
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountants

MARCH 2016

DEALING WITH CREDITORS OF A LIQUIDATED TRUSTEE COMPANY

The issue was considered *In the matter of Independent Contractor Services (Aust) Pty Ltd (in liquidation) (No2)* [2016] NSWSC 106 by Justice Brereton.

Brief facts

A corporate trustee was in liquidation, having previously been subject to voluntary administration. The company's only function was to act as trustee of a trust. It owned no assets in its own right and there was a significant deficiency in available trust assets compared to the claims of creditors, described as beneficiaries. The beneficiaries were described in the trust deed as persons who provided services to the trust, which included contractors. There was a debt of \$2.6M owed the Australian Taxation Office ("ATO") for a superannuation guarantee charge ("SGC") for unpaid employer superannuation contributions, plus interest and administrative charges. There were also administrative penalties of \$7.5M for failing to withhold PAYG withholdings and administrative penalties of \$1.9M for failure to pay SGC. In the earlier judgement, *Re ICS Real Estate Pty Ltd (in liquidation)* [2014] NSWSC 479, Justice Brereton had found that contractors to the trust were not employees and that the trust arrangement was not a sham.

Relevant legislation

Section 12 of the *Superannuation Guarantee (Administration) Act, 1992* ("SGAA") deems a person who works under a contract, that is wholly or principally for the provision of labour, to be an employee of the other party, for the purposes of the SGAA.

Generally in the liquidation of a company, unpaid superannuation contributions, including SGC and other employees' entitlements, are afforded priority in payment over ordinary unsecured creditors, who would otherwise rank equally pursuant to Section 556(1) of the *Corporations Act 2001* ("Corporations Act"). An employee is defined in Section 556(2) as a person who has been or is an employee of the company, whether remunerated by salary, wages, commission or otherwise.

Application

The Liquidator sought directions from the Court that he would be justified in distributing the available trust funds, after payment of his fees and expenses, to the ATO for the unpaid SGC, or alternatively, to the contractors who provided services.

DISCLAIMER:

The material contained in this newsletter is merely general commentary and the comments and information do not represent a legal or professional service. Advice should be sought from Woodgate & Co. in relation to the circumstances of each matter before acting in this area.

The basic law

Justice Brereton reiterated the basic trust law as follows:

- (i) a trustee is entitled to apply trust assets to discharge liabilities incurred in the authorised conduct of the trust;
- (ii) that right of indemnity is secured by an equitable lien over the trust assets, which is a security interest and has priority over claims of beneficiaries;
- (iii) upon bankruptcy or liquidation of a trustee, its right of indemnity and lien vest in its trustee in bankruptcy or Liquidator; and,
- (iv) a trust creditor is entitled to be subrogated to the trustee's right and lien.

Issues and decision

1. Were the liabilities of the company to its creditors, particularly that of the ATO, covered by the trustee indemnity?

As the liabilities of the company, including SGC, were incurred in the course of its acting as a trustee, the company through its Liquidator was entitled to be indemnified from the trust assets, in priority to the interests of beneficiaries. Justice Brereton noted the company had no other activity other than as trustee of the trust.

2. Was SGC entitled to priority and, if not, how was the liability to rank? The answer depended upon whether the SGC liability fell within Section 556(1)(e) of the Corporations Act and, if so, did Section 556 apply to the rights of trust creditors over trust property?

Justice Brereton had found in his 2014 judgment that the contractors were not employees. He held that the expanded definition of employee in Section 12 of the SGAA was for the purposes of that Act

only. This had no application to the *Corporations Act*, which defined employees more narrowly in Section 556. Therefore, Section 556 did not capture all of the SGC payable by a company but only to the extent that SGC was payable in respect of services rendered to the company by employees, as defined in Section 556(2).

His Honour found that a South Australian appellate decision in *Re Suco Gold Pty Ltd* (1993) 33 SASR 99, which applied the statutory priorities in predecessor legislation to the *Corporations Act* to trust liabilities payable from trust property was virtually universally accepted to be incorrect. That was because Section 556 was concerned only with the distribution of assets beneficially (ie absolutely) owned by a company and available for division amongst its creditors. His Honour noted that this was consistent with the position in the *Bankruptcy Act*.

His Honour stated that there were two alternatives as to how the trust assets could be distributed:

- (a) the trust creditors had priority in accordance with the order in which the claims arose, on the basis that when a claim arose, it brought with it an interest, via subrogation, in the trustee's lien over the trust assets; or,
- (b) that the trust creditors rank *pari passu* (ie equally) and rateably between themselves.

His Honour found that all creditors were entitled to be subrogated to the Liquidator's lien *pari passu* and share equally in the trusts assets, after the costs of the insolvency administration. The trustee's lien did not attach to any particular asset, nor secure any particular liability, but was in the nature of a floating charge over all the trust assets. Multiple creditors shared the right to be subrogated to the trustee's indemnity.

Conclusions

As all the company's liabilities were incurred in its trustee capacity, all its creditors, including the ATO in respect of SGC, were entitled to be subrogated to the Liquidator's lien over trust assets and share *pari passu* in the trust assets, after the costs of administration. Section 556 of the *Corporations Act* did not apply to trust assets and, even if it did, the expanded definition of employee in the SGAA had no application to the *Corporations Act*, so as to deem the contractors as employees for the purposes of priority payment in liquidation.

A further issue – Liquidator's remuneration

Justice Brereton also held that the *Corporations Act* procedures for approval of Liquidator's remuneration by a meeting of creditors or of a Committee of Inspection, had no application when the company carried on business as a trustee. His Honour held that the Liquidator required Court approval for his/her fees and expenses, pursuant to the Court's general equitable jurisdiction. The Court had a wide discretion in fixing the level and basis of remuneration. Relevant factors included the percentage of realisations, compared to the time-cost fees claimed, the degree of risk, responsibility involved, the complexity and size of the administration. His Honour did not object to the Administrator's remuneration approved at the second meeting of creditors.

Much discussion within the insolvency profession has subsequently ensued.

Public policy issues arising from the judgment

It is debateable as to whether parliament intended to create a situation where SGC would be treated as an ordinary unsecured claim in the winding up of a trust but classified as a preferred claim in the liquidation of a company or in a

bankruptcy. According to statistics released by the Australian Securities and Investments Commission ("ASIC"), in December 2015 there were 2.3M companies incorporated in Australia. The latest statistics from the ATO, as at 30 June 2013, recorded that there were about 780,000 trusts who filed income tax returns, of which about 609,000 were discretionary trusts. Given the role of the discretionary trust in tax planning and asset protection, it would be reasonable to assume that most of the trustees were companies with nominal capital. The ATO's 30 June 2013 statistics recorded that there were about 448,000 self-managed superannuation funds, many of which would also have companies as trustees. Therefore, it is probable that about a third of companies are trustees of trusts or self-managed superannuation funds. This creates a real public policy issue in insolvency situations, if the *Corporations Act* does not apply when a trustee company becomes insolvent in respect of trust assets and liabilities.

It is indeed unfortunate that the Commonwealth Parliament did not adopt the recommendations of the 1992 Hamer Report to expressly include a provision stating that any reference to business or affairs of a company for the purpose of the insolvency provisions of the legislation, should include a reference to its business or affairs as trustee of a trust.

If the winding up of a trust is not governed by the *Corporations Act*, then how should the liquidation of the trust be governed? Unfortunately, the state and territory trust legislation are uniformly silent on this issue. In some cases, the trust deed may be of assistance, if the deed can be located. However, many trust deeds do not deal with the distribution of assets, if the trust becomes insolvent. There is also the question of who should be the regulator of insolvent trusts? If not ASIC, then should it properly be the Courts? This could result in a lack of uniformity

between jurisdictions. There would also be greater involvement by the Courts, particularly if the Liquidator is obliged to make an application to the Court to be appointed as Receiver of the trust, as suggested by His Honour *in the Matter of Stansfield DIY Wealth Pty Ltd (In liquidation)* [2014] NSWSC 1484. In that case, the company had ceased to act as

trustee because of a provision in the trust deed automatically terminating the trustee's appointment upon the winding up of the trustee. The requirement to have Liquidator's remuneration approved by the Court rather than at a meeting of creditors or a Committee of Inspection will no doubt result in greater insolvency administration costs and legal costs.

WOODGATE & CO.

Chartered Accountants

**Business Recovery Services
Official Liquidators & Trustee in Bankruptcy**

Level 8, 6 - 10 O'Connell Street, Sydney, NSW, 2000

GPO Box 882, Sydney, NSW, 2001

Telephone: (02) 9233 6088 Facsimile: (02) 9233 1616

www.woodgateco.com.au

Associated Offices: **Melbourne · Brisbane · Adelaide · Perth**