FORUM STATUTES AND INTERNATIONAL FINANCING

By Christopher Cunningham Hodgekiss*

1. THE PROBLEM

It is a common occurrence for an international loan agreement to contain a provision whereby the borrower is required to pay to the lender an amount of money equivalent to any tax which the lender is required to pay.[1] However, in Australia, such a clause may encounter problems deriving from the application of s.261 of the *Income Tax Assessment Act* 1936. This section provides in part:

> (1) A covenant or stipulation in a mortgage, 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 — ... shall be absolutely void.
>
> ....
>
> (5) For the purposes of this section, 'mortgage' includes any charge, lien or encumbrance to secure the repayment of money, and any collateral or supplementary agreement, whether in writing or otherwise, and whether or not it be one whereby the terms of any mortgage are varied or supplemented, or the due date for the payment of money secured by mortgage is altered, or an extension of time for payment is granted.

This problem has been noted on a number of occasions, and recently it was said[2] that s.261 *Income Tax Assessment Act* "... gives rise to a difficulty with the grossing-up clause in a secured loan agreement. The loan agreement is clearly collateral to any mortgage and the grossing-up provision would be absolutely void."[3]

In a recent article entitled "Current Legal Problems in Project Financing",[4] the problem of withholding tax and s.261 was discussed, and it was stated that,

> Without going into detail, we have taken the view that a loan agreement the proper law of which is not Australian law is not a collateral or supplementary agreement for the purposes of s.261. In doing so, we have relied upon those landmark cases in the development of Australian conflict of laws principles decided by the High Court and the Privy Council in *Barcelo* v. *Electrolytic Zinc Company of Australasia Ltd.*, *Wanganui-Rangitikei Electric Power Board* v. *AMP.*, and *Mount Albert Borough Council* v. *Australian Temperance and General Mutual Life Assurance Society.*
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> These cases, it is submitted, indicate that s.261 should be construed, in the absence of a clear contrary intention, so as to confine its operation to matters pertaining to Australia so as to avoid any conflict with the laws applicable to obligations the proper law of which is that of a country other than Australia.

This passage suggests that, if the proper law of an international loan agreement is not Australian law, such a loan agreement would not fall within the definition of a "mortgage" contained in s.261(5) of the *Income Tax Assessment Act*, and thus any provision in such a loan agreement entitling the lender to "gross-up" would be valid and enforceable in an Australian Court.

The question of the application of s.261 of *Income Tax Assessment Act* to a loan agreement, revolves around the interpretation to be given to a "forum statute" in general terms.[5] It is suggested that an examination of the case-law, and the academic writings in the area of forum statutes indicates that the matter is not as simple as the authors of the abovementioned article seem to suggest.

The following points emerge from a consideration of the case-law and the articles on forum statutes and conflict of laws. First, there is not one uniform approach to the interpretation of a forum statute in general terms.[6] It is true that one approach is to say that where there is a forum statute in general terms the statute will only apply to those cases in which the law of the forum would be applied by virtue of the forum's choice of law rules. This approach comes out clearly in the judgment of Dixon J. in *Wanganui-Rangitikei Electric Power Board* v. *A.M.P.*[7] However, it must be noted that this case involved the interpretation of a New South Wales statute, the *Interest Reduction Act* 1931. This matter is of importance since it is trite law that the New South Wales legislature is not a sovereign legislature, and thus cannot validly enact a law reducing interest upon *any* debt.[8] In the *Wanganui* case the relevant statute was in general terms, and there was no indication of how the transaction, that is the obligation to pay interest, was connected with New South Wales. In these circumstances, Dixon J. thought that one needed to apply "the well-settled rule of construction", i.e. where a statute was in general terms, the statute was only to apply where the choice of law rules in question pointed to the law of the forum as being applicable. In this case the New South Wales Act regulated the discharge of contractual obligations, and this was a matter for the proper law of the contract, therefore if the proper law of the contract was New South Wales, the New South Wales Act would apply, but in this case the proper law was New Zealand law, and therefore the New South Wales Act was inapplicable.[9] However, it should be noted that Dixon J. did observe that there was a qualification to the rule which he had stated. His Honour said that the rule was "... one of construction only, and it may have little or no place where some other restriction is supplied by context or subject matter."[10]

The following comments need to be made on the Dixonian approach to the interpretation of forum statutes in general terms: First, in the *Wanganui* case Dixon J. referred to his judgment in *Barcelo* v. *Electrolytic Zinc Company of Australasia Ltd.*[11] where his Honour had used a similar process of statutory interpretation.[12] However, it should be noted that the other judges in the High Court in *Barcelo* ascertained the territorial ambit of the statute in a number of different ways.[13]

Secondly, one also needs to take note of the joint dissenting judgment of Gavan Duffy C.J. and Starke J. in the *Wanganui* case. In an article by Kelly entitled "Theory and Practice in the Conflict of Laws"[14] the author refers to this joint dissenting judgment as containing "... the most significant dicta against the approach consistently used by Dixon J." The approach of Gavan Duffy C.J. and Starke J. was to consider the language of the Act, the object of the Act and the mischief to be remedied. After referring to the Dixonian approach to construction of forum statutes in general terms Gavan Duffy C.J. and Starke J. stated that "Such a result seems to ignore the circumstances in which the Act was passed, and the mischief to be remedied, and it would lead to diversities in the operation of the Act according to the expressed intention of the parties ..."[15]

Thirdly, it has also been noted by a number of commentators[16] that Dixon J.'s approach does not seem to have achieved universal approval, and also that there has been a gradual decline in the importance of Dixon J.'s approach in cases involving legislation modifying or avoiding contractual provisions.

As to the first point one can see this clearly by reference to the *Wanganui* and *Barcelo* cases. In *Wanganui*, Dixon J. applied the rule of construction based on

choice of law rules, whilst Evatt and McTiernan JJ. relied on s.17 of the *Interpretation Act* (NSW). In that case, as previously noted, Gavan Duffy C.J. and Starke J. dissented. In the *Barcelo* case only Dixon and McTiernan JJ. applied the Dixonian "rule of construction"; the other judges approached the question on different bases.[17]

As to the second point, this becomes evident when one examines the second main approach to the construction of a forum statute in general terms. Sometimes the Courts may read into the statute a particular territorial limitation, and thus create an implied territorial scope. This approach can be seen in the decisions of the High Court in *Kay's Leasing Corporation* v. *Fletcher*,[18] and *Goodwin* v. *Jorgensen*.[19]

2. CONCLUSION

The above examination of the case-law indicates the following:

(1) Dixon J.'s approach, in the cases quoted by the authors of the article entitled "Current Legal Problems in Project Financing", did not receive the unanimous support of the other judges in *Barcelo's* case, and the *Wanganui* case.

(2) The recent decisions of the High Court in *Kay's Leasing*, and *Goodwin* v. *Jorgensen*, concerned with the interpretation of forum statutes of State legislatures have not followed the Dixonian approach.

(3) The Courts may be able to avoid the Dixonian approach by relying on the qualification to the approach noted by his Honour in the *Wanganui* case. In that case, Dixon J. stated that his approach was a "rule of construction" only, and that the context or the subject matter of the legislation might supply a different restriction upon the generality of the language. Indeed, this qualification was adopted by Kitto J. in *Kay's Leasing*.[20]

(4) The courts may also be reluctant to apply Dixonian approach since it can lead to evasion of the statute, e.g. by the parties choosing some other law, apart from that of the forum, as the proper law of the contract. As Kitto J. noted in *Kay's Leasing*.[21]

> Where a provision renders an agreement void for non-compliance by the parties or one of them with statutory requirements, especially where the requirements can be seen to embody a specific policy directed against practices which the legislature has deemed oppressive or unjust, a presumption that the agreements in contemplation are only those of which the law of the country is the proper law according to the rules of private international law has no apparent appropriateness to recommend it, and indeed, for a reason of special relevance here, it would produce a result which the legislature is not in the least likely to have intended. It would mean that provisions enacted as salutary reforms might be set at nought by the simple expedient adopted in the present case of inserting in an agreement a stipulation that validity should be a matter for the law of some other country.

The following additional points need to be noted in relation to the interpretation of s.261 of the *Income Tax Assessment Act*. First, the case-law referred to above, is basically concerned with the interpretation of state legislation which is in general terms, and it is a basic proposition that the state legislatures are not fully sovereign legislatures, and that there must be some territorial nexus between the enacting state, and the relevant legislation. However, this problem of course does not arise for federal legislation since Federal Parliament, ". . . as a matter of *power*,

... can indeed deal with extra-territorial conduct, certainly since the *Statute of Westminster* 1931 (U.K.) s.3 was received in the Commonwealth by the *Statute of Westminster Adoption Act* 1942 (Cth) ..."[22] However, it has been observed by Professor Lane in his work *The Australian Federal System* that:

> Four elements can be isolated in the law underlying the cases just given or, to put it more generally, there are four notions associated with the amorphous and will o' the wisp conception of 'extra-territoriality':
>
> (1) Parliament's intention and — and this is a separate issue — Parliament's power to give its law an application outside Australia.
>
> (2) The elements in the particular power under consideration.
>
> (3) An Australian concern or interest in the overseas matter — qualification imported into Commonwealth power because of the words 'peace, order, and good government of the Commonwealth' which occur in Constitution s.51 and 52.
>
> (4) Effective enforcement of the law and public international law rules.[23]

However, if a connection with Australia has to be shown in the case of s.261, surely there is such a connection since the income tax referred to in s.261(1) is clearly Australian income tax.

Secondly, it is suggested that s.261 of the *Income Tax Assessment Act* would catch a "mortgage" as defined by s.261(5) whatever the proper law of the "mortgage".[24] This matter assumes particular importance if a lender purporting to act on a clause in a "mortgage" attempted to enforce a "grossing-up" provision in the "mortgage" in an Australian Court. It is suggested that in these circumstances an Australian Court would apply s.261, and the effect of this would be that the "grossing-up provision" would be void. However, if the lender purported to enforce the "grossing-up" provision in the Court of the country chosen as the proper law, being some other country apart from Australia, then it is possible that such a court would ignore s.261 *Income Tax Assessment Act*, and would apply the relevant proper law of the contract. This is obviously a matter for the conflict of laws of the relevant foreign forum. However, the additional question may then arise as to whether a judgment obtained in the foreign Court could be enforced in Australia. Ths subject matter is beyond the scope of this present article, but is obviously of considerable significance.

In discussing the difficult questions surrounding the interpretation of s.261 *Income Tax Assessment Act* it is clear that the section is fraught with difficulties, but I take some comfort from the statement made by Lord Holt in *Coggs* v. *Bernard*, ... "I have said thus much, ... because it is of great consequence that the law should be settled on this point; but I don't know whether I may have settled it, or may not rather have unsettled it. But however that may happen, I have stirred these points which wiser heads in time may settle."[25]

FOOTNOTES

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1. Philip Wood *Law and Practice of International Finance* Sweet & Maxwell, London, 1980, 287-288.
2. J. A. Dunstan, "Limited Recourse Financing and Some Aspects of International Finance", a paper presented at a seminar on *Public Company Finance*, held at the University of Sydney, 18th and 25th November, 1981. There is a brief discussion of s.261 in E. F. Mannix and D. W. Harris *Australian Income Tax and Practice*, Eleventh edition 1975, Butterworths, 4386.2-4387; and in *Australian Federal Tax Reporter*, paragraph 88-150.

3. "Public Company Finance" Seminar *ibid.*, paper presented on 25 November, 1981, 20. The author of the paper does suggest means of overcoming the difficulties associated with s.261: 20-22.
4. R. A. Ladbury, P. Fox, G. A. A. Nettle, "Current Legal Problems in Project Financing", (1981) *3 Australian Mining and Petroleum Law Journal* 139, 144.
5. There is a growing body of literature on statutes and conflict of laws, of which the following is a selection taken from A. V. Dicey & J. H. C. Morris *Conflict of Laws* — Morris (1946) 62 L.Q.R. 170; Unger (1967) 83 L.Q.R. 427; Kelly (1969) 18 I.C.L.Q. 249; F. A. Mann (1972-73) 46 B.Y.I.L. 117; Kelly, *Localising Rules in the Conflict of Laws*, Woodley Press, Adelaide, 1974; Kahn-Freund (1974) Recueil Des Cours, III, 234-247; Lipstein (1977) 26 I.C.L.Q. 884. The following articles are of particular relevance to the situation in Australia: D. St. L. Kelly, "Theory and Practice in the Conflict of Laws (1972) 46 A.L.J. 52; M. C. Pryles, "The Applicability of Statutes to Multistate Transactions" (1972) 46 A.L.J. 629; D. St. L. Kelly, *Localising Rules in the Conflict of Laws ibid.*; E. I. Sykes & M. C. Pryles, *Australian Private International Law.* The Law Book Company Ltd. 1979 pp. 120 ff; and D. St. L. Kelly, "International Contracts and Localising Rules" (1973) 47 A.L.J. 22. The recent decision of the Supreme Court of Canada in *R. V. Thomas Equipment Limited* [1979] 2 S.C.R. 529 is also of interest in relation to the question of the extra territorial effect of provincial legislation on the proper law of a contract. This case has been noted by H. Patrick Glenn in 59 *The Canadian Bar Review* (December 1981), 840-846.
6. This point is made clear by M. C. Pryles, "The Applicability of Statutes to Multistate Transactions" (1972) 46 A.L.J. 629 at 632 ff., and by E. I. Sykes and M. C. Pryles, *Australian Private International Law ibid.*, 122 ff.
7. (1934) 50 C.L.R. 581.
8. See M. C. Pryles, "The Applicability of Statutes to Multistate Transactions" *op. cit.*, 629 ff.
9. (1934) 50 C.L.R. 581 at 600-601 per Dixon J., and see M. C. Pryles *ibid.*, 629, 634-635; and E. I. Sykes and M. C. Pryles, *Australian Private International Law op. cit.*, 122-123.
10. (1934) 50 C.L.R. 581, 601.
11. (1932) 48 C.L.R. 391.
12. See E. I. Sykes and M. C. Pryles *op. cit.*, 122-123, and M. C. Pryles, "The Applicability of Statutes to Multistate Transactions" *op. cit.*, 633-636.
13. This point is clearly stated in E. I. Sykes and M. C. Pryles *op. cit.*, 122-123.
14. (1972) 46 A.L.J. 52, 57 ff.
15. (1933) 50 C.L.R. 581, 597.
16. D. St. L. Kelly "Theory and Practice in the Conflict of Laws" *op. cit.*, 56-57, and E. I. Sykes and M. C. Pryles *op. cit.*, 122-123.
17. D. St. L. Kelly *ibid.*, 57.
18. (1964) 116 C.L.R. 124.
19. (1973) 128 C.L.R. 374.
20. (1964) 116 C.L.R. 124, 143-144.
21. (1964) 116 C.L.R. 124, 143.
22. P. H. Lane, *The Australian Federal System* (2nd ed.) Law Book Company, Sydney, 1979, 88, and see B. J. McMahon, "Constitutional and Territorial Limitations on the Powers of Australian Governments to Tax the Incomes of Overseas Residents" (1965) 39 A.L.J. 268.
23. P. H. Lane, *The Australian Federal System ibid.*, 88. The effect of the amendment to *Acts Interpretation Act* 1901 (Cth) by the addition of s.15AA must also now be considered, on this see "Statutory Guidelines for Interpreting Commonwealth Statutes" (1981) 55 A.L.J. 711.
24. It has been noted by R. I. Barrett *Principles of Income Taxation.* (2nd ed.), Butterworths, 200-201 that: "Division 11A of Part III of the *Income Tax Assessment Act* provides for the imposition of withholding tax on interest derived from Australian sources by non-residents and on dividends paid by resident companies to non-resident shareholders."
    In these circumstances, it would indeed be peculiar if s.261 *Income Tax Assessment Act* which "... is designed to protect a mortgagor from being made liable directly or indirectly for income tax in respect of interest under the mortgage and provides that any

covenant or stipulation in a mortgage which has or purports to have this effect is void." (*Australian Federal Tax Reporter* paragraph 88-150), could be avoided by the simple device of making the proper law of the mortgage or loan agreement a foreign (i.e. non-Australian) law.

25. (1703) 2 Ld. Raym. 909, 920.