[HIGH COURT OF AUSTRALIA.]

BRETT AND ANOTHER . . . . . APPELLANTS: PLAINTIFFS,

AND

BARR SMITH AND ANOTHER . . . RESPONDENTS. DEFENDANTS,

ON APPEAL FROM THE SUPREME COURT OF VICTORIA.

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MELBOURNE, *March* 7, 17.

Isaacs, Higgins and Gavan Duffy JJ.

Income Tax—Mortgage—Covenant imposing on mortgagor obligation to pay income tax in respect of interest—Income Tax Assessment Act 1915-1916 (*No.* 34 *of* 1915—*No.* 39 *of* 1916), *sec.* 54.

By a mortgage executed before the passing of the *Income Tax Act* 1915 the mortgagors covenanted to pay interest at 5¾ per cent. per annum with a proviso that if they should, within a certain time after the dates fixed for the payment of interest, pay interest at such a rate as, after deducting (*inter alia*) the income tax payable by the mortgagee in respect of a specified sum amounting to 4½ per cent. on the mortgage debt, would leave a clear remainder of 4½ per cent. per annum, the mortgagee would accept interest at such reduced rate.

Held, by *Isaacs* and *Higgins* JJ., *Gavan Duffy* J. doubting, that the proviso was not and did not contain a covenant or stipulation which had or purported to have the purpose or effect of imposing on the mortgagors the obligation of paying income tax on the interest to be paid under the mortgage within the meaning of sec. 54 of the *Income Tax Assessment Act* 1915-1916, and therefore that the mortgagors were liable to pay interest at the rate of 5¾ per cent. reducible as prescribed by the proviso.

Decision of the Supreme Court of Victoria: *Brett* v. *Barr Smith*, (1918) V.L.R., 476; 40 A.L.T., 136, affirmed.

APPEAL from the Supreme Court of Victoria.

In an action brought in the Supreme Court by Frank Pilkington Brett and Arthur Frederick Hooper against Tom Elder Barr Smith

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and Henry Percival Moore, as trustees of the estate of Robert Barr Smith, deceased, the following special case was stated for the opinion of the Court and was referred by *Hood* J. to the Full Court :—

This action was commenced on 21st January 1918 by a writ of summons whereby the plaintiffs claimed for money payable by the defendants to the plaintiffs for money received by the defendants for the use of the plaintiffs, being interest in excess of that properly payable demanded by the defendants from the plaintiffs and paid by them ; and the parties have concurred in stating the question of law arising in this action in the following case for the opinion of the Court :—

1. Robert Barr Smith in par. 2 hereof mentioned died on 20th November 1915, and since his death the defendants have at all times material to this case been his executors and the trustees of his estate.

2. By a memorandum of mortgage dated 28th February 1913, and registered Number A.13786 under the *Real Property Act* 1900 of the State of New South Wales, the plaintiffs mortgaged to the said Robert Barr Smith, his executors or transferees, the parcels of land therein described, and situate in the said State, as security for the repayment by the plaintiffs to the mortgagee, his executors or transferees, of the principal sum of £9,000 and interest thereon as by the said memorandum provided.

3. The plaintiffs, the mortgagors, by the said memorandum of mortgage covenanted with the said Robert Barr Smith the mortgagee as follows, that is to say :—

" Firstly—That we or one of us our or his heirs executors administrators or transferees will pay in gold to the mortgagee his executors administrators attorneys or transferees at the Chief Banking House of the English Scottish and Australian Bank Limited in the City of Melbourne in the State of Victoria or at such other place in the same City as the mortgagee his executors administrators or transferees shall direct or appoint in writing the principal sum of £9,000 on 28th August 1913 with interest for the same in the meantime computed from 28th February 1913 at the rate of five pounds fifteen shillings per centum per annum reducible as hereinafter mentioned.

"Secondly—That if the said sum of £9,000 or any part thereof shall remain unpaid after the said 28th August 1913 we or one of us our or his heirs executors administrators or transferees will so long as the said principal sum or any part thereof shall remain unpaid pay in gold to the mortgagee his executors administrators attorneys or transferees as aforesaid interest for the said principal sum or for so much thereof as shall for the time being remain unpaid at the rate of five pounds fifteen shillings per centum per annum reducible as hereinafter mentioned by equal half-yearly payments on 28th February and 28th August in each year until the said principal sum shall be fully paid.

"Thirdly—That we or one of us our or his heirs executors administrators or transferees will and shall pay all land tax and other taxes charges assessments (including any property tax) impositions and outgoings whatsoever whether similar to those now in existence or not and whether imposed by Parliament or otherwise which now are or which may at any time hereafter during the continuance of this mortgage become payable in respect of any of the lands comprised in this mortgage as and when the same shall become payable and that we or one of us our or his heirs executors administrators or transferees will repay on demand to the mortgagee his executors administrators attorneys or transferees all and every sums and sum of money which he or they may pay on account of such tax or taxes or other charges aforesaid with interest thereon up to the time of payment at the rate aforesaid and until every such sum and interest shall be fully paid the same shall be a charge upon the lands hereby mortgaged Provided always and it is hereby declared that nothing herein contained shall be deemed or taken to extend or apply to any tax charge or assessment which or any part of which now is or at any time hereafter shall be required by law to be paid or borne by the mortgagee and not by the mortgagor or to bind us our heirs executors administrators or transferees to make any payment which we may not lawfully covenant to make or which it shall or may at any time hereafter become unlawful for us to make."

4. The said memorandum of mortgage further provides as follows, that is to say :—

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"Seventhly—Provided always and it is hereby agreed and declared that if we (the mortgagors) or one of us or his heirs executors administrators or transferees shall on every 31st August and 28th February so long as the said principal sum of £9,000 or any part thereof shall remain unpaid or within ten days next after each of the said days respectively pay in gold to the mortgagee his executors administrators attorneys or transferees at the banking house aforesaid or at such other place in the said City of Melbourne as the mortgagee his executors administrators or transferees shall from time to time appoint in writing interest on the said principal sum or on so much thereof as shall for the time being remain unpaid at such a rate as will after deduction of such sum or sums as under any existing or future Statute of the Commonwealth of Australia and of the States forming such Commonwealth or of such Commonwealth and States or any or either of them the mortgagee shall or may be or become liable to pay in respect of the said lands or of the said principal or interest moneys respectively for land tax for property tax for income tax without any exemption on £405 sterling at the highest rate payable by the mortgagee in each year during the continuance of this loan notwithstanding that such rate may be based on income of which the said sum of £405 forms part only or for any other rate tax or assessment leave a clear remainder of four pounds ten shillings per centum per annum then the mortgagee his executors administrators and transferees shall and will accept interest for the said principal sum or for so much thereof as shall for the time being remain unpaid at such reduced rate for any and every half-year for which such interest shall be so paid to him or them within the ten days aforesaid in lieu of the higher rate of interest hereinbefore mentioned Provided always that the acceptance of interest at the reduced rate hereinbefore mentioned for any half-year shall not prejudice or affect the rights of the mortgagee his executors administrators attorneys or transferees or any of them to require and compel payment of interest at the higher rate hereinbefore mentioned for any subsequent half-year in case interest at the reduced rate for such subsequent half-year shall not have been paid within the ten days aforesaid."

5. The said memorandum of mortgage or copies thereof may be looked at as part of this case.

6. The plaintiffs contend that the clause numbered seventhly in the said mortgage is or contains a covenant or stipulation which has or purports to have the purpose or effect of imposing on the mortgagor the obligation of paying income tax on the interest to be paid under the mortgage within the meaning of sec. 54 of the *Income Tax Assessment Act* 1915.

7. The plaintiffs also contend that upon payment by the plaintiffs within the time and in the manner provided by the said clause numbered seventhly of interest at such a rate as will yield a sum equal to 4½ per centum per annum upon the principal sum then unpaid plus an amount equal to the income tax which would be payable upon an income consisting solely of £405 in interest the defendants are bound to accept interest at the reduced rate so computed in lieu of the higher rate of interest in the said mortgage provided.

8. The questions for the opinion of the Court are :—

(1) Are the plaintiffs right in their contention mentioned in par. 6 ?

(2) Are the plaintiffs right in their contention mentioned in par. 7 ?

(3) What rate or rates of interest are the plaintiffs liable to pay ?

The Full Court answered the first question in the negative, and thought it unnecessary to answer either of the other questions: *Brett* v. *Barr Smith* (1).

From that decision the plaintiffs now appealed to the High Court.

Pigott, for the appellants. The proviso in the mortgage is a "stipulation" within the meaning of sec. 54 of the *Income Tax Assessment Act* 1915-1916. That word is the proper term to apply to a condition of a contract (*Blackstone's Commentaries*, vol. II., c. 20, p. 299). The proviso is a stipulation that if the mortgagors do something the interest will be at a certain rate. The proviso, if taken advantage of, has the effect of imposing upon the mortgagors an "obligation" within the meaning of sec. 54. The word

(1) (1918) V.L.R., 476; 40 A.L.T., 136.

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"obligation" in that section is not used in a conveyancer's sense but in a business sense, that is, as including an obligation of practical compulsion due to self-interest. In another view the $5\frac{3}{4}$ per cent. is stipulated for only for the purpose of compelling the mortgagors to pay the income tax and other taxes. Taking all the provisions as to interest, the proper construction is that the obligation upon the mortgagors is to pay interest at the rate fixed by the proviso. The words "the interest to be paid under the mortgage" in sec. 54 mean in this case, where the interest is paid punctually, the interest in fact to be paid and not the higher rate of $5\frac{3}{4}$ per cent. [Counsel referred to *Mitchell* v. *Hart* (1); *Elder* v. *Dennis* (2).]

Starke, for the respondents. It is practically a rule of law that, on the proper construction of an instrument in the form of this mortgage, the higher rate of interest is the interest payable under the mortgage and, as an indulgence, the lower rate will be accepted on punctual payment (*Wallingford* v. *Mutual Society* (3)). There is no obligation to pay the lower rate.

Pigott, in reply.

Cur. adv. vult.

March 17. The following judgments were read:—

ISAACS J. Sec. 54 of the *Income Tax Assessment Act* 1915 enacts as follows:—"A covenant or stipulation in a mortgage of land, which has or purports to have the purpose or effect of imposing on the mortgagor the obligation of paying income tax on the interest to be paid under the mortgage" is to have certain consequences according as the mortgage was made before or after the commencement of the Act. If the mortgage was made after the commencement of the Act, the covenant or stipulation is to be absolutely void; but if the mortgage was made before that time, it is not wholly abrogated but is modified. The effect of the modification is, in substance, that instead of paying the amount of tax which the mortgagee is bound to pay the Crown in respect of the interest, and perhaps on

(1) 19 C.L.R., 33, at p. 41. (2) 22 V.L.R., 125; 18 A.L.T., 25.
(3) 5 App. Cas., 685, at p. 702.

the basis of being part of a larger income, and therefore on a higher graduated scale, the mortgagor pays in respect of the mortgagee's income tax only such sum as he would pay if his own income amounted only to the sum he pays for interest.

The first thing is to interpret the enactment. It has been argued that its terms, particularly the word "obligation," are to be read in a popular sense. Its subject matter, however, is a "mortgage" of land, which is a term of art, and the expressions which are used with respect to the mortgage are legal and technical terms, namely, "covenant," "stipulation," "imposing the obligation" and "interest to be paid under the mortgage." It is a cardinal rule of interpretation that technical words must have their legal effect unless the contrary is made perfectly clear. It was so held by the Privy Council in *Lalit Mohun Singh Roy* v. *Chukkun Lal Roy* (1), which was the case of a will. The principle applies *à fortiori* to a Statute (see *Burton* v. *Reevell* (2); *The Queen* v. *Commissioners of Income Tax* (3), and *Attorney-General* v. *Glossop* (4)). In the last-mentioned case *Collins* M.R. applied the principle to the *Finance Acts*, notwithstanding an argument very similar to that addressed to us, that words primarily technical should be read from a popular standpoint. This principle applies with "special cogency," said Lord *Robertson* in *Lord Advocate* v. *Stewart* (5), "when the words in question present only legal conceptions. The popular use of such words does not represent the primary meaning of the words, but some half understanding of them." I therefore read the governing portion of the section in a legal sense. So reading it, we must, in order to assent to the appellants' contention, find a stipulation having the "effect" of imposing on the appellants the *obligation* of paying income tax on *the interest to be paid under the mortgage*.

Turning to the mortgage, it is one made before the commencement of the Act. The principal sum is £9,000, and by the first clause of the mortgage the mortgagors covenant to repay that sum and interest "at the rate of five pounds fifteen shillings per centum per annum reducible as hereinafter mentioned." The "hereinafter" consists of clause 7, which says: "Provided always and it is

(1) 24 Calc., at p. 846; L.R. 24 Ind. App., 76.
(2) 16 M. & W., 307, at p. 309.
(3) 22 Q.B.D., 296, at p. 309.
(4) (1907) 1 K.B., 163, at p. 172.
(5) (1902) A.C., 344, at p. 356.

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hereby agreed and declared that " if the mortgagors shall on the dates mentioned or within ten days afterwards pay interest at such a rate as will, after deducting certain taxes, which include Commonwealth income tax on £405 at the highest rates the mortgagee may be liable to pay on that sum, leave a clear remainder of £4 10s. per cent., the mortgagees will receive that in lieu of the interest mentioned in clause 1.

One observation must be made at the outset. No question arises under sec. 53 of the Act, and learned counsel at the Bar expressly stated that that section was not relied on. It is, therefore, a question not of whether the document should be reformed or whether it embodies any transaction struck at by sec. 53, but only whether, taking it as it stands, it contains a covenant or stipulation of the nature described in the opening words of sec. 54. The document has to be construed according to well settled rules. The anomaly of the rule of higher interest reducible on punctual payment being good, and of lower interest being increased for unpunctuality, is well known. In the note to *Strode* v. *Parker* (1) it is truly said that the agreement of the parties seems to be the same in either case, and the only difference is in the mode of expressing one and the same thing. Nevertheless, the difference has important results, which equity has firmly established.

The mortgage before us is carefully drawn so as to conform to the rule that maintains in certain cases the higher rate as the true interest to be paid under the mortgage. This rule the 54th section in no way seeks to alter, and therefore the effect of the mortgage, both at law and in equity, is that the interest to be paid under the mortgage is primarily $5\frac{3}{4}$ per cent., but that, on punctual payment within the limits mentioned in clause 7, a reduced rate of interest is all that can be demanded. That is an instance of what is termed by Lord *Hardwicke*, in *Nicholls* v. *Maynard* (2), an " abate . . . for prompt payment," and by Lord *Hatherley*, in *Wallingford* v. *Mutual Society* (3), an " indulgence " to the mortgagors. If they comply with the condition of payment, the reduced rate (if it be a reduced rate) becomes the rate of *interest to be paid under the mortgage*, but

(1) 2 Vern., 316, at p. 317.
(2) 3 Atk., 519, at p. 520.
(3) 5 App. Cas., at p. 702.

only if the condition is performed. If taxation exceeds $1\frac{1}{4}$ per cent. on the principal borrowed, there would be no "reduced rate." A good deal of argument has taken place as to whether payment of income tax by the mortgagors is compulsory or voluntary on their part. As I view the matter, that is entirely beside the question. The only condition for reduced interest is prompt payment within the period specified by clause 7. That prompt payment, and even more prompt payment, has already by clause 2 been expressly covenanted for by them. But in order to induce them to adhere to that covenant, and perform what they are already under an obligation to do, with a slight extension in their favour, a reduced rate of interest is promised.

But here, again, we must observe that it is not correct to say the reduced rate of interest is $4\frac{1}{2}$ per cent. It is a variable rate. On prompt payment the mortgagors are entitled to pay only a sum for interest calculated at such a rate as will provide for two factors, one variable and the other constant, neither of which, however, in itself constitutes the reduced interest, but both of which, added together, constitute the amount which will be accepted as interest, and therefore will determine the reduced rate. The variable factor is such amount as will pay (*inter alia*) the mortgagee's highest income tax on £405, stated as a fixed amount, but not identified as the interest under the mortgage, and the constant factor is a clear remainder of $4\frac{1}{2}$ per cent. per annum, and obviously part of the $5\frac{3}{4}$ per cent. per annum, the unreduced interest.

But it is very important to remember that the mortgagee does not agree to accept under any condition whatever $4\frac{1}{2}$ per cent. as reduced interest. His reduced interest is $4\frac{1}{2}$ per cent. plus the variable factor, and the total of the two, namely, $4\frac{1}{2}$ per cent. plus the rate required to produce the variable factor, is what he receives as the reduced rate of interest under the mortgage. How he chooses to apply the amount of the variable factor when he gets it, is immaterial to the mortgagors and immaterial to the Crown. It may be an interesting question what sum he returns to the Crown for income tax purposes as being the interest he gets under the mortgage. The document is drawn having in view secs. 30 and 63 of the *Land Tax Assessment Act* 1910-1911, and very adroitly and carefully to exclude,

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as far as words can exclude, the notion that the reduced interest is 4½ per cent., and that the mortgagors are compelled to pay the mortgagee's income tax on that or any tax of the mortgagee. It is drawn so as to provide that the mortgagors do not pay tax on interest at all, but pay nothing but *interest*, measured, if reduced, by adding (*inter alia*) a sum corresponding to what the mortgagee has to pay on £405 of his income to the amount calculated at the rate of 4½ per cent. on the £9,000. For all that legally concerns the mortgagors, the sum which is to govern the reduced rate of interest might have been measured by such sum as will pay the mortgagee's rent, or purchase a motor car, and leave him £100 clear. The total so ascertained is the reduced interest on the mortgage in the event of punctual payment, and the reduced rate is such rate as will produce that total sum. Consequently, the appellants are not under any obligation to pay income tax on "the interest to be paid under the mortgage." They are not under any obligation to pay income tax at all. They are bound only to pay interest at the rate of 5¾ per cent. or on prompt payment such a smaller rate as will produce the same sum as, having regard to the existing law, will amount to the sum of the two factors I have mentioned.

That being the legal construction of the instrument, we are not at liberty to paraphrase or reconstruct it, and treat it as if it were a mortgage reserving 4½ per cent. interest with an added covenant or stipulation by the mortgagors to pay the mortgagee's income tax on the interest so reserved. There is no such stipulation, and we are not at liberty to create one. The interest reserved is not 4½ per cent., and we not at liberty to prescribe that rate. There is no covenant even making it obligatory to pay the 4½ per cent. plus the variable sum necessary to make up the reduced rate of interest, and we are not at liberty to frame one. If such an instrument is to be dealt with for the purpose of testing its reality, or its validity, having regard to what is behind it, sec. 53 must be resorted to, not sec. 54. But sec. 53, as I have stated, has not been relied on in this case.

For the reasons mentioned, this case is not within sec. 54 as that at present stands. If the intention of the Legislature were to include such a case as the present, the language of the enactment does not

carry out the intention, and a Court can only judge of intention from the language actually used. More particularly should this be observed where *ex post facto* legislation alters contracts already made.

Higgins J.

HIGGINS J. The only section on which the appellants rely is sec. 54; and they are not entitled to succeed unless they show that in the mortgage there is something imposing on the mortgagors an "obligation" to pay the mortgagee's income tax on the interest to be paid under the mortgage. Where is there any such obligation? "Obligation" is a technical term of law, with a clear definite meaning; and Statutes which make law must *primâ facie* be treated as using technical words in their technical sense. There is no ground here for treating "obligation" as meaning moral obligation, or social obligation, or business obligation (in the sense of commercial pressure or expediency), or anything but legal obligation. The test is: Is there any legal sanction—would an action lie (if there were no sec. 54) against the mortgagors for failure to pay the income tax? "Obligation" involves binding; and there is nothing here to bind the mortgagors to pay the amount of the tax. There is merely an obligation on the part of the mortgagors to pay $5\frac{3}{4}$ per cent. interest on the £9,000, unless they pay punctually—not even $4\frac{1}{2}$ per cent. plus the income tax in addition, but such a rate as will, after deduction of an amount equivalent to income tax and other taxes relating to the property, yield a net $4\frac{1}{2}$ per cent. to the mortgagee. If, for instance, the mortgagee's income tax as to the mortgage were £30, the land tax £25, the property tax £20, the mortgagors would be relieved of the burden of paying $5\frac{3}{4}$ per cent. (£517 10s.) by paying punctually £480 (£405 plus £75). But there is no "obligation" to pay the income tax. Mr. *Pigott* admits that an agreement of A to give a horse to B if B pay A's income tax or an amount equal to that tax, does not impose on B an "obligation" to pay the tax; and that really settles the question. The case of *Elder* v. *Dennis* (1), cited by *Cussen* J. in the Supreme Court, is an *à fortiori* case, and one of the many demonstrations that the man who needs money, even if aided by the parliamentary draftsman, is no match for the man who has money with his skilled conveyancer.

(1) 22 V.L.R., 125; 18 A.L.T., 25.

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GAVAN DUFFY J. During the argument I was in some doubt as to whether the effect of clauses 1 and 7 of the memorandum of mortgage was not to prescribe $4\frac{1}{2}$ per cent. per annum as the rate of interest to be paid under the mortgage, and in addition to impose on the mortgagors a further obligation of paying either income tax on such interest and certain other imposts, or in the alternative of paying an annual sum equal to $1\frac{1}{4}$ per cent. on the money advanced by the mortgagee, which he might of course allocate to the payment of such imposts or any part of them. This doubt has not been removed from my mind, but I am not prepared to differ from the other members of the Court, who are of opinion that not $4\frac{1}{2}$ per cent. but $5\frac{3}{4}$ per cent. is the rate of interest which in form and substance is to be paid on the money advanced by the mortgagee. If this is so, I agree that the memorandum of mortgage contains no covenant or stipulation which has or purports to have the purpose or effect of imposing on the mortgagee the obligation of paying income tax on the interest to be paid under the mortgage.

Appeal dismissed. First and second questions answered in the negative. Third question answered thus: At the rate prescribed by clause 1 of the mortgage, reducible as prescribed by clause 7. Appellants to pay costs of appeal.

Solicitors for the appellants, *Blake & Riggall.*

Solicitors for the respondents, *Malleson, Stewart, Stawell & Nankivell.*

B. L.