STAMP DUTY: THE MEANING OF "INSTRUMENT OF SECURITY" IN THEORY AND PRACTICE

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This article examines the meaning of the phrase "instrument of security" in the Second Schedule to the West Australian Stamp Act. English and Australian cases are analysed, in particular the recent decision of the WA Supreme Court in National Mutual Life Nominees Limited v Commissioner of State Taxation. Whilst these cases give the phrase a decidedly wide meaning, the Commissioner of State Taxation does not apply the law as rigorously as he might. This gives rise to uncertainty in practice. The author suggests ways in which the problem might be overcome.

The decision of the WA Supreme Court in *National Mutual Life Nominees Limited v Commissioner of State Taxation*[1] ("*National Mutual Life*") has once again brought to the fore the vexed question of the meaning of the words "instrument of security" in item 13 of the Second Schedule to the Western Australian Stamp Act 1921 ("the Act"). The decision confirms that any document containing an obligation to pay money will potentially constitute an "instrument of security" and will be liable to duty at the rates set forth in item 13. The purpose of this article is to examine the interpretation of the words "security" and "instrument of security" by English and Australian courts and to advance some propositions about the meaning of these terms.

HISTORICAL FRAMEWORK

At the time of its enactment in 1922, the Act imposed duty on a:

> bond, covenant, or instrument of any kind whatsoever -
>
> (1) being the only or principal or primary security for any annuity ... or for any sum

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1. (1991) 4 WAR 226.

> or sums of money at stated periods not being interest for any principal sum secured by a duly stamped instrument, nor wages or salary, nor rent reserved by a lease ... [the "bond head"].[2]

The Act also imposed duty on a mortgage, bond, debenture, covenant, warrant of attorney and foreign security of any kind for the payment or repayment of money ("the mortgage head").

The bond and the mortgage heads of duty were also found in the Schedule to the English Stamp Act 1891 ("the 1891 Act") and its predecessor, the English Stamp Act 1870 ("the 1870 Act").

THE AUTHORITIES

1. English cases

By 1922, the bond head of duty found in the 1870 Act and the 1891 Act had been considered by the English courts on a number of occasions. In *Limmer Asphalte Paving Company Limited v Commissioners of Inland Revenue*[3] ("*Limmer Asphalte*") the company granted to one Hetherington a licence to carry on the business of asphalt paving. The consideration for the grant of the licence was the sum of £7 500, of which £1 500 was paid at the time of execution of the agreement and the balance of £6 000 was to be paid by six equal instalments, the first to be paid some six months after the date of the agreement. It was held by the court, almost as an aside, that the agreement constituted a covenant securing the payment of the sum of £6 000, being the sum of £7 500 less the sum of £1 500 paid at the time of execution of the agreement. *Limmer Asphalte* thus suggested that an instrument containing an obligation to pay money could be a "security" for the purposes of the bond head of duty.

Limmer Asphalte was followed by the decision of the Queen's Bench Division in *Jones v Commissioners of Inland Revenue*[4] ("*Jones*"). By this time, the 1891 Act had superseded the 1870 Act and imposed duty on a "bond, covenant or instrument of any kind whatsoever, being the only or principal or primary security for any sum or sums of money"[5] and also on a mortgage, bond, debenture or covenant.

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2. Section 16 and the Second Schedule.
3. (1872) LR 7 Ex 211.
4. *Jones v Commissioners of Inland Revenue*; *Sweetmeat Automatic Delivery Company v Commissioners of Inland Revenue* [1895] 1 QB 484.
5. Section 1 and the First Schedule.

Jones involved an agreement whereby the National Telephone Company agreed to erect and maintain certain telephone lines between Jones' head office in London and various branch offices. For the use of the telephone lines, Jones agreed to pay, each year, the sum of £11 5s per line, with a minimum of £506 5s being payable each year. The agreement was to continue for a term of ten years and thereafter from year to year.

The Commissioners assessed the agreement to duty as a security for the sum of £506 5s payable annually for an indefinite period by quarterly payments and chargeable under the bond head of duty. On appeal to the Queen's Bench Division, two arguments were raised by the taxpayer. First, that the agreement was a lease and hence was not liable to assessment under the bond head; secondly, that the agreement did not constitute a "security" because the principal object of the agreement was not to secure the payment of sums of money but rather to obtain a telephone service.

Mr Justice Wright held that, if the agreement had constituted a covenant to pay the sum of £5 000, it would have fallen within the mortgage head of duty, as a covenant securing the payment or repayment of money.[6] However, it was not such a covenant; rather, it was a covenant to pay the sum of roughly £5 000 by instalments over ten years. Such a covenant fell within the bond head of duty, which dealt expressly with cases which would have fallen within the mortgage head but for the fact that the sum payable was to be paid in a number of instalments at stated periods. He went on to hold that, notwithstanding the reference to a period of ten years in the agreement, the payments were to extend over an indefinite period. On the question whether the agreement constituted a "security" for any sum or sums of money, he held that the word did not mean an obligation which was auxiliary to some other obligation, but meant any obligation created by an instrument.[7] Finally, he rejected the argument that the agreement constituted a lease.[8] Mr Justice Collins, the other judge hearing the case, came to the same conclusion, stating that an instrument creating an obligation to pay money may be a security within the meaning of the 1891 Act.[9]

Neither of the judges dealt with the argument raised by the taxpayers' counsel which was to become increasingly important over time, namely, that the principal object of the agreement was not to secure the payment of sums of money but to obtain a telephone service.

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6. Supra n 4, 491.
7. Ibid, 492.
8. Ibid.
9. Ibid, 493.

The next occasion on which the bond head of duty was considered was the case of *National Telephone Company Limited v Commissioners of Inland Revenue*[10] ("*National Telephone*"). This case concerned an agreement under which a telephone company agreed to allow an individual to use a private telephone wire between the individual's premises and the company's exchange. In return the individual agreed to pay the company the sum of £12 per annum in advance.

The Commissioners considered that the agreement fell within the bond head and assessed it to duty as a security for the payment of £12 annually for an indefinite period. It was argued by the taxpayer that the agreement did not constitute a "security" simply because it created an obligation to pay money; in order to be a "security" there had to be a separately existing obligation for which the agreement was the security. Furthermore, it was necessary to have regard to the primary purpose of the agreement, which was the right to use a telephone wire.

The assessment was confirmed by the Court of Appeal. Lord Justice Smith referred to the argument that a "security" meant something auxiliary to an antecedent obligation, with the result that a simple contract for the payment of £12 a year for the use of a telephone was not a security within the meaning of the 1891 Act, and rejected it, on the basis that the word "security", as used in the Act, clearly included an instrument by which the obligation to pay was originally created.[11] He went on to hold that a contract in writing, whereby an obligation was undertaken to pay a certain sum of money at stated periods for an indefinite period, was chargeable under the bond head of duty. Lord Justices Rigby and Collins delivered separate judgments to the same effect.

Somewhat prophetically, Lord Justice Smith acknowledged the far reaching result of his judgment and observed that any alteration would have to be by way of legislative amendment. In a very short opinion, the House of Lords affirmed the judgment of the Court of Appeal, without commenting on Lord Justice Smith's remarks.[12]

The authorities were in this state when the Act became law in Western Australia in 1922. Surprisingly, the bond head of duty was not considered by

10. [1899] 1 QB 250.
11. Ibid, 258.
12. *National Telephone Company Limited v Commissioners of Inland Revenue* [1900] AC 1. See also *County of Durham Electrical Power Distribution Company v Commissioners of Inland Revenue* ("*County of Durham*") [1909] 2 KB 604; *British-Italian Corporation Limited v Inland Revenue Commissioners* (reported as a note to *Inland Revenue Commissioners v Henry Ansbacher and Co* [1963] AC 191, 211).

a West Australian court until forty years later, when the decision of the Supreme Court in *Neon Signs (Australia) Limited v Commissioner of Stamps*[13] ("*Neon Signs*") was handed down. In the meantime, however, the House of Lords had decided the case of *Independent Television Authority and Associated-Rediffusion Limited v Inland Revenue Commissioners*[14] ("*Independent Television*").

The document under consideration in that case was an agreement whereby Associated-Rediffusion Ltd ("AR") agreed to provide television programmes for broadcasting by the Independent Television Authority ("ITA"). The agreement was dated 23 May 1955 but was not to come into operation until 15 August 1955 (at the earliest). It was to continue in force until 29 July 1964. As consideration for the provision of the programmes, ITA was to pay AR a fee at the rate of £495 600 a year for two and a half years and at a rate of £536 900 a year thereafter. The agreement also provided for the fee to be increased or decreased in the event of an increase or decrease of five per cent or more in the retail price index.

The Commissioners assessed the agreement to nominal duty as a deed and to ad valorem duty as an instrument, being the only or principal or primary security for the payment of any sum or sums of money at stated periods. They further decided that the period was definite and certain so that the total amount to be ultimately payable could be ascertained.

The taxpayer argued that the agreement had been wrongly assessed for two reasons. First, it was not a "security" for an annuity or for a sum or sums of money at stated periods and the bond head of duty did not extend to executory contracts. To the extent that *National Telephone* decided otherwise, it was wrong and should be overruled. The primary purpose of the agreement was the provision of mutual services, not the payment of money. Secondly, even if it was a "security", it was impossible to ascertain the amount "ultimately payable" under the agreement at the date of the agreement, due to the possibility of the fee being varied.

The leading speech was delivered by Lord Radcliffe,[15] with whom Lords Tucker and Morris agreed. He noted that it had been conceded that an instrument could be a security even if it was itself the original and only source of the obligation to pay periodical sums of money, and thought this interpretation was required by the 1891 Act. He then went on to consider the substance of the taxpayer's argument on the first point, which was that, the

13. [1963] WAR 167.
14. [1961] AC 427.
15. Ibid, 438.

agreement being fundamentally executory on both sides at the date of its execution, it could not be a "security".

Lord Radcliffe rejected this argument on the ground that the point had already been determined by the decisions of the Queen's Bench Division in *Jones* and by the Court of Appeal and the House of Lords in *National Telephone*. His Lordship conceded that the interpretation placed upon the word "security" had "created some anomalies which remain unresolved", and questioned the practice of the Crown in assessing service agreements to nominal duty as agreements instead of to ad valorem duty as securities. He summarised the law in the following terms:

> I have not myself been able to see why, if the recording of an enforceable promise for the payment of money under seal or in a written instrument constitutes a 'security' for the payment of that money under the Stamp Act, such a document is any the less a security for that purpose because the promise is contingent or conditional or dependent for its enforceability upon the performance of some parallel engagement by the promisee.[16]

Insofar as the second argument was concerned, Lord Radcliffe conceded that it would be impossible to tell from the agreement how much money would eventually be paid under it due to the existence of the variation clause. However, all that was necessary was that it should be possible to ascertain from the agreement that there was some specified sum agreed upon as the subject of payment which could be called the prima facie or basic payment. Lord Radcliffe held that the sums "prima facie payable" were the annual sums of £495 600 and thereafter £536 900 and that the possible variations due to movements in the retail price index were irrelevant.[17]

2. Western Australian cases

Some two years later the scope of the bond head in the Act was examined for the first time in Western Australia in the case of *Neon Signs*. The document under consideration in that case was an agreement under which Neon Signs (Australia) Limited undertook to construct, instal and maintain a sign on the premises of the hirer, the hirer undertaking to pay monthly hire instalments during the term of the agreement. It was thus similar to the documents considered in *Jones* and *National Telephone*. The Commissioner assessed the agreement to duty under the bond head which, at the time, was in the form set out on page 375, above.

16. Ibid, 442.
17. Ibid, 443.

The taxpayer argued that the assessment was incorrect on the basis that the agreement was a hiring agreement and nothing more. In rejecting this argument, Mr Justice Virtue referred to the decisions in *Jones* and *Independent Television* and stated:

> These authorities make it clear that the term 'security' as used in the particular part of the Schedule, is used in a wide and not a limited sense; and that it includes an instrument which creates a liability to make periodic payments as well as a document which is merely collateral to a previously existing obligation. It clearly follows that an agreement for the hiring of a chattel which confers upon the hirer the obligation to make periodic payments of hire to the owner, is a security for the payment of money within the 'bond, covenant' heading in the Schedule and, unless otherwise exempted by the statute, chargeable with duty accordingly.[18]

A subsidiary argument to the effect that the agreement constituted a lease, and so fell within the exception found in the heading, was rejected.[19]

In 1979, a number of substantial amendments were made to the Act by the Stamp Act Amendment Act ("the Amending Act"). One of the amendments amalgamated the formerly separate bond and mortgage heads into one head of duty, now found in item 13 of the Second Schedule. That item imposes duty on every mortgage, bond, debenture, covenant, bill of sale, guarantee, lien or "instrument of security of any other kind whatsoever":

(1) for the payment or repayment of any sum or sums of money at stated periods:
   (a) for a definite and certain period;
   (b) for a term of life or any other indefinite period;

(2) for the payment or repayment of money.[20]

According to the Explanatory Memorandum which accompanied the Amending Act, the purpose of the amendment was to simplify the law and reduce the number of instruments that would normally be dutiable.

The first (and, so far, only) occasion on which item 13 in its revised form has been considered by the courts was the decision of the Supreme Court of Western Australia in *National Mutual Life*. That case was concerned with an agreement whereby a company granted to National Mutual Life Nominees Limited ("NML") a licence to use the grantor's pathology laboratory and service business. Under the agreement NML covenated to pay the licensor a monthly licence fee of $108 333.33. In addition, NML agreed to meet the

18. Supra n 13, 168.
19. See also *Kenworthy Homes (1971) Pty Ltd v Commissioner of State Taxation* (1975) 5 ATR 311 ("*Kenworthy Homes*").
20. Section 108.

salary and leave entitlements of the staff of the business, the rent of the premises and the rental payments due under various equipment lease agreements.

The Commissioner assessed the agreement to duty as an instrument of security for the payment of moneys for an indefinite period, within the meaning of item 13(1)(b) of the Second Schedule to the Act. On appeal to the Supreme Court, NML raised two arguments, namely, that the agreement was not an instrument of a kind referred to in the heading to item 13, and that the payment of the licence fee was incidental to the grant of the licence and did not constitute the leading and principal object of the agreement.

After a review of the English authorities and the two earlier decisions of the Supreme Court in *Neon Signs* and *Kenworthy Homes*,[21] Mr Justice Wallwork concluded that the agreement was an "instrument of security of any other kind whatsoever" and accordingly fell within item 13 of the Second Schedule.[22] A passing reference was made to the amendment made in 1979 by the Amending Act, but it was assumed that this had not affected the pre-existing law.

WAS *NATIONAL MUTUAL LIFE* CORRECTLY DECIDED?

Notwithstanding Mr Justice Wallwork's decision in *National Mutual Life*, it is respectfully submitted that it is still open to argument that the effect of the changes made by the Amending Act was to overcome, to some extent, the decisions of the Supreme Court in *Neon Signs* and *Kenworthy Homes*. As the Act stood prior to 1979, the question was whether an instrument (that is, something in writing) could be said to be the only or principal or primary security for (amongst other things) the payment of any sum or sums of money at stated periods. If the instrument in question evidenced a promise to pay, it was of no concern that it also evidenced the grant of a licence (as in *National Telephone*) or the sale of goods (as in *County of Durham*).[23] Since 1979, the first question should be, it is submitted, not whether the document is an "instrument" (something which will inevitably result in a positive answer) but whether the document in question is properly characterised as an "instrument of security for the payment or repayment of money". Once that question has been answered affirmatively, it is necessary to determine

21. Supra n 19.
22. Supra n 1, 233.
23. Supra n 12.

whether it is a security "for the payment or repayment of any sum or sums of money at stated periods [or otherwise]".

How does one determine whether an instrument is an "instrument of security ... for the payment or repayment of money"? In the absence of any definition, the only guidance as to the meaning of the expression is to be found in the context in which it occurs. The heading to item 13 refers, amongst other things, to a mortgage, bond, debenture, covenant and guarantee, as well as to an instrument of security of any other kind whatsoever. The words "of any other kind whatsoever" indicate that a mortgage and the like are regarded as instruments of security. Presumably this is because they primarily evidence an obligation to pay money (although they may, of course, secure the performance of a non-monetary obligation). Whatever may be the precise bounds of the concept indicated by the words of the heading, it is difficult to see how an agreement whereby a licence to use property is granted could come within the concept. Such an agreement would not constitute a mortgage, a bond, a debenture or a guarantee. That being the case, it seems to be placing undue weight on the words "instrument of security of any other kind" to treat them as encompassing an agreement whereby a licence is granted.

The difficulty with the foregoing argument is that the exemptions found in item 7 of the Third Schedule to the Act assume that an instrument will be an instrument of security if it evidences an obligation to pay or repay money irrespective of whether the instrument can be properly characterised as such. Some of the exemptions existed prior to the amendments made to the Act in 1979 by the Amending Act. Others, however, were introduced after 1979. These include the exemptions presently found in item 7(1) of the Third Schedule, and they clearly assume that the amendment made to item 13 in 1979 did *not* change the law as expounded in *Neon Signs* and *Kenworthy Homes*. This view is, of course, supported by the decision of Mr Justice Wallwork in *National Mutual Life*.

PROPOSITIONS

Assuming that *National Mutual Life* does represent the law, what propositions can be drawn from the authorities?

The first proposition which can be advanced is that an instrument which secures the payment of money will not be liable to duty under item 13 to the extent that the money secured was paid prior to, or contemporaneously with, the execution of the instrument. As an example, a deed whereby litigation between two parties is settled on the basis that the defendant makes a payment to the plaintiff will not be liable to duty under item 13 to the extent that the payment is made prior to the execution of the deed of settlement or contemporaneously with the execution of the deed of settlement. The authority for this is *Limmer Asphalte*.

The second proposition is that, in order to be an instrument of security, the obligation secured must be one for the payment or repayment of money. An instrument will not satisfy this test if the obligation secured is not of a monetary nature. A common example of an instrument of security falling outside item 13 is a guarantee given by a holding company, guaranteeing the performance of a building contract by a subsidiary which is a construction company. The same point arises with "gold loans", under which a quantity of gold is delivered by a "lender" to a "borrower" under a gold loan agreement, one of the conditions being that the "borrower" will deliver to the lender, at some time in the future, an equivalent quantity of gold of the same quality. A security given by the "borrower" securing its obligation to deliver gold will not be an instrument of security. In both these cases, the obligation secured is not of a monetary nature.

The third proposition is that an amount will be "payable" for the purposes of item 13 if it is contingently payable or is payable subject to conditions. So much appears from the speech of Lord Radcliffe in *Independent Television* and the judgment of the English Court of Appeal in *Underground Electric Railways Company of London Limited v Commissioners of Inland Revenue*.[24]

The fourth point is that it can be extremely difficult to determine when an instrument will be assessed to duty as an instrument of security for the payment or repayment of money. As a matter of *practice*, the Commissioner of State Taxation in Western Australia does not assess every agreement which contains a promise or undertaking to pay money after the date of execution to duty as an instrument of security, notwithstanding that the authorities seemingly authorise him to do so. As an example, the Commissioner does not in practice assess an agreement for the sale of property containing a promise or undertaking by the purchaser to pay the purchase price to duty as an instrument of security as well as a conveyance. This is so even if the agreement for sale is exempt from duty as a conveyance (for example, an agreement for the sale of property constituting "goods, wares or merchandise"). Furthermore, the Commissioner does not appear to assess underwriting agreements, whereby an underwriter agrees to take up shares to a certain value in the event of investors failing to take up the shares, as instruments of security. These examples can be multiplied, but they serve to

24. [1916] 1 KB 306.

make the point that it can be very difficult to determine in practice when an instrument will be assessed to duty as an "instrument of security".

CONCLUSION

The decision in *National Mutual Life* confirms the width of item 13 of the Second Schedule to the Act and its potential application to a wide range of commercial documents. In the writer's view, the Act ought to be further amended to make the precise boundaries of item 13 much clearer than they presently are. More particularly, item 13 ought to be amended so that it applies only to instruments securing loans of money or the provision of financial accommodation generally. This would not only remove the degree of uncertainty which presently exists but would make the Act consistent with most of the other Australian States, a factor which is of some relevance when many loan transactions and their accompanying securities are liable to duty in more than one State of Australia.