

[HIGH COURT OF AUSTRALIA.]

ATKINSON

APPELLANT ;

AND

FEDERAL COMMISSIONER OF TAXATION . RESPONDENT.

H. C. OF A. *Income Tax (Cth.)—Assessable income—Annuity—Quarterly payments under heri-
1951. tage policy—Income Tax Assessment Act 1936-1946 (No. 27 of 1936—No. 6
of 1946), s. 26 (c).*

PERTH,
Sept. 4.

MELBOURNE,

Nov. 5.

Dixon,
Webb and
Fullagar JJ.

By a policy of assurance an assurance company covenanted to pay to the executors, administrators or assigns of the assured—(1) In the event of the death of the assured within twenty years, £4,120 diminished by the sum of £39 for every completed period of three months that he survived 18th December, 1933, payable as follows : (a) £100 on death ; (b) £39 in addition on death and a similar payment at the expiration of each period of three months commencing subsequent to death and completed on or before the last day of the twenty years ; (c) £900 on the last day of the twenty years calculated from 18th December, 1933. (2) In the event of the death of the assured after the expiration of the twenty years, £1,000 payable on death. The assured died before the expiration of twenty years, and the company duly made to his widow, who was his executrix and sole beneficiary, the payment of £100 on his death and quarterly payments of £39 each.

Held that on its true construction the purpose of the policy was to provide “an income” during the period between the death of the insured and the expiration of twenty years from the date of the insurance, and that accordingly the quarterly payments of £39 were properly included in the assessable income of the widow under s. 26 (c) of the *Income Tax Assessment Act 1936-1946* as an annuity.

Perrin v. Dickson, (1929) 2 K.B. 85 ; (1931) 1 K.B. 107, and *Sothorn-Smith v. Clancy*, (1941) 1 K.B. 276, considered.

REFERENCE BY BOARD OF REVIEW.

This was a reference by a Board of Review to the High Court made pursuant to s. 196 (2) of the *Income Tax Assessment Act 1936*, as amended, on an agreed statement of facts which was substantially as follows :—

1. On 11th December 1933 Sydney Atkinson the husband of Gladys Bella Archer Atkinson (hereinafter referred to as “the

taxpayer") took out a policy of assurance with the Prudential Assurance Company Limited. H. C. OF A.
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2. The policy provided (*inter alia*) for the payment of the following benefits:—“(1) In the event of the death of the Life Assured within twenty years from and including the eighteenth day of December One thousand nine hundred and thirty-three (hereinafter called “the Commencement”) Four thousand one hundred and twenty pounds diminished by the sum of Thirty-nine pounds for every completed period of three months that the Life Assured shall have survived the Commencement payable as follows:—(a) One hundred pounds on death. (b) Thirty-nine pounds in addition on death and a similar payment at the expiration of each period of three months commencing subsequent to death and completed on or before the 1st day of the said twenty years. (c) Nine hundred pounds on the last day of the said twenty years. (2) In the event of the death of the Life Assured after the expiration of twenty years from and including the Commencement: One thousand pounds payable on death”.

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3. All premiums were paid by Sydney Atkinson in respect of the policy and were allowed as deductions in his assessments pursuant to s. 79 (e) (i) of the *Income Tax Assessment Act* 1936-1941 and the relevant corresponding prior enactments for the respective years in which they were paid to the Prudential Assurance Company Limited.

4. Sydney Atkinson died on 10th August 1940.

5. Probate of the will of Sydney Atkinson was granted on 11th September 1940 to his wife, the taxpayer, as executrix who was the sole beneficiary thereunder.

6. Between the date of death of the deceased and 30th June 1946 the Prudential Assurance Company Limited paid to the taxpayer the initial payment of £100 and the quarterly payments of £39 each mentioned in par. 2 (1) (b) hereof.

7. On 23rd April 1948 the Deputy Commissioner of Taxation for Western Australia issued to the taxpayer a notice of assessment for the financial year ended 30th June 1946 in which the sum of £156 representing four quarterly payments of £39 each received by her pursuant to the policy was included as assessable income.

8. On 25th May 1948 the taxpayer lodged with the Deputy Commissioner of Taxation an objection in writing against the assessment.

9. By a notice dated 30th November 1948 the Deputy Commissioner of Taxation notified the taxpayer that the objection had been considered and disallowed.

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10. On 1st December 1948 the taxpayer requested the Deputy Commissioner of Taxation to refer such decision to a Board of Review for review.

11. By reason of the time which elapsed between the date of the policy (18th September 1933) and the date of death of Sydney Atkinson (10th August 1940) the total amount of £4,120 referred to in the policy was diminished in accordance with the provisions of the said policy to an amount of £3,106 representing a reduction of £39 for each completed period of three months between the date of the policy and the date of death. The amount of £3,106 was made up as follows :—(i) £100 payable on death ; (ii) £2,106 being fifty-four quarterly amounts of £39 each ; (iii) £900—payable on 18th September 1953.

12. The total annual premium paid by Sydney Atkinson to the Prudential Assurance Company Limited in respect of the policy was £43 17s. 4d. per annum and the total premium which would have been payable annually for a whole of life policy for £1,000 without participation in profits would have been £25 9s. 4d. per annum and the total premium payable for a whole of life policy for £4,120 without participation in profits would have been £104 18s. 3d. per annum.

13. The taxpayer in her estate duty return lodged under the provision of the *Estate Duty Assessment Act* 1914, as amended, included the policy as an asset for the total sum of £3,106 representing the total amount to be paid over a period of years pursuant to the terms of such policy.

14. In his assessment pursuant to the *Estate Duty Assessment Act* the Commissioner of Taxation reduced the amount which should have been included as an asset to £2,121 1s. 7d., which was calculated as follows :—

	£	s.	d.
Capital or commuted value of instalments payable by £39 a quarter	1,552	2	10
The initial amount payable	100	0	0
Commuted value of deferred cash payment of £900	468	18	9
	<hr/>		
	£2,121	1	7
	<hr/>		

Pursuant to such assessment the taxpayer paid estate duty on the said amount of £2,121 1s. 7d.

15. The Commissioner of Taxation did not assess the amount of £100 being the amount payable on the death of Sydney Atkinson

under the policy and received by the taxpayer during the financial year ended 30th June 1941 as being part of her assessable income.

The questions of law referred were as follow :—(a) Whether the sum of £156 being four quarterly payments of £39 each received during the year of income ended the 30th June 1946 by the taxpayer pursuant to the policy was properly included in the assessment as assessable income? (b) If the answer to the previous question is “No” whether any part of the sum of £156 should have been properly included in the assessment as assessable income and if so what part?

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T. S. Louch K.C. (with him *H. N. Guthrie*), for the appellant. An income purchased with a sum of money only becomes an annuity when the capital is gone and ceases to exist. The classical definition of an annuity is that given by *Watson B.* in *Foley v. Fletcher* (1). The acquisition of an annuity by purchase involves a change of capital into income: *Scoble v. Secretary of State in Council for India* (2). If it is agreed *inter partes* that a debt shall be paid by instalments such instalments are not annuities: *Chadwick v. Pearl Life Insurance Co.* (3).

[*Fullagar J.* referred to *Commissioner of Taxes (Vict.) v. Phillips* (4).]

In the present case the principal is never parted with but is repaid with interest. The repayments are not income: *Perrin v. Dickson* (5). In this case the repayment of the principal sum is spread over a period and is repaid with interest: *Egerton-Warburton v. Deputy Federal Commissioner of Taxation* (6). The arrangement may be one for the return of capital even though the number of instalment payments is unknown and is dependent on the life of the creditor: *Dott v. Brown* (7). The fact that the payment is made annually does not determine the question: *Sothorn-Smith v. Clancy* (8); *Watkins v. Deputy Commissioner of Taxation* (9). Whether the sums received be income or capital must depend upon the true construction of the contract under which the sums are received and paid: *Inland Revenue Commissioners v. Wesleyan & General Assurance Society* (10).

(1) (1858) 3 H. & N. 769, at pp. 784, 785 [157 E.R. 678, at pp. 684, 685].

(2) (1903) 1 K.B. 494; (1903) A.C. 299.

(3) (1905) 2 K.B. 507.

(4) (1936) 55 C.L.R. 144.

(5) (1929) 2 K.B. 85; (1931) A.C. 107.

(6) (1934) 51 C.L.R. 568, at p. 572.

(7) (1936) 1 All E.R. 543.

(8) (1941) 1 K.B. 276, per Sir Wilfrid Greene M.R., at pp. 282, 283.

(9) (1946) 49 W.A.L.R. 63.

(10) (1946) 2 All E.R. 749; (1948) 1 All E.R. 555.

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L. D. Seaton K.C. (with him *P. Connaughton*), for the respondent. The quarterly payments when received are taxable under s. 26 (c). A sum of money received periodically over a term of years is an annuity and it matters not what the parties themselves call such payments: *Scoble v. Secretary of State in Council for India* (1). The purpose of the present policy was to secure an income for the dependants of the life assured. [He referred to *Commissioner of Taxation (Vict.) v. Phillips* (2).] The transaction in this case amounts to the purchase of an income and it is for this reason taxable: *Sothorn-Smith v. Clancy* (3). The amount received under the policy has no relation to the number of premiums paid and there is no question of a capital sum being returned by instalments. *Perrin v. Dickson* (4) is a very doubtful decision and one turning on very special facts.

T. S. Louch K.C. in reply.

Cur. adv. vult.

Nov. 5.

THE COURT delivered the following written judgment:—

This is a reference by a Board of Review made pursuant to s. 196 (2) of the *Income Tax Assessment Act* 1936 as amended, on the request of the commissioner. The taxpayer is the widow of Sydney Atkinson, who died 10th August 1940. She is the executrix of his will and takes thereunder as sole beneficiary. Over six years before his death her late husband had obtained from the Prudential Assurance Company Ltd. a policy of insurance called a "heritage policy". He was then forty years of age. The insurance commenced as from 18th December 1933 and the policy stipulated for a half-yearly premium of £21 18s. 8d. payable until 18th June 1953, a period of twenty years, or until the previous death of the insured. If the premiums were paid, then the company covenanted to pay Atkinson's executors administrators or assigns "the benefit or benefits", as the policy expressed it, set out in the policy substantially thus:—(1) In the event of the death of Atkinson within such twenty years, £4,120 diminished by the sum of £39 for every completed period of three months that Atkinson had survived 18th December 1933, payable as follows (a) £100 on death (b) £39 in addition on death and a similar payment at the expiration of each period of three months commencing subsequent to death and completed on or before the last day of the twenty years (c) £900

(1) (1903) 1 K.B. 494; (1903) A.C. 299.

(2) (1936) 55 C.L.R. 144.

(3) (1941) 1 K.B. 276, per Sir Wilfrid Greene M.R., at pp. 282, 283.

(4) (1929) 2 K.B. 85; (1931) 1 K.B. 107.

on the last day of the twenty years calculated from 18th December 1933. (2) In the event of the death of Atkinson after the expiration of the twenty years, £1,000 payable on death.

The company duly made to the widow as executrix the payment of £100 on the death of her husband and has since made the quarterly payments to her of £39 each. The Commissioner of Taxation insists that these quarterly payments, amounting annually to £156, form part of her assessable income.

He appears to have made assessments of her taxable income on this footing for the four years of income ending 30th June 1943 to 1946. Against these assessments she objected and, on the objection being disallowed, she requested the commissioner to refer the decision to a Board of Review. One year was chosen by her advisers for obtaining the actual decision by the Board of Review, that for the year of income ending 30th June 1945. The board decided that the commissioner was wrong and that the payments amounting to £156 per annum did not form part of her assessable income. The commissioner did not appeal from that decision. But he did not accept the board's decision and by amendment apply it to the assessment for the next year of income, that ending 30th June 1946. When the reference in that year came before the Board of Review he exercised his right under s. 196 (2) of requiring a reference of the question to this Court.

In including the sum of £156 in the taxpayer's assessable income the commissioner acted upon s. 26 (c). That provision says that the assessable income of a taxpayer shall include the amount of any annuity. The question for decision is whether the quarterly payments amounting to £156 a year constitute an annuity within this provision. Section 26 (c) does not end with the words quoted, and, although what follows is not relevant to the decision of this case it is better to set it out. The paragraph runs: "the amount of any annuity, excluding, in the case of an annuity which has been purchased, that part of the annuity which represents so much of the purchase price as has not been allowed or is not allowable as a deduction or in respect of which a rebate of income tax has not been allowed or is not allowable in assessments for income tax under this Act or any previous law of the Commonwealth". The words of exclusion cannot be relevant in this case because, even if the "annuity" were regarded as "purchased", the premiums paid by Atkinson in his life time must presumably be considered the purchase price and they were allowed as deductions in his assessments pursuant to s. 79 (e) (i) of the *Income Tax Assessment Act 1936-1941* and the corresponding previous enactment.

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In considering whether the quarterly payments of £39 to the widow constitute an annuity, it is well to begin by noticing some of the features of the "benefit" the policy assures to her as executrix of the insured. First it will be seen that no sum certain is named as that payable in consequence of the death of the insured. There is a sum fixed as the base, the maximum, and that is to be diminished as time advances by £39 a quarter. The diminishing amount is payable only in the event of death within twenty years. In the event of death after that period a fixed sum of £1,000 is payable. But upon death within the twenty years what is actually payable is not one lump sum but the two lump sums of £100 and (at the end of the period) £900 and the quarterly payments to the end of the period. This will, however, add up to the diminished sum, that is to say, to the £4,120 minus £39 multiplied by the number of completed quarters between 18th December 1933 and the death of the insured. Thus in the events which happened in the present case, the widow as executrix will have received by 18th December 1953 £2,106 in quarterly payments of £39 and £100 and £900, making in all £3,106. The insured survived 18th December 1933 for twenty-six completed quarters and therefore £1,014 is the amount by which the £4,120 is to be reduced. That leaves the figure of £3,106.

The question what constitutes an "annuity" for the purpose of income tax laws has been the subject of much judicial decision without any clear or satisfactory test emerging. In England "any annuity or other annual payment" is chargeable under r. 1 (a) of the Rules applicable to Case III. of Schedule D of the *Income Tax Act 1918* (Imp.) (8 & 9 Geo. 5 c. 40). That provision goes back substantially in its present form to the Act of 1853 and in other forms almost to the beginning of income tax: cf. per Lord Macnaghten, *London County Council v. Attorney-General* (1). In deciding whether annual payments form an annuity the difficulty has been to find a satisfactory test for distinguishing between periodical instalments by way of payment or repayment of a capital sum and a fixed sum by way of income terminating at a time certain or on an uncertain event, as on the death of the payee. Yet such an income annuity may be purchased by a capital payment. In *Scoble v. Secretary of State for India* (2) *Vaughan Williams L.J.*, whose judgment was approved in the House of Lords (3), said:—"It could not be said that every annual sum payable on a contract was necessarily an annuity within the

(1) (1901) A.C. 26, at pp. 37-39.

(2) (1903) 1 K.B. 494, at p. 501.

(3) (1903) A.C., at p. 303.

Income Tax Acts. It had to be admitted that, in any case in which it appeared on the face of the contract that there was a debt existing of such a nature that it could be said that the contract was not to purchase an annuity, but a contract under which a debt was made payable by instalments, in such a case the Income Tax Acts would not apply to the whole sum payable by such annual instalments". There the Secretary of State, having purchased the Indian Railway, had an option, instead of paying the value in a gross sum, to pay what was called an annuity for a term of years, the annuity being ascertained in a prescribed manner and being payable to annuity trustees. "The method of payment provided by the . . . clause was in substance and in fact the payment of the price . . . by means of half-yearly instalments, each of such instalments being composed in part of capital and, as to the residue, of interest on the amount of the price for the time being unpaid" (1). Notwithstanding the use of the description "annuity", the payments, except in so far as they represented interest, were held to be but instalments of the capital price and therefore not within Case III. Lord *Lindley* said (2):—"The annuity in this case is to my mind proved to demonstration to be nothing more than the payment by equal instalments of the purchase-money for the railway with interest." In *Chadwick v. Pearl Life Insurance Company* (3) Walton J. said:—"It is obvious that there will be cases in which it will be very difficult to distinguish between an agreement to pay a debt by instalments, and an agreement for good consideration to make certain annual payments for a fixed number of years. In the one case there is an agreement for good consideration to pay a fixed gross amount and to pay it by instalments; in the other there is an agreement for good consideration not to pay any fixed gross amount, but to make a certain, or it may be an uncertain, number of annual payments. The distinction is a fine one, and seems to depend on whether the agreement between the parties involves an obligation to pay a fixed gross sum."

It may be doubted whether the test of a fixed gross sum may not mislead, because after all the fixed gross sum may be applied or appropriated as the consideration for the grant of an annuity; and "an annuity means where an income is purchased with a sum of money and the capital has gone and has ceased to exist, the principal having been converted into an annuity"—per *Watson B.*,

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(1) (1903) 1 K.B., at p. 497.

(2) (1903) A.C., at p. 305.

(3) (1905) 2 K.B. 507, at p. 514.

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Foley v. Fletcher (1). The decision of this Court in *Egerton-Warburton v. Deputy Federal Commissioner of Taxation* (2) affords an example, and the observations of *Rowlatt J.* in *Jones v. Commissioner of Inland Revenue* (3) give others. In *Perrin v. Dickson* (4) the taxpayer, a clergyman, had effected an insurance with the Clergy Mutual Assurance Society for the purpose of making a provision for his infant son's education when he grew older. For six premiums of £90 paid from 1912 to 1917 he obtained an annuity of £100 for seven years from 1920. If his son died in the meantime the premiums were to be returned less any payment on account of the annuity but without interest. It was decided that this annuity was not taxable. *Rowlatt J.* so decided on the ground that "the position was not so much that the principal was repaid by means of the annuities as that it was never parted with". His Lordship said:—"In the case of a life annuity the principal sum is of necessity parted with and disappears. But here the principal is never lost sight of. It is always there and is repaid, in certain events without interest, in other events with interest" (5). In the Court of Appeal this decision was affirmed. But, of the reasons given in the Court of Appeal, it was said by *Greene M.R.* that he must confess that he found the reasoning of the judgments difficult to follow: *Sothorn-Smith v. Clancy* (6), and *Clauson L.J.* (7), after referring to the fact that if the premiums had not been kept up the insured would not have been entitled to any payment, said this circumstance might in a court having power to overrule the decision be a matter for serious consideration. *Goddard L.J.* (8) distinguished the decision on the facts. *Sothorn-Smith v. Clancy* (9) related to payments under a contract by the taxpayer with the Equitable Life Assurance Society of the United States. He paid a lump sum in consideration of which the Society agreed to pay him an annuity during his life and, if at his death the aggregate payments did not equal the amount he had paid, then to pay the annuity to his wife or sister until they did so. The Court of Appeal held that what the taxpayer was paid was subject to tax as an annuity. *Greene M.R.* expressed the essential ground of his decision in this sentence (10):—"It seems to me that the capital sum did cease to exist when once it was paid; and that the so-called

(1) (1858) 3 H. & N. 769, at pp. 784-785 [157 E.R. 678, at p. 684].

(2) (1934) 51 C.L.R. 568.

(3) (1920) 1 K.B. 711, at pp. 714, 715.

(4) (1929) 2 K.B. 85; (1931) 1 K.B. 107.

(5) (1929) 2 K.B., at pp. 89, 90.

(6) (1941) 1 K.B. 276, at p. 284.

(7) (1941) 1 K.B., at pp. 291, 292.

(8) (1941) 1 K.B. 276, at p. 294.

(9) (1941) 1 K.B. 276.

(10) (1941) 1 K.B., at p. 286.

guarantee was an undertaking not to refund a capital sum or any part of a capital sum, but to continue annual payments for an ascertainable period". *Clauson* L.J. said (1):—"The only continuing relation between the annuity and the vanished capital sum is that the amount of the vanished capital sum is arbitrarily taken to measure the minimum period for which the annuity is to run". *Goddard* L.J. said (2):—"The only principle that I can deduce from the cases is that the court must have regard to the true nature of the transaction from which the annual payment arises and ascertain whether or not it is the purchase of an annual income in return for the surrender of capital. If it is the purchase of an income the annual payment is taxable; if it is a capital payment it is not, though in the latter case if the annual sum represents a payment or a return of capital coupled with interest, the sum may be dissected and tax charged on so much as represents interest." It is impossible to read the judgments through without concluding that *Perrin's Case* (3) did not in the least commend itself to their Lordships. The important features of *Perrin's Case* (4) and of *Sothorn-Smith's Case* (5) upon which the decisions turned are not found in the present case. So far as the reasoning provides guidance it is the second case which should be used: the earlier decision may safely be neglected.

An obvious circumstance of the case now to be decided is that the number of premiums paid in no way determines the amount of the policy moneys. There is therefore no question of the investment of a capital sum which may be considered returned by annual instalments. The feature of the policy upon which the taxpayer's case appears to us to depend is that the policy money is described first as a lump sum and that sum is made payable by means of the £100, the quarterly payments of £39 and the £900.

The lump sum is uncertain because it is ascertainable only by reference to the date of the insured's death. But when ascertained it is described in terms as the amount payable by means of the quarterly payments and the two other sums. Arithmetically the lump sum depends as much upon the quarterly payments and the two other sums as they do upon it. They are equivalents depending upon the fact that at whatever date within the twenty years the

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(1) (1941) 1 K.B., at pp. 291.

(2) (1941) 1 K.B., at p. 293.

(3) (1929) 2 K.B. 85; (1931) 1 K.B.
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(4) (1929) 2 K.B. 85; (1931) 1 K.B.
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(5) (1941) 1 K.B. 276.

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insured died, £39 must be deducted for every quarter since 18th December 1933 that he had survived and £39 must be paid for every quarter of the remaining years of the twenty. The £4,120 is calculated by taking eighty (possible) payments of £39, with the addition of the £100 on death and the £900 at the end of twenty years. The statement in the policy that the sum of £4,120 diminished &c. is "payable as follows", is therefore without any but a formal significance. As the question whether the £39 a quarter is an annuity is to be governed, not by the intention of the parties that it should or should not be so classified, but on substantial considerations disclosing "its true nature", it would seem that little importance should be attached to the formal manner in which the policy states "the benefit" it assures. But an examination of that "benefit" makes it clear that the purposes of the policy were first to provide a sum, although not a very large sum immediately on death, then to provide a quarterly payment equivalent to £3 a week in case of premature death for an interval of time thereafter fixed by reference to the date of insurance, and finally to provide at the end a substantial lump sum. It seems obvious that the purpose was to provide "an income" during the period between the death of the insured and the expiration of twenty years from the date of the insurance, the use of which the insured could direct by his will. The diminishing liability of the company as time advanced shows, of course, the basis in actuarial probability upon which the profitable character of the company's "heritage policies" must rest. But the distinction drawn between on the one hand the initial and final lump sums and on the other hand the quarterly payments indicates the different objects of these provisions. The limitation of twenty years from the date of insurance, the periodicity of the payments of £39, the amount itself of £39, and the contrast with the two lump sums of £100 and £900, all show that the quarterly payments were provided as an income. The premiums were the consideration for which the "income" of £39 a quarter was obtained. The quarterly payment in no sense represents the premiums and its intrinsic character is an income for the maintenance of those on whom the insured by his will should bestow it, in case of his premature death, until the end of a time regarded by him as either adequate having regard to their circumstances or else as being as much as he was prepared to provide for.

For these reasons the first question in the reference should be answered—Yes. Having regard to that answer the second question

does not arise. There should be no order as to the costs of the reference. H. C. OF A.

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*First question in the reference from the Board
of Review answered—Yes.*

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No order as to costs of the reference.

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Solicitors for the appellant, *Lohrmann, Tindal & Guthrie*.

Solicitors for the respondent, *D. D. Bell*, Crown Solicitor for the Commonwealth.

F. T. P. B.