**IN THE HIGH COURT OF NEW ZEALAND**
**AUCKLAND REGISTRY**

**CIV-2012-404-5870**
**[2013] NZHC 575**

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| UNDER | Part 18 of the High Court Rules |
| IN THE MATTER OF | the equitable jurisdiction of the High Court |
| BETWEEN | DAVID PHILLIP SELKIRK<br>Plaintiff |
| AND | DONALD ALEXANDER MCINTYRE<br>Defendant |

Hearing: 26 February 2013

Counsel: J E Riddle for Plaintiff
No appearance for Defendant

Judgment: 25 March 2013

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**JUDGMENT OF KATZ J**

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In accordance with r 11.5 High Court Rules
I direct the Registrar to endorse this judgment
with a delivery time of 4 p.m. on 25 March 2013.

Solicitors: Fortune Manning, Auckland – jenna.riddle@fortunemanning.co.nz

## Introduction

[1] The plaintiff, Mr Selkirk, is a partner in the law firm Fortune Manning. In 1997 he accepted appointment as an independent professional trustee of the Donald McIntyre Family Trust ("Trust"). The Trust was settled by the defendant, Mr McIntyre, who was also a discretionary beneficiary and its other trustee.

[2] Between 1997 and 2004 the trustees acquired a farm, subdivided it and sold the resulting sections, incurring liability for GST. The trustees failed to file a number of GST returns or make the required GST payments to the Inland Revenue Department ("IRD"). Mr Selkirk says the blame for this can be laid squarely at Mr McIntyre's door, for reasons which are discussed in further detail below. However, as Mr McIntyre had moved to Australia in 2002, the Inland Revenue Department ("IRD") elected to pursue recovery action against Mr Selkirk only. The sum outstanding was by then in excess of $500,000 (including interest and penalties).

[3] Mr Selkirk settled the IRD proceedings by paying $200,000 from his own resources. Although the Trust Deed included the normal indemnity in favour of the trustees out of the Trust assets, this proved to be worthless. Mr Selkirk accordingly now seeks to recover from Mr McIntyre the $200,000 he paid to IRD.

[4] This case raises the important issue of when, and to what extent, a trustee is entitled to a contribution or indemnity from his or her co-trustee(s) in respect of trustee liabilities which he or she has met personally. To what extent, if any, is it relevant that the paying trustee is an independent professional trustee with no personal interest in the Trust? Further, is it relevant that the co-trustee undertook day to day responsibility for the management of the trust and the paying trustee's role was essentially "passive"?

[5] Somewhat surprisingly, given that contribution and indemnity developed as equitable remedies in the English Courts of Chancery from the early 19th century onwards, there is a paucity of New Zealand authority directly on point. While the principles of equitable contribution are relatively straightforward, determining

whether Mr Selkirk is entitled to a full indemnity from Mr McIntyre is rather more complex.

[6] Mr McIntyre has not filed a defence to Mr Selkirk's claim. He was notified of the hearing but did not appear. The matter accordingly proceeded by way of formal proof, based on an affidavit filed by Mr Selkirk which set out the factual basis for the claim.

**Further background**

[7] On 18 February 2004 Mr Selkirk received a letter from IRD advising that the Trust owed tax of $30,789.64 and had not filed all its GST and income tax returns. Mr Selkirk was surprised to receive this letter as he had assumed that Mr McIntyre and the Trust's accountants had "taken care of these obligations".

[8] During 2004 and 2005 Mr Selkirk urged Mr McIntyre to put the Trust's tax affairs in order. Mr McIntyre filed some of the outstanding returns and set up an automatic payment to IRD of $200 per week. However in December 2005 IRD advised Mr Selkirk that they had not heard from Mr McIntyre for some time. The outstanding debt was now $93,480.36, based in part on default assessments. IRD advised that the case was being considered for prosecution action.

[9] Mr Selkirk had an email exchange with IRD regarding the outstanding tax in April 2006 and forwarded that on to Mr McIntyre, asking for an update as to progress in filing the outstanding returns. There is no record of a response.

[10] On 8 November 2006 IRD wrote to Mr Selkirk reiterating that it was considering prosecution and recovery action. Mr Selkirk phoned Mr McIntyre, who assured him that he would speak to IRD and would fax through the outstanding GST returns. Following further correspondence in November and December 2006 Mr McIntyre told Mr Selkirk that he would need to get some further information from his accountants, in order to prepare the final outstanding GST returns over the summer holiday period.

[11] Mr Selkirk followed up with Mr McIntyre after the holidays, on 22 January 2007, inquiring as to progress. No response was received. Somewhat surprisingly, the matter rested there for just over four years. Meanwhile, penalties and interest continued to mount.

[12] IRD next contacted Mr Selkirk in February 2011. Matters then escalated from July 2011 onwards. A final warning was given by IRD on 31 January 2012. During this period Mr Selkirk wrote to Mr McIntyre four times, forwarding correspondence from IRD and again urging him to put the Trust's tax affairs in order.

[13] In early May 2012 IRD issued proceedings against Mr Selkirk (only) for outstanding income tax and GST of $518,027.94. The base tax arrears comprised $165,938.51, which was largely based on default assessments due to GST returns not being filed. The balance of the sum owing was interest and penalties. Mr Selkirk settled the claim by paying $200,000 to IRD in full and final settlement of his personal liability as a trustee.

**Personal liability of trustees**

[14] A trust is not a separate legal entity. Trust assets are held in the individual names of the trustees. The same applies to liabilities. Trustees will be personally liable to creditors, including the IRD. In *Macalister Todd Phillips Bodkins v AMP General Insurance Ltd* the Supreme Court summarised the relevant principles as follows:[1]

> [42] In imposing personal liability the tax statutes do no more than recognise the general principle that liabilities incurred by a trustee in relation to a trust are always the personal liabilities of the trustee. This is an aspect of the nature of a trust, which is not a person but an equitable obligation to deal with property for the benefit of beneficiaries. A creditor has a personal right to sue a trustee and to get judgment and make the trustee bankrupt.
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> (citations omitted)

[15] Two decisions of the Court of Appeal illustrate the practical application of such principles in a tax context. In *Commissioner of Inland Revenue v Chester*

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[1] *Macalister Todd Phillips Bodkins v AMP General Insurance Ltd* [2007] 1 NZLR 485 (SC).

*Trustee Services Ltd*[2] and *Commissioner of Inland Revenue v Newmarket Trustees Ltd*[3] the Court of Appeal held professional trustee companies liable for GST debts incurred in relation to trusts under their trusteeship. In both cases IRD was successful in having the trustee companies placed into liquidation for failure to meet their tax liabilities.

[16] Trustees' liability is joint and several. As a result, where there are two or more trustees, a creditor can choose to pursue any one of them (as happened in this case). If that trustee is found liable, he or she may then seek a contribution (or in some limited cases, an indemnity) from his or her co-trustee(s).

**Right of contribution from co-trustee(s)**

[17] The concept of equitable contribution entitles parties who share a coordinate liability to seek a contribution from each other for any payment incurred in meeting that liability, so that the burden is shared equally among those liable for it.[4] The general equitable right to contribution is based on the principles of natural justice. There is a clear risk of injustice arising if a person who is liable for the same damages or expense does not bear their share of the burden. Accordingly, if any one trustee is sued, he or she may claim a contribution from any other trustee who is also liable.[5] The comparative culpability of each trustee is generally not relevant.

[18] In accordance with these well established equitable principles, Mr Selkirk is entitled to a contribution from Mr McIntyre of 50 per cent of the $200,000 he has paid to IRD in respect of the trustees' joint and several tax obligations. He is also entitled to a contribution of 50 per cent of the legal expenses he incurred in relation to the proceedings brought by IRD.

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2 *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA).
3 *Commissioner of Inland Revenue v Newmarket Trustees Ltd* [2012] 3 NZLR 207.
4 *Laws of New Zealand*, Equity, (online ed) at [84]; *Marlborough District Council v Altimarloch Joint Venture Ltd* [2012] 2 NZLR 726 at [57], [129].
5 *Westpac Banking Corporation v Savin* [1985] 2 NZLR 41, at 54 per Richardson J, citing Garrow and Kelly, *Law of Trusts and Trustees* (5th ed, 1982) at 392-395.

**Right of indemnity from co-trustee(s)**

[19] The issue of whether Mr Selkirk is entitled to a full indemnity from Mr McIntyre is unfortunately somewhat more difficult.

*Relevant legal principles*

[20] In the trustee context at least, equity does not recognise an intermediate position between the two extremes of equal contribution or full indemnity. The starting point is one of equal contribution. However in some exceptional situations courts have developed specific "rules" to mitigate the harshness of the equal contribution rule. In such circumstances equity will require one trustee to fully indemnify another.

[21] The leading case is *Bahin v Hughes*, where Cotton LJ summarised the then (1886) state of the English law as follows:[6]

> ... [there are] very few cases in which one trustee, who has been guilty with a co-trustee of breach of trust and held answerable, has successfully sought indemnity as against his co-trustee ... Of course, where one trustee has got the money into his hands, and made use of it, he will be liable to his co-trustee to give him an indemnity ...
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> ...
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> Now I think it wrong to lay down any limitation of the circumstances under which one trustee would be held liable to the other for indemnity, both having been held liable to the cestui que trust; but, so far as cases have gone at present, relief has only been granted against a trustee who has himself got the benefit of the breach of trust, or between whom and his co-trustees there has existed a relation, which will justify the Court in treating him as solely liable for the breach of trust.

[22] Although there are some inconsistencies in the relatively sparse case law (much of which dates back to the 19th Century) it appears that the "trustee indemnity rules" can be summarised broadly as follows:

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6 *Bahin v Hughes* (1886) 31 Ch D 390 at 395-396; *Hammond v Walker* (1854) 3 Jur. N.S. 686; *Reilly v Lockhart* (1856) 25 L.J. Ch. 697; *Re Linsley* [1904] 2 Ch 785 and *Nocton v Ashburton* [1914] 1 AC 932.

(a) Where one of the trustees is a solicitor an indemnity may be claimed against that trustee by a co-trustee who has reasonably relied on the advice of the solicitor trustee ("solicitor-trustee rule").[7]

(b) Where a trustee receives a personal benefit from a breach of trust which the other trustees did not actively participate in, an indemnity may be claimed, requiring the defaulting trustee to first contribute the amount of the personal benefit received ("personal benefit rule").[8]

(c) A trustee who commits fraud will be required to fully indemnify his or her innocent co-trustees ("fraudulent trustee rule").[9] Fraudulent trustees may not, however, obtain contribution from other fraudulent trustees.[10]

(d) Where a trustee who is also a beneficiary benefits from a breach of trust, the value of the trustee-beneficiary's interest will be deducted from the amount owed by all the liable co-trustees as compensation to the trust fund. The remaining sum is then shared equally as an obligation between the co-trustees ("trustee-beneficiary rule").[11]

[23] Generally only trustees who have acted innocently or reasonably will be indemnified. A trustee who, acting on his own judgment, has actively participated in a breach will not be entitled to an indemnity.[12] Nor will a trustee who has simply

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7 *Bahin v Hughes* (1886) 31 Ch D 390 at 395 (Cotton LJ); *Chillingworth v Chambers* [1896] 1 Ch 685; *Re Linsley* [1904] 2 Ch 785; *Head v Gould* [1898] 2 Ch 250 (Kekewich J); *In re Turner* [1897] 1 Ch 536; *In Re Parlington*, 57 T.L.R. 654 (Ch 1888); *Price v Price* 42 T.L.R 626 (Ch 1880); *Reilly v Lockhart* (1856) 25 L.J. Ch 697; *Re Mulligan* [1998] 1 NZLR 48 at 502.

8 *Power v Hoey* (1871) 19 W.R. 916; *Bahin v Hughes* (1886) 31 Ch D 390 at 395-6; *In Re Parlington*, 57 T.L.R. 654 (Ch 1888); *Wynne v Tempest* [1897] 1 Ch 110; *Goodwin v Duggan & Ors* (1996) 41 NSWLR 158 at 166; *Re Mulligan* [1998] 1 NZLR 481 at 502 and 511 per Pankhurst J

9 *Baynard v Woolley* (1855) 20 Beav 583; 52 ER 729; *Re Smith* [1896] 1 Ch 71; Andrew Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Brookers, Wellington, 2009) at 143.

10 Lord Goff of Chieveley and Gareth Jones, *The Law, of Restitution* (7th ed, Sweet & Maxwell, London, 2007) 417; Andrew Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Brookers, Wellington, 2009) at 143.

11 *Chillingworth v Chambers* [1896] I Ch 685 at 707 (Kay LJ). This summary is based on the comments of Kay LJ in that case, which it appears A.L Smith LJ agreed with. I note, however, that Lindley LJ took a somewhat different approach to calculating how the trustees beneficial interest was to be brought to account.

12 *Head v Gould* [1898] 2 Ch 250.

abdicated his responsibilities, in circumstances where the breach is occasioned by the honest but erroneous actions of his co-trustee.[13]

[24] A modern illustration of the personal benefit rule is the decision of the Supreme Court of New South Wales in *Goodwin v Duggan & Ors.*[14] Ms Goodwin and her brother were executors and trustees of their late sister's estate. The brother was found to have misused trust funds for his own benefit. Ms Goodwin was found to be jointly and severally liable at first instance. Her appeal succeeded, on the ground that she had an equitable right to be fully indemnified by her brother as co-trustee, as he had personally received the trust funds and converted them to his own use. The Court applied the *Bahin v Hughes* line of authority.

[25] A necessary pre-requisite to securing an indemnity under any of the trustee indemnity rules which I have outlined is that there has been a breach of trust. I therefore now consider the pleadings and evidence relating to this issue.

**Has Mr McIntyre acted in breach of trust?**

*The statement of claim*

[26] It is pleaded that Mr McIntyre has breached his fiduciary duties as a trustee of the Trust:

(a) by failing to file GST and income tax returns; and

(b) by failing to make payment, from available trust funds, of all relevant tax or default assessments; and

(c) by transferring funds out of the Trust's control without the consent of Mr Selkirk as co-trustee.

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13 *Bahin v Hughes* (1886) 31 Ch D 390.
14 *Goodwin v Duggan & Ors* [1996] NSWSC 363.

[27] It is further pleaded that, but for these breaches of trust, Mr Selkirk would not have incurred personal liability for the overdue taxes (and associated legal costs of $10,674.88) and would have been indemnified from the Trust's assets for any liability arising through his capacity as trustee. Judgment is sought in the sum of $210,674.88.

[28] At the heart of the breach of trust allegations is the assertion that Mr McIntyre converted Trust funds for his own use or otherwise misappropriated them. If he had not done so, there would have been sufficient Trust assets to meet the relevant tax obligations. If proved, the conduct pleaded would likely bring Mr McIntyre within the personal benefit rule, and possibly also the trustee-beneficiary rule or the fraudulent trustee rule.

*The evidence*

[29] Mr Selkirk's affidavit focuses primarily on his own lack of culpability and the fact that he diligently "chased" Mr McIntyre to put the Trust's tax affairs in order. Mr Selkirk's evidence is primarily directed at establishing that he was a "passive" trustee and accordingly significantly less culpable than Mr McIntyre. I address this issue further at [39]-[45] below. The aspects of Mr Selkirk's evidence which are directly relevant to the breach of trust allegations are fairly limited.

[30] Firstly, there is evidence that following the sale of one of the subdivided farm lots (Lot 4) Mr McIntyre instructed Fortune Manning by fax dated 17 June 2004 that the balance of the proceeds of sale were to be deposited into the Trust's ASB bank account. Mr McIntyre's fax concluded that:

> I will notify the ASB Bank as to how much to put onto my mortgage and I will be forwarding the GST onto the IRD personally.

[31] It is not clear from the evidence whether or not Mr McIntyre did forward the GST from Lot 4 on to the IRD, but I infer that he did not. It appears that the reference to "my mortgage" was probably a reference to a mortgage over property (possibly the farm property) which formed part of the Trust assets. Certainly no exception was taken to the comment at the time.

[32] A subsequent letter from Mr Selkirk to Mr McIntyre dated 20 January 2005 refers to the sale of a further lot having settled. On that occasion Fortune Manning forwarded the balance of the sale proceeds (only $3,545.65) directly to IRD "in reduction of the Trust's indebtedness, as per your instructions".

[33] On 20 November 2006 Mr McIntyre wrote to Mr Selkirk regarding the outstanding GST returns. In that letter he commented as follows:

> The Donald McIntyre Family Trust has for some time had no income and probably never will for some years. I have had a number of trips back to NZ to check up on what is left of its assets but I find it not even worth claiming any of the costs involved in making the trip as it just creates more hassle than its worth.

[34] The only other aspect of Mr Selkirk's evidence which is relevant to the breach of trust allegations is the following passage:

> I subsequently believed that the Trust's cash assets have been transferred out of the Trust's ASB bank account without my authority as co-trustee. This view was held as the Trust appeared unable to make payments of monies due to IRD.
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> By 2007, it appeared to me that there were no assets left in New Zealand other than a property in Paihia, which was valued at $600,000 in 2010, as the Trust appeared to have no liquid assets in New Zealand to meet its IRD commitments ... [The Paihia property] was also subject to a mortgage, which the Trust ultimately defaulted on. The property was sold at a mortgagee sale on 25 October 2012 for $90,000 which was less than the amount owing to the mortgagee. I am not aware of any remaining funds in New Zealand to meet the shortfall to the mortgagee or the IRD.

[35] No documents relating to the Paihia property, including the 2010 valuation referred to, are in evidence before me. Nor are there any financial statements relating to the Trust, ASB bank statements or other documents which might show what the Trust's financial position was during the relevant time and whether any funds appear to have been misappropriated.

[36] One inference that cannot be excluded on the limited evidence before me is that the Trust was essentially insolvent (or near insolvent) throughout the relevant period. The property development activities undertaken by the trustees may not have been profitable. The Trust's assets (including in particular the Paihia property) appear to have either been significantly over-valued or were possibly detrimentally

impacted by market conditions. Evidence consistent with an "insolvency" scenario includes the "drip feed" nature of the payments made to IRD (including an occasional small lump sum and an automatic payment for only $200 per week), Mr McIntyre's letter of 20 November 2006 to Mr Selkirk, the low sale price of the Paihia property (and that neither trustee pressed for it to be sold sooner to meet the outstanding tax liabilities), and the fact that the proceeds of sale of one of the farm lots in January 2005 was only $3,545.65, which sum was forwarded direct to IRD by Fortune Manning, at Mr McIntyre's request.[15]

[37] There is simply no direct evidence before me which establishes that Mr McIntyre has wrongfully converted or misappropriated trust assets. There are a number of possible inferences I could draw from the limited information available. The evidence therefore falls far short of cases such as *Goodwin v Duggan,* where there was clear evidence that the testator's brother had misappropriated trust funds for his own use, without the knowledge of his sister as co-trustee.

[38] In such circumstances there is an insufficient evidential basis to find, on the balance of probabilities, that any of the trustee indemnity rules outlined at [22] above apply in this case.

**Active and passive trustees**

[39] Mr Selkirk submitted that he was essentially blameless, being a "passive" trustee in the day to day administration of the Trust. It was Mr McIntyre who was responsible for the day to day administration of the Trust, including ensuring compliance with the relevant tax obligations. He failed to do so. Mr Selkirk wrote to him repeatedly requesting that he put the Trust's tax affairs in order.

[40] Given that the respective roles of the two trustees was a key focus of both evidence and submission, I consider below whether Mr Selkirk's role as a passive trustee is a factor which weighs in favour of relief in this case.

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15 There is no evidence what the balance of the sale proceeds of the other lots was.

[41] Passive trustees have been seeking relief from the courts, on the basis of their lesser culpability, since the earliest days of the development of contribution and indemnification as equitable remedies. For example in *Lingard v Bromley*, a case which is now over 200 years old, Grant MR rejected a claim by two passive trustees for an indemnity from their active co-trustee, in the following rather robust terms:[16]

> The Defence is of a Kind, which a Court of Justice is very unwilling to listen to: that, having undertaken a Trust, they abdicated all Judgment of their own in the Performance of it; and did whatever the Plaintiff desired: "without examining" (as they say in so many Words) "into the Matter, or Ground, of the Proceeding". Nothing could be more mischievous than to hold, that Trustees may thus act; and avoid Responsibility by throwing the Burthen upon the Person, in whom they have reposed this blind Confidence.

[42] Those principles remain good law to this day. They were reiterated in the leading case of *Bahin v Hughes* where Fry LJ explained the rationale for not allowing a trustee to escape liability by claiming that their role was merely a passive one as follows:[17]

> In my judgment the Courts ought to be very jealous of raising any such implied liability (to indemnify) because if such existed it would act as an opiate upon the consciences of the trustees; so that instead of the cestui que trust having the benefit of several acting trustees, each trustee would be looking to the other or others for a right of indemnity, and so neglect the performance of his duties. Such a doctrine would be against the policy of the Court in relation to trusts. ...

[43] Fry LJ's well known dictum has stood the test of time and has found favour throughout the Commonwealth including in Australia[18] and New Zealand.[19]

[44] A "passive" trustee is not entitled to simply delegate their responsibilities to the "active" trustee. In this case the Trust deed required that the trustees act unanimously (as is the norm). The names of both trustees were presumably recorded as the legal owners on the various properties which formed part of the Trust assets. The relationship between Mr Selkirk and Mr McIntyre was not solely a solicitor-client relationship, but also one of co-trustees. There was no evidence before me, however, of any systems or procedures aimed, for example, at ensuring that as

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16 *Lingard v Bromley* [1812] 1 V & B 114; 35 ER 45 at 46.
17 *Bahin v* Hughes 31 ChD 390 at 398.
18 *Goodwin v Duggan & Ors* [1996] NSWSC 363.
19 *Re Mulligan* [1998] 1 NZLR 481.

properties were sold GST was appropriately accounted for. I acknowledge Mr Selkirk's evidence that he trusted Mr McIntyre to attend to this. However, the case law is clear that such reliance will not give rise to an entitlement to an equitable indemnity from a co-trustee.

[45] Equity simply does not recognise the concept of an "active" trustee or a "passive" trustee. All trustees are accountable to the beneficiaries of the trust and must account to them for its proper administration. In order to be indemnified by a co-trustee, a trustee (whether active or passive) must be able to demonstrate that their case falls within one of the recognised categories of exceptional cases outlined at [22] above. Unfortunately for Mr Selkirk, this case does not.

**Result**

[46] The plaintiff's claim for contribution is successful in the sum of $105,337.44, together with interest at the prescribed rate. I order accordingly.

[47] The plaintiff's claim for an equitable indemnity from the defendant fails.

[48] The plaintiff is entitled to costs on a 2B basis, together with disbursements as approved by the Registrar.

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Katz J