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# Alert

Tax

## Former trustee indemnification from transferred trust assets - or not?

By John Tucker

Following the explosion in popularity for holding assets and conducting businesses through family trusts, in significant part driven by tax and duty considerations, manipulations relating to trust assets, whether concerning other family member interests or those of creditors, are emerging areas for advice.

On 5 February 2025 the High Court of Australia judges handed down their judgments in the appeal of *Anthony Naaman (Appellant) and Jaken Properties Australia Pty Ltd (Respondent) [2025] HCA 1*.

At issue was the right of the Appellant, as a judgement creditor of the former trustee of a trust, who was subrogated to the right of indemnity of that trustee, to be indemnified out of trust assets transferred to the new trustee, the new trustee being found to have, dishonestly and fraudulently, transferred trust assets to associated third parties leaving insufficient trust assets to satisfy the former trustee's right of indemnity.

By a majority decision of Gagler CJ, Gleeson, Jagot and Beech-Jones JJ, as against those of Gordon, Edelman and Steward JJ in dissent, the appeal was dismissed.

The primary judge had held the third parties amenable to orders for equitable compensation and to account based on their knowing assistance to the Respondent new trustee.

A majority the Court of Appeal rejected the notion of a putative fiduciary obligation that formed the basis for the primary judge's decision.

The majority judges of the High Court supported the Court of Appeal. They did so on the basis that the trustee's entitlement to indemnification out of trust assets for


recoupment or exoneration is limited to an entitlement to having trust assets applied for that purpose and does not impose a beneficial interest in assets to be retained by a former trustee via a personal fiduciary obligation on the part of a successor trustee to the former trustee.

The majority analysed the equitable principles underlying the trustee's entitlement to indemnification out of the trust assets as an entitlement to have assets applied, arising from equity acting in personam to enforce the trustee's underlying equitable proprietary interest being a beneficial interest that the former trustee retains in the trust assets after replacement by a successor trustee, this interest taking priority over that of the cestuis que trust.

The interest was explained to arise from and be commensurate with the continuing ability that a former trustee has to obtain the assistance of a court of equity to enforce its entitlement to have the trust assets applied to recoup their expenditures or to exonerate them from liability.

The final orders that a court of equity was identified as able to make on an application of a former trustee to enforce its entitlement to have the trust assets applied to recoup its expenditure or to exonerate it from liability were orders authorising and, if necessary, requiring, the sale of the trust assets and payment to the former trustee out of the proceeds or payment to the former trustee from trust funds.

While a Court of equity was found to have ample power pending the making of any such final order to ensure the efficacy of the final order and to protect the equitable proprietary interest of the former trustee, the available interim protection is by means of an interlocutory order either granting an injunction to restrain the successor trustee or appointing a receiver to take possession of the trust assets.



Equity acting in personam requires an order against a person holding the property, not an order in rem.

The effect is to create an equitable interest in property held by the person commensurate with the ability of the former trustee to obtain the assistance of a court of equity to enforce its entitlement to recoup its expenses or to exoneration.

The equitable interest of the former trustee, retained in respect of the trust assets, is for the former trustee to seek assistance from the courts through orders that may involve selling trust assets. However, this right was held not to extend to the Court imposing a fiduciary duty on the new trustee to protect the interest of the former trustee at the expense of the interest of the beneficiaries.

The court can issue temporary orders (e.g. injunction or appointment of receiver) to prevent the successor trustee from damaging or removing the assets until such court orders are made. This ensures the former trustee's right remains intact while awaiting a final decision on indemnification.

The majority pointed to the differences in the orders to protect these entitlements and those through an equitable lien or equitable charge.

The equitable proprietary interest of an equitable chargee was noted to be enforceable by orders directed against the property the subject of the charge and to be only for the purpose of satisfying the indebtedness secured by the charge out of that property.

This was contrasted with orders for relief available to the cestuis que trust being directed to the holder of the property the subject of the charge.

Summarising, the Court adopted the submission of the Respondent that "the trustee holds the trust property for the cestuis que trust but *subject* to the interest of the former trustee".

The fundamental difference between the majority and the dissenting judges was in the majority holding that a successor trustee does not owe a fiduciary obligation to a former trustee in respect of the entitlement of the former trustee to indemnification out of the trust assets, or the commensurate beneficial interest that the former trustee has in the trust assets.

The dissenting Judges were willing to superimpose a fiduciary relationship between the successor trustee and the former trustee not to intentionally destroy, diminish or jeopardise the former trustee's entitlement to be indemnified from the trust estate. They characterised this as a duty of loyalty, including not to allow the successor trustee's personal interests to conflict with this objectively assumed duty to the former trustee when dealing with the trust assets to which the former trustee had an equitable proprietary right. The duty was framed as fact specific arising from the successor trustee having made known to it the equitable interest of the former trustee to indemnity from the trust assets where the former trustee could reasonably expect the successor trustee to act in the former trustee's interest and not to its prejudice.

It has not been uncommon for tax law practitioners to encounter trustees with tax liabilities seeking to appoint a new trustee to a trust with assets in the hope of frustrating the Commissioner of Taxation's recovery of tax owed by the existing trustee. This decision may encourage these thoughts but there are strong reasons, for practitioners as well as others, to think very carefully about assisting in such a course, most significantly the provisions of the *Crimes (Taxation Offences) Act 1980* (Cth). On the other hand, the factual situation and its outcome before the High Court may be seen to invite exploitation in circumstances unrelated to tax liabilities.



MORE INFO

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