter on the correct trustee as a prelude to any legal recovery action. A copy of such demand letter should also be given to the successor trustee (as the correct trustee may be entitled to indemnity by way of exoneration or recoupment from trust assets which the successor trustee holds).

Director penalties

46. The object of Division 269 is to impose a duty on directors of companies to ensure that a company:

- meets its obligations to remit amounts deducted under Subdivision 16-B or pay estimates of those liabilities under Division 268, or
- has an administrator appointed (under sections 436A, 436B or 436C of the *Corporations Act 2001*) or begins to be wound up.[24]

47. These duties are enforced by penalties equal to the unpaid amount of the company's obligations (section 269-20). The penalty amounts are then applied towards meeting the company's obligations.

48. In the context of a corporate trustee, where a change of trustee has occurred during a particular month, liability for the PAYG withholding amounts withheld would fall on the corporate trustee in office at the time the withholding event occurred. In terms of section 269-20, any director of the corporate trustee who was in office at any time between the date the withholding event occurred and the due date for payment of that amount who fails to meet the requisite obligations would be liable to a penalty. Further, any new director of the corporate trustee appointed after the due date for payment of the PAYG withholding amounts withheld would also become liable to a penalty under subsection 269-20(3) if they fail to comply with their obligations to remit those amounts within 14 days of the date of their appointment.

Styling and service of notices of assessments

49. It is our standard practice to issue notices of income tax assessments to a trustee styled in the form '*The Trustee of XXX trust*' and not in the name of the trustee. That approach is supported by the decision of the High Court in *Commissioner of Taxation v Prestige Motors Pty Ltd* [1994] HCA 39.

50. However, where there has been a change of trustee after the end of an income year and we are aware of the identity of both the former and successor trustee, the notice of assessment should be addressed to the trustee by name, as trustee of the relevant trust at the end of the relevant income year as follows:

> *XYZ Co in its capacity as trustee as at 30 June XXXX of the XXX trust*.

[24] See Part 5.6 of Division 1A of the *Corporations Act 2001*.

51. As the principal purpose of a notice of assessment is to bring to the attention of the person on whom it is served that such person is liable to pay on the due date the amount of tax assessed in the notice on the income stated in the notice[25], this process will ensure that the correct person is made aware that the notice of assessment is intended for them and that service of the notice of assessment has occurred in accordance with subsection 174(1) of the ITAA 1936.

52. A copy of the notice of assessment served on the former trustee should also be given to the successor trustee with a covering letter advising that the original notice has been served on the former trustee. This will put the successor trustee on notice that the former trustee may have a claim against the trust property arising from their right of indemnity. To this end, you should exercise care in ensuring that the original and copy of any assessment to be served in those circumstances are posted to the respective trustee's correct address for service as prescribed by section 14 of the *Taxation Administration Regulations 2017*.

53. The same process described for income tax should be followed in styling notices of assessment for GST.

System deficiency and work around

54. Our computer systems may not always support the process prescribed in this Practice Statement for styling notices to current and former trustees. Accordingly, the styling of notices may need to be manually executed.

Recovery of tax liabilities from trustees

55. Once the tax liability has been properly attributed or assessed to the correct trustee, recovery proceedings can be pursued in the normal course (see, for example, *Direen v D.C.T* [2007] FMCA 895).

56. As mentioned in this Practice Statement, a trustee is personally liable for debts incurred as trustee in the administration of a trust fund. A right of indemnity out of the trust estate arises concurrently with the incurring of such a liability. It may take the form of a right to reimburse itself for expenses reasonably and properly incurred ('a right of recoupment') or that of a right to pay expenses out of the trust fund ('a right of exoneration').[26] For the purpose of enforcing the indemnity, the trustee possesses a charge or right of a lien over those assets.[27] The nature of a trustee's rights was explained by the High Court in *Chief Commissioner of Stamp Duties (NSW) v Buckle* [1998] HCA 4 at [50] (footnotes omitted):

> …The term "trust assets" may be used to identify those held by the trustee upon the terms of the trust, but, in respect of such assets, there exist the respective proprietary rights, in order of priority, of the trustee and the beneficiaries. The interests of the beneficiaries are not "encumbered" by the trustee's right of exoneration or reimbursement. Rather, the trustee's right to exoneration or recoupment "takes priority over the rights in or in reference to the assets of beneficiaries or others who stand in that situation". A court of equity may authorise the sale of assets held by the trustee so as to satisfy the right to reimbursement or exoneration. In that sense, there is an equitable charge over the "trust assets" which may be enforced in the same way as any other equitable charge. However, the enforcement of the charge is an exercise

[25] *Taxation, Commissioner of v Bayly* [1952] HCA 31.
[26] See *Vacuum Oil*; *Custom Credit Corporation Limited v Ravi Nominees Pty Ltd* (1992) 8 WAR 42 at [52].
[27] See *Octavo Investments Pty Ltd v Knight* [1979] HCA 61; 144 CLR 360 at [367].

> of the prior rights conferred upon the trustee as a necessary incident of the office of trustee. It is not a security interest or right which has been created, whether consensually or by operation of law, over the interests of the beneficiaries so as to encumber them in the sense required by s 66(1) of the [Stamp Duties] Act.

57. The right of indemnity of a former trustee is not extinguished by replacement, resignation or retirement.[28] This right persists even after the trustee has lost possession of the trust assets.[29] The former trustee's right of indemnity may therefore be enforced by a liquidator of the former trustee or trustee in bankruptcy of the former trustee[30] on behalf of the creditors of the former trustee.

58. You should be mindful that a common law judgment against a trustee for a sum or debt, whether incurred personally or as trustee, cannot be enforced directly by common law execution levied by the judgment creditor upon trust assets.[31] However, we (along with other creditors of the trustee) are entitled to be subrogated to the rights of the trustee to indemnity out of the trust fund.

59. Accordingly, where the tax liability attaches to a former trustee, we are entitled to commence proceedings against the trustee and proceed to judgment and execution against the trustee's personal assets. If this proves fruitless, we may seek to be subrogated to the trustee's right of indemnity against the trust property.

60. As a general principle, recovery action should be initiated by way of issue of a letter of demand for payment of the relevant tax liability to the former trustee with a copy being served on the successor trustee.

61. Non-compliance with the letter of demand should lead to the issue of a summons or writ in civil proceedings against the former trustee. Legal action should then proceed to judgment and execution against the former trustee's personal assets. Where the trustee does not have sufficient assets to satisfy the debt, we should seek to be subrogated to the trustee's right of indemnity either through his own application or through the agency of a liquidator or trustee in bankruptcy.

When subrogation is available

62. Subrogation is an equitable remedy by which rights are transferred from one person to another by operation of law. As an equitable remedy, it will only be granted in appropriate circumstances.[32]

63. The effect of the grant of a remedy of subrogation to us in a trust context is that we, along with other unsecured trust creditors of the former trustee, would stand in the shoes of the former trustee. We can, therefore, have no higher right than the former trustee's right of indemnity as secured by the equitable lien or charge, and can claim no greater amount than the trustee can claim.

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[28] *Leo Dimos trading as Leo Dimos & Associates v Dikeakos Nominees Pty Ltd* [1996] FCA 590; 68 FCR 39 at [43], per Heerey J, citing *Coates v McInerney* (1992) 6 ACSR 748.

[29] Whether because they have vested in the new trustee by operation of the relevant state legislation (for example, section 15 of the *Trusts Act 1973* (Qld)) or because they have been effectively transferred or assigned to the new trustee (for example, *Statewide Developments Pty Ltd v Azure Property Group (Holdings) Pty Ltd* [2012] NSWSC 616).

[30] See *Octavo Investments Pty Ltd v Knight* [1979] HCA 61; 144 CLR 360 at [369–370].

[31] *Re Morgan; Pillgrem v Pillgrem* (1881) 18 Ch D 93 at [101]*; Jennings v Maher* [1901] 1 KB 108*; General Credits Ltd. v Tawilla Pty. Ltd.* [1984] 1 QD R 388.

[32] See Parkinson, P (1996) *The Principles of Equity*, 1st edn, Law Book Co of Australasia, Australia, p.551 and Parkinson, P (2003) *The Principles of Equity* 2nd edn, Thomson Reuters, Australia, p.557 for a list of situations where equity will not grant a subrogatory remedy; the former cited with approval by Young J in *Re Trivan Pty Ltd* (1996) 134 FLR 368.

64. Accordingly, where the balance of account between trustee and beneficiary turns out to be not in favour of the trustee, we may have no right of subrogation.[33]

65. It is not necessary for a trust creditor to pursue their common law or other rights to judgment before they can be subrogated to the trustee's indemnity against the estate. If the creditor has demanded payment from the trustee and has failed to receive payment and the circumstances are such as to lead to the reasonable conclusion that a judgment, if obtained, would be fruitless, then a subrogatory remedy may be granted.

66. The principal way of establishing that a judgment against the trustee, if obtained, would be fruitless is to show that:

    (a) we have demanded payment from the trustee but has failed to receive payment, and

    (b) the trustee's personal assets would be insufficient to meet the tax debt.

67. The value of the trust assets is not to be taken into account in this analysis; the question is whether a judgment against the trustee can be met without recourse to those assets. The value of the trustee's right of indemnity is also not to be taken into account for this purpose, given that it is the right in relation to which we seek subrogation.

68. Alternatively, if the trustee is insolvent, it would also follow that an attempt to recover the debt would be fruitless. There may also be other circumstances in which a judgment against a trustee might be considered fruitless, therefore each case will have to be considered on its own particular facts.

69. Where liability for the tax debt falls on a former trustee, the originating process for subrogation would require us to issue proceedings in their own name in the Equity Division of the relevant court of competent jurisdiction against the former trustee, seeking declaratory relief by way of subrogation to the right of the former trustee to be indemnified out of the trust assets. The current trustee (who is the legal owner of the trust assets) is also a necessary respondent in such a proceeding (see *Jacobs' Law*[34] at [2112], cited with approval by McMurdo J in *Arkmill Pty Ltd v Tippers & Co Pty Ltd* [2006] QSC 248).

70. It would not be strictly necessary to join the beneficiaries of the trust or other creditors of the trust in such a proceeding, although there may be cases where it will be appropriate to join those parties (or a representative party to ensure their interests are represented).

71. In *Jacobs' Law*[35] at [2112], it is said that the better view is that the subrogation should be enforced only in proceedings to which creditor, trustee and beneficiary are parties. The rationale is that a creditor can be no better off than the trustee and where the final balance of account between the trustee and beneficiary has not been ascertained, subrogation should only be enforced in proceedings to which the beneficiary is a party. In those circumstances, it would therefore be proper to join the beneficiary, or a representative party, where there are numerous beneficiaries in the same interest.

72. It is expected that, in such proceedings, the court would make the appropriate orders with respect to the subrogation of the right to the indemnity to ensure that the equitable remedy of subrogation is shared by the unsecured creditors of the trustee so that, in effect, we are not given a priority over other

[33] Meagher, RP, McGummow, W (1997) *Jacobs' Law of Trusts in Australia*, 6th edn, Butterworths, Australia, p.2112.
[34] Meagher, RP, McGummow, W (1997) *Jacobs' Law of Trusts in Australia*, 6th edn, Butterworths, Australia.
[35] Meagher, RP, McGummow, W (1997) *Jacobs' Law of Trusts in Australia*, 6th edn, Butterworths, Australia.

unsecured creditors of the trustee. While a trustee's right of recoupment gives rise to a 'priority in the further administration of the trust'[36], it is not a priority over other creditors; it is only a priority over the right of the beneficiaries to receive trust assets.[37]

73. In some high-risk cases, it may be necessary for us to also seek the appointment of a receiver or a provisional liquidator to protect the trust assets.

74. Accordingly, where the trustee is already bankrupt or in liquidation, it may be cost-effective for the trustee in bankruptcy or liquidator to claim subrogation of the trustee's right of indemnity on behalf of all the creditors of the trustee. The High Court observed in *Octavo* that in the event of the trustee's bankruptcy, the creditors will be subrogated to the beneficial interest enjoyed by the trustee. It followed that the beneficial interests which, by subrogation, the creditors have in the assets held by a bankrupt trustee form part of the property of the bankrupt divisible among his creditors.

75. Given the complexity of the matters outlined in this Practice Statement, it is recommended that staff dealing with the recovery of tax liabilities from a former trustee seek advice from their business line's TLA area in the first instance.

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Business line: Frontline Operations

[36] *Chief Commissioner of Stamp Duties (NSW) v Buckle* [1998] HCA 4; 192 CLR 226 at [246].
[37] *Vacuum Oil* 72 CLR 319 at [335]; *Octavo Investments Pty Ltd v Knight* [1979] HCA 61; 144 CLR 360 at [369–370].

Amendment history

16 January 2025

Part	Comment
Throughout	Content checked for technical accuracy and currency. Updated in line with current ATO style and accessibility requirements.

4 December 2013

Part	Comment
Various	Amended to articulate the ATO position under the indirect taxes self-assessment regime.

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