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TECHNICAL

Direct Taxation

TAX CASE UPDATE

Whether franchise fees received from overseas franchisees were income derived from source outside Malaysia? Whether consequential penalty imposed under Section 113(2) of the ITA is correct in law.

Kyros International Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (2013) (CA)
(Civil Appeal No: B-01-16-2010)

Facts:

Kyros International Sdn. Bhd. (KISB) is in the business of operating kebab fast food chain and investment holding. It is the registered owner of the trade mark, KYROS, and granted the sole and exclusive right to the franchisee to establish and operate in a designated area. The operation of fast food chan activities was transferred to KYROS Kebab Sdn Bhd. In other words, there is a separation between the operations from the holding of rights and trademarks in the two separate entities.

KISB entered into franchise agreement with overseas franchisees. There are two types of franchise agreements, the Master Franchise Agreement and the Non-exclusive Unit Franchise Agreement. The former were subject to payments for *franchise fee, royalties* (consist of a sum equal to 5% of the turnover and a sum equivalent to 50% of the continuing monthly royalty) and *business development fees*. The latter were subject to payment for *franchise fee* and monthly *royalty* equal to 5% of the gross turnover. The franchise fees payable include the cost of initial technical and outlet training and other matters (if any).

It was asserted that the right granted has 2 distinct aspects, namely, the proprietary trade mark, KYROS, and the operating system of the appellant. Support for the franchisee is provided by sending KISB's staff to audit on the operating system, and advice on ways to improve operations and business development.

Issues

(1) whether payments received by KISB under the franchise agreement it entered with foreign entities are exempted under Paragraph 28, Schedule 6 of the ITA;

(2) whether the penalty imposed under Section 113(2) of the ITA is correct in law.

Decision:

Franchise Fees

The SCIT found as a fact that the "*"execution or operations of business by the foreign franchisees took place outside Malaysia",* and *"hold that all activities in respect of the agreements entered into with the foreign entities took place outside Malaysia.*". Relying on Privy Council case of *CIR v. Hang Seng Bank Ltd [1990]* STC 733, the SCIT held that all the activities in respect of the franchise agreement is akin to letting property as stated in that case and the franchise fees received from the foreign franchisees are income received "from the place where the property was let.". Hence, they are exempted of income tax under Paragraph

28, Schedule 6 of ITA and allowed appeal by KISB.

The High Court ruled that:

- From the facts established, it is clear that franchise fees excludes royalty, which is to be charged separately based on turnover. Hence, "the franchise fee is essentially for the purpose of the services rendered by the franchisor to the franchisee." KISB contention that the exploitation of trade mark was outside Malaysia was irrelevant as the franchise fees do not include exploitation of trade mark.
- The reliance placed by the SCIT on the fact that "…the execution or operation of business by the foreign franchisees took place outside" is irrelevant in determining whether the receipt of franchise fee is outside or within Malaysia. The fact that the operations of franchisees are abroad does not support the SCIT's findings that operation of KISB is abroad. KISB is in receipt of franchise fee from the franchisee and not income from the business of selling kebab.
- The proper consideration before the SCIT should be, whether the franchise owned, services and advice provided by KISB to the overseas franchisees under the franchise agreements, are indeed an operation outside Malaysia by KISB. The SCIT had misdirected itself in concluding that the operation of the franchisor was outside Malaysia on the basis that the operations of the franchisees were outside Malaysia.
- As decided in *ABC v Comptroller of Income Tax, Singapore (1959)* 1 MLJ 1963, the burden to show that the assessment was erroneous and what is right is always on the taxpayer. However, KISB failed to establish in evidence to show that the operation or activities of KISB in providing the services to the foreign franchisee is an operation outside Malaysia. The SCIT's findings made without any evidence is an error.
- An appellate court can intervene with the decision of the SCIT on the grounds of misconception of law, or conclusion of law which cannot be supported by the primary facts and conclusion of mixed fact and law that no reasonable SCIT could have reached if they had correctly directed themselves. Such principle is supported in the Court of Appeal decision in *Chua Lip Kong v Director General of Inland Revenue [1982] 1 MLJ 235* and in the Supreme Court decision in *Lower Perak Co-operative Housing Society Bhd v. KPHDN [1994] 3 CLJ 265.* Consequently, the appeal by IRB is allowed.

The Court of Appeal held that:

- "Appeal is a rehearing of a case." Where a court sits in its appellate jurisdiction and interferes in the finding of facts of a trier of facts, three things must appear from the judgment of the court:
  " (i) that the court has applied its mind to reasons given by the trier of facts
  (ii) that the court's cognisance that the trier of facts had the advantage of seeing and hearing the witnesses the benefit of which the appellate court do not have; and
  (iii) that the court must give cogent reasons for disagreeing with trier of facts."
- "It is not permissible for court exercising appellate jurisdiction to extract abstract statements from the submission of the parties without going through a process of full hearing as advocated in the Courts Judicature Act 1964, and stating in the grounds that there was "insufficient judicial appreciation" or the judge or tribunal "fell into error" etc."
- "Where the decision of the SCIT is appealed to the High Court by way of case stated, the burden lies on the appellant (in this case the IRB) to satisfy the court that the SCIT's decision was based on the misconception of the law or their conclusion cannot be supported by the primary facts and that conclusion on the mixed facts and law in this case was such that no reasonable Special Commissioners could have reached it if they had correctly directed themselves."

- It is well settled that the appellate court generally recognizes the special position of the SCIT. In Edwards v Bairstow & Harrison 36 TC 207, Lord Radcliffe has stated that "the reason why the Courts do not interfere with Commissioners' findings or determinations when they really do involve nothing but questions of fact is not any supposed advantage in the Commissioners of greater experience in matters of business or any other matters. The reason is simply that by the system that has been set up, the Commissioners are the first tribunal to try an appeal and in the interest of the efficient administration of justice, their decision can only be upset on appeal if they have been positively wrong in law. The Court is not a second opinion, where there is a reasonable ground for the first."
- In Chua Lip Kong v Director General of Inland Revenue [1982] 1 MLJ 235, the Privy Council held that "their Lordships cannot stress too strongly how important it is that, in every Case Stated for the opinion of the High Court, the Special Commissioners should state clearly and explicitly what are the findings of fact upon which their decision is based and not the evidence upon which those findings, so far as they consists of primary facts, are founded. They can be neither overruled nor supplemented by the High Court itself; occasionally they may be insufficient to enable the High Court to decide the question of law sought to be raised by the Case Stated, but in that event it will be necessary for the Case to be remitted to the Commissioners themselves for further findings."
- On the factual matrix of the instant case, the Court of Appeal agreed with learned counsel for KISB that the finding of facts of the SCIT does not warrant the appellate interference by the High Court and allowed the appeal of KISB.

Penalty

KISB relies on the case of Office Park Development v Ketua Pengarah Hasil Dalam Negeri [2011] 9 MLJ 479, where the High Court held that the SCIT were correct in their finding that the taxpayer's incorrect return was made in good faith and that the penalty imposed by the IRB in respect of the same should be waived. In that case, the Court indicated that "(the) IRB's contention that s.113(2) of the ITA did not provide the defence of good faith was without basis. The penalty provisions in ss113(1) and (2) of the ITA are to punish taxpayers who deliberately submit incorrect tax returns and information and it was not the intention of the Parliament to punish innocent taxpayers. Further, it was not mandatory for the IRB to impose a penalty in all tax audits."

The SCIT found that there was no non-disclosure of information on the accounts in the book of KISB and it had also given full disclosure during audit. The SCIT made its finding that KISB had not been recalcitrant and "had not made incorrect returns for all the tax years under appeal". The SCIT allowed KISB appeal on the imposition of penalty by the IRB.

The High Court held that:

It is clear that under s.113(2) of ITA, the discretion to impose penalty or otherwise is solely at the discretion of Revenue Department. In view of the fact that "franchise fee" is not given specific treatment under ITA, neither is there any guideline or direction issued by the IRB on the same, it is an appropriate situation for the DGIR to exercise his discretion in favour of the taxpayer. The appeal of the IRB should be dismissed.

The Court of Appeal takes the view that the learned judge (of the High Court) was right to sustain the decision of the Special Commissioners.

IN THE COURT OF APPEAL OF MALAYSIA

(APPELLATE JURISDICTION)

CIVIL APPEAL NO: B-01-16-2010

BETWEEN

KYROS INTERNATIONAL SDN BHD … APPELLANT

AND

KETUA PENGARAH HASIL DALAM NEGERI … RESPONDENT

[In the matter of Suit No: R2-14-15-2011
In the High Court of Malaya in Kuala Lumpur

Between

Ketua Pengarah Hasil Dalam Negeri … Appellant

And

Kyros International Sdn Bhd … Respondent]

CORAM:
Linton Albert, JCA
Mohtarudin Bin Baki, JCA
Hamid Sultan Bin Abu Backer, J

Hamid Sultan Bin Abu Backer, J. (Delivering Judgment of The Court)

[1] This is our judgment in respect of the appellant's appeal and the respondent's cross appeal. We heard both the appeals on 5.12.2012 and allowed the appellant's appeal and dismissed the respondent's cross appeal with costs to the appellant. My learned brothers, Datuk Linton Albert and

Datuk Wira Mohtarudin bin Baki, have read the judgment in draft form and approved the same.

[2] The appeal revolves on a complaint of the appellant that the learned High Court judge interfered in the finding of facts of the Special Commissioners of Income Tax (SCIT) and to drive home the point relies on the case of *Chua Lip Kong v Director-General of Inland Revenue [1982] 1 MLJ 235* where the Privy Council in no uncompromising terms held:

> *"Their Lordships cannot stress too strongly how important it is that, in every Case Stated for the opinion of the High Court, the Special Commissioners should state clearly and explicitly what are the findings of fact upon which their decision is based and not the evidence upon which those findings, so far as they consist of primary facts, are founded. Findings of primary facts by the Special Commissioners are unassailable. They can be neither overruled nor supplemented by the High Court itself; occasionally they may be insufficient to enable the High Court to decide the question of law sought to be raised by the Case Stated, but in that event it will be necessary for the Case to be remitted to the Commissioners themselves for further findings."* (emphasis added)

[3] At this stage of our judgment itself, we must say that courts exercising the appellate jurisdiction have over the years placed upon themselves various levels of self-imposed restrictions for appellate interference on the finding of facts of trial courts or tribunal, or statutory appeal by case stated as in the instant case [see *Colgate Palmolive (M) Sdn Bhd v Yap Kok Foong and Another Appeal [2001] 4 MLJ 97*]. It must also be noted that the scope of appellate interference may be further restricted depending on the nature of the appeal as the jurisdiction relating to appeal, revision, review, reference

etc., and the jurisprudence relating to such *'heads'* are not one and the same [see *Hari Shankar v Rao Girdhari Lal AIR 1963 SC 698*].

[4] When dealing with appellate interference on finding of facts, it is important to appreciate that the *Evidence Act 1950* categorises facts into two types. They are physical fact and psychological fact. Physical facts under the Act refer to anything, state of thing, or relations of thing capable of being perceived by the senses. Psychological facts refer to any mental condition of which any person is conscious of.

[5] As a general rule finding of facts of trier of facts is rarely disturbed by appellate court more so when it relates to physical facts. As long as the trier of facts has directed his mind to the relevant issues, and had acted in accordance with the law and the decision passes the test of reasonableness, the finding of facts relating to physical facts will not be ordinarily disturbed notwithstanding the judgment is brief and direct to the point. However, when it relates to psychological facts the trier of facts is expected to give more cogent reasons to ensure every aspect of the relevant evidence has been considered in the right perspective to pass the test of reasonableness. [see *Lee Ing Chin @ Lee Teck Seng & Ors v Gan Yook Chin & Anor [2003] 2 MLJ 97*]. Failure to give sufficient reasons in the grounds of judgment may result in appellate interference. This is evident from decided criminal cases and very seldom in civil cases as psychological facts may not be relevant unless it is a probate matter, consisting of issues such as *animus testandi*, undue influence or fraud etc. or in civil cases relating to conspiracy or motive etc. When it relates to statutory appeals concerning SCIT the test for

appellate interference is much stricter [see *Edwards v Bairstow & Harrison 36 TC 207*].

Brief Facts

[6] The SCIT unanimously allowed the appellant's appeal before them on the following issues, namely: (i) whether or not the following payments (overseas) received under the franchise agreement entered by the appellant with foreign entities are exempted under *Paragraph 28 Schedule 6* of the *Income Tax Act 1967* (ITA 1967); and (ii) whether the penalty imposed under *Section 113 (2)* of the *ITA 1967* is correct in law.

[7] The respondent succeeded before the High Court on the first issue but failed on the second, and hence the cross-appeal before the Court of Appeal by the respondent. The learned High Court judge had given some consideration to the issues in the Grounds of Judgment and *inter alia*, had stated:

> *"[36] As found by the SCIT the imposition of penalty by the Revenue Department was on the ground of failure of the taxpayer to make or give accurate returns and information. It was found by SCIT also that there was no non-disclosure of information on the accounts in the book of the taxpayer. The taxpayer had also given full disclosure during audit. The SCIT made its finding through witness RW1, that the taxpayer had not been recalcitrant, and "had not made incorrect returns for all the tax years under appeal."*
>
> *[37] It is clear that under s. 113 (2) ITA the discretion to impose penalty or otherwise is solely at the discretion of Revenue Department. In view of the fact that "franchise fee" is not given specific treatment under ITA at this point in time, neither is there any guideline or direction issued by the Appellant on the same, in*

my view this is an appropriate situation for the KPHDN to exercise his discretion in favour of the taxpayer. In the circumstances of the present facts, the appeal of the KHDN on this issue should be dismissed."

[8] The learned counsel for the appellant's submission can be summarised as follows:

(a) The law to be considered for the purpose of appeal is *Sections 3, 12* and *Paragraph 28 Schedule 6* of the *ITA 1967*.

(i) *Section 3* reads as follows:

*"**Section 3. Charge of income tax***
Subject to and in accordance with this Act, a tax to be known as income tax shall be charged for each year of assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia."

(ii) *Paragraph 28 Schedule 6* reads as follows:

*"**SCHEDULE 6: Exemption from tax***

28. (1) Income of any person, other than a resident company carrying on the business of banking, insurance or sea or air transport, for the basis year for a year of assessment derived from sources outside Malaysia and received in Malaysia."

(iii) *Section 12 (1) (a)* reads as follows:

*"**12. Derivation of business income in certain cases.***

(1) Where for the purposes of this Act it is necessary to ascertain any gross income of a person derived from Malaysian from a business of his, then-

(a) Subject to subsection (2), so much of the gross income from the business as is not attributable to operations of the business carried on outside Malaysia shall be deemed to be derived from Malaysia;"

(iv) The appellant established a substantial reputation and goodwill in the business of operating kebab fast food chain.

(v) The appellant is the registered owner of the trade mark, KYROS.

(vi) The appellant granted the sole and exclusive right to the franchisee to establish and operate in a designated area.

(vii) The appellant asserts the right granted has two distinct aspects namely: the proprietary trade mark, KYROS, and the operating system of the appellant.

(viii) The appellant supports the franchisee in the operations by giving the following services: audit on the operating system to ensure compliance with the standard operating procedure and

giving advice to the franchisee on ways to improve operations and business development.

(ix) In order to achieve the services in (viii) above, the appellant sends staff.

(x) The SCIT found that the franchise fees received from Pakistan, China, Indonesia, Singapore, and Brunei are exempt under *Paragraph 28 (1) Schedule 6* of the *ITA 1967*.

(xi) The SCIT held:

"We find as a fact the execution or operations of business by the foreign franchisees took place outside Malaysia, through the evidence of the Respondent's witness (RW1). The foreign franchisees are independent i.e. not related to the Appellant. We therefore hold that all activities in respect of the agreements entered into with the foreign entities took place outside Malaysia."

(xii) The learned judge recognised that the SCIT found as a fact that the foreign franchise took place outside Malaysia. This is how the learned judge put it:

"The SCIT in the Case Stated at paragraph 4 on page 19 found that the "execution or operation of business by foreign franchisees took place outside Malaysia" through the evidence of RW1. Relying on this evidence the SCIT made a finding that the activities in respect of the agreement entered into between the foreign entities (Franchisee) took place outside

Malaysia. Accordingly the SCIT held that the franchise fees received from the foreign Franchisees are income received "from the place where the properly was let ... " as enunciated in the case of CIR v. Hang Seng Bank Ltd [1990] STC 733. For this reason the SCIT hold that all the activities in respect of the franchise agreement is akin to the phrase "by letting property" as stated in Hang Seng Bank Ltd."

(xiii) The learned judge is therefore, in error of law in holding that the franchise fee was not given or derived from outside Malaysia viz:

"However as have alluded to earlier the franchise fees in question do not include exploitation of trade mark because they are only confined to provision of services by the Franchisor."

(xiv) The finding of fact that the franchise was given outside of Malaysia is for the SCIT to decide.

(xv) The learned judge is in error of law to hold that the SCIT is not supported by evidence because the ledgers, exhibit D, support the SCIT's findings.

(xvi) The learned SCIT found as a fact that the granting of rights was overseas. It follows that *Paragraph 28 Schedule 6* exemption applies and also *Section 12 (1) (a)* of the *ITA 1967* applies and correctly applied by the SCIT.

(xvii) The income is derived where the franchise was exercised and relies on the case of *CIR v Hang Seng Ltd [1990] STC 733* where it was stated:

> *""profit will have arisen in or derived from the place where the property was let, the money was lent."*

And relies on a number of cases, which support the proposition that income is earned where the operation on the granting of rights take place. The cases are as follows: (i) *Commissioner of Inland Revenue (N.Z.) v N.V. Philips' Gloeilampenfabrieken [1995] N.Z.L.R. 868*; (ii) *Ch Pte Ltd v Comptroller of Income Tax (1988) 1 MSTC 7,022*; and (iii) *Commissioner of Inland Revenue v Orion Caribbean Limited (in vol liq) [1997] HKRC 90-089*.

[9] And the appellant says that the case of *Orion Caribbean Ltd (supra)* supports the appellant's case i.e. trademarks exploited overseas is derived overseas, *'other things being equal'*.

[10] On the issue of penalty, the appellant says that franchise fee was shown in taxpayer's computation and therefore, there was no *'hiding'* of any income.

[11] The learned counsel for the appellant on the issue of penalty relies on the case of *Office Park Development v Ketua Pengarah Hasil Dalam Negeri [2011] 9 MLJ 479*, where the High Court held that:

"(4) The special commissioners were correct in their finding that the appellant's incorrect return was made in good faith and that the penalty imposed by the respondent in respect of the same should be waived. The respondent's contention that s 113(2) of the Act did not provide the defence of good faith was without basis. The penalty provisions in ss 113(1) and (2) of the Act are to punish taxpayers who deliberately submit incorrect tax returns and information and it was not the intention of Parliament to punish innocent taxpayers. Further, it was not mandatory for the respondent to impose a penalty in all tax audits."

[12] The court in that case also relied on the Canadian Court of Appeal's decision in *Yarrows v Frowde Ltd [1934] 3 DLR 711* and observed:

"*[51] It is worth noting that the Canadian Court of Appeal in Yarrows v Frowde Ltd [1934] 3 DLR 711 held that 'a penalty is a sum of money of which the law exacts payment by way of punishment for doing some act that is prohibited or omitted to do some act that is required to be done. The term involves the idea of punishment, either corporal of pecuniary …'. The penalty provision in ss 113(1) and 113(2) is to punish taxpayers who deliberately submit incorrect tax return and information. It cannot be the intention of Parliament to punish taxpayers who innocently submit incorrect tax returns or those taxpayers who engage professional tax agents to prepare and submit their tax returns.*

[52] Further it is not mandatory for the respondent to impose penalty in all tax audits. I agree that the fact that the respondent has a discretion amplifies the appellant's submission that a penalty should not be imposed in this case as the appellant had acted in good faith and made full disclosure of information."

[13] The submission of the learned counsel for the respondent can be summarised as follows:

(i) The reliance placed by the SCIT on the fact that the franchisees operate the business outside Malaysia and concluding that the franchisor's operation took place outside Malaysia is an error.

(ii) The proper consideration before the SCIT should be whether the franchise owned, services and advice provided by the Franchisor which is the subject matter of the agreement between parties, are indeed an operation outside Malaysia by the Franchisor. There is no evidence to support a finding that the fees received, by the franchisor is based on its operation outside Malaysia. The SCIT's finding pertaining to this was made without any evidence and therefore it is an error.

(iii) The SCIT had misdirected itself in concluding that the operation of the franchisor was outside Malaysia on the basis that the operations of the franchisees were outside Malaysia.

(iv) The learned High Court judge had dismissed the respondent's appeal on the imposition of penalty on the appellant based on the following reasons:

(a) In the circumstances of the present case, it is noted that "franchise fee" is not clearly stipulated in the ITA 1967.

(b) There is no guideline issued by the respondent on the same.

(c) There was no non-disclosure of information on the accounts in the book of the appellant. The appellant had also given full disclosure during audit.

(d) The discretion to impose penalty or otherwise is solely at the discretion of respondent. In view of the fact that the "franchise fee" is neither given specific treatment under the Act at this point in time, nor is there any guideline or direction issued by the respondent on the same, this is an appropriate situation for the respondent to exercise his discretion in favour of the appellant.

[14] We have read the appeal record, the relevant memorandum of appeal and the detailed submission of the parties. We are grateful to the learned counsels for the comprehensive submission on law and facts. It will serve no useful purpose to repeat the same save to deal with the core issues. After having given much consideration to the submission of the learned counsel for the respondent, we take the view that the appellants' appeal must be allowed and the respondents' cross appeal must be dismissed. Our reasons, *inter alia*, are as follows:

(a) It has been well settled by long line of authorities that the finding of facts by a trial judge or tribunal or it's like must be given utmost respect and interference on finding of facts is only exercised in limited circumstances. The House of Lords in *Watt (or Thomas) v Thomas [1947] A.C. 484*, after having gone through all leading authorities on the subject matter, has held that:

"*When a question of fact has been tried by a judge without a jury and it is not suggested that he has misdirected himself in law, an appellate court in reviewing*

the record of the evidence should attach the greatest weight to his opinion, because he saw and heard the witnesses, and should not disturb his judgment unless it is plainly unsound. The appellate court is, however, free to reverse his conclusions if the grounds given by him therefor are unsatisfactory by reason of material inconsistencies or inaccuracies or if it appears unmistakably from the evidence that in reaching them he had not taken proper advantage of having seen and heard the witnesses or has failed to appreciate the weight and bearing of circumstances admitted or proved."

(b) His Lordship, Justice Gopal Sri Ram sitting in the Court of Appeal has dealt with this area of jurisprudence in more than ten reported cases mostly related to physical facts. The most often repeated quote of His Lordship was that of Lord Shaw of Dunfermline's speech in *Clarke v Edinburgh Tramways Co [1919] SC 35* (HL), where His Lordship said:

"When a judge hears and sees witnesses and makes a conclusion or inference with regard to what on balance is the weight of their evidence, that judgment is entitled to great respect, and that quite irrespective of whether the judge makes any observations with regard to credibility or not. I can of course quite understand a Court of Appeal that says that it will not interfere in a case in which the judge has announced as part of his judgment that he believes one set of witnesses, having seen them and heard them, and does not believe another. But that is not the ordinary case of a cause in a court of justice. In courts of justice in the ordinary case things are much more evenly divided; witnesses without any conscious bias towards a conclusion may have in their demeanour, in their manner, in their hesitation, in the nuance of their expressions, in even the turns of the eyelid, left an impression upon the man who saw and heard them which can never be reproduced in the printed page. What in such circumstances, thus

psychologically put, is the duty of an appellate court? In my opinion, the duty of an appellate court in those circumstances is for each judge of it to put to himself, as I now do in this case, the question, Am I — who sit here without those advantages, sometimes broad and sometimes subtle, which are the privilege of the judge who heard and tried the case — in a position, not having those privileges, to come to a clear conclusion that the judge who had them was plainly wrong? If I cannot be satisfied in my own mind that the judge with those privileges was plainly wrong, then it appears to me to be my duty to defer to his judgment."

(c) The test is much stricter when it relates to psychological facts as opposed to finding of physical facts as alluded in the Court of Appeal's decision in Lee Ing Chin @ Lee Teck Seng & Ors v Gan Yook Chin & Anor [2003] 2 MLJ 97 which relates to probate. His Lordship, Justice Gopal Sri Ram sitting in the Court of Appeal went to elaborate what amounts to judicial appreciation of evidence. The Court of Appeal held:

"(2) Generally, an appellate court will not intervene unless the trial court was shown to be plainly wrong in arriving at its decision or where there had been no or insufficient judicial appreciation of the evidence. Judicial appreciation of evidence meant that a judge who was required to adjudicate upon a dispute must arrive at his decision on an issue of fact by assessing, weighing and, for good reasons, either accepting or rejecting the whole or any part of the evidence placed before him. He must, when deciding whether to accept or to reject the evidence of a witness, test it against relevant criteria. Thus, he must take into account the presence or absence of any motive that a witness may have in giving his evidence. Where contemporary documents existed, he must test the oral evidence of a witness against these. He must also test the evidence of a particular

witness against the probabilities of the case. The principle central to appellate interference is that a decision arrived at by a trial court without judicial appreciation of the evidence may be set aside on appeal."

(d) When it relates to physical facts much reliance is placed on the trier of facts on the decision *per se* rather than failure to capture every aspect of the evidence in the judgment [see *Clarke's* case]. However, when it relates to psychological facts cogent reasons must be given, failing which it may attract appellate interference [see *Lee Ing Chin's* case].

(e) The distinction in relation to physical facts and that of psychological facts is like apple and orange. A court exercising appellate jurisdiction which relies on *Lee Ing Chin* test expressly and/or impliedly in relation to physical facts must be seen as perverse and not according to law.

(f) It is also well settled that appeal is a rehearing of a case [see Sections 29 and 69 of the *Courts Judicature Act 1964 (CJA 1964)*]. However, when a court sits in its appellate jurisdiction and interferes in the finding of facts of a trier of facts there is a duty and obligation to meticulously go through the pleadings, witnesses' evidence, notes of proceedings and very importantly, the memorandum of appeal in full, and provide grounds of judgment. In *Coghlan v Cumberland [1898] 1 Ch 704*, the Court of Appeal stated that:

"Even where, as in this case, the appeal turns on a question of fact, the Court of Appeal has to bear in mind that its duty is to rehear the case, and the Court must

reconsider the materials before the judge with such other materials as it may have decided to admit. The Court must then make up its own mind, not disregarding the judgment appealed from, but carefully weighing and considering it; and not shrinking from overruling it if on full consideration the Court comes to the conclusion that the judgment is wrong."

(g) In such a case, three things must appear from the judgment of the court exercising its appellate jurisdiction. They are as follows: (i) the court has applied its mind to reasons given by the trier of facts; (ii) the court's cognisance that the trier of facts had the advantage of seeing and hearing the witnesses the benefit of which the appellate court do not have; (iii) the court must give cogent reasons for disagreeing with trier of facts. There are a number of cases to support the proposition that no doubt an appellate court has undoubted jurisdiction to reconsider the oral evidence and reach a finding contrary to that arrived by the trial court or trier of facts (as the case may be) but this it can do only if the grounds of its judgment satisfied the three conditions stated above [see *B.N. Bannerjee's Law of Civil Appeals and Revisions, 4th edition (1994), page 723*].

(h) It is not permissible for court exercising appellate jurisdiction to extract abstract statements from the submission of the parties without going through a process of full rehearing as advocated in the *CJA 1964*, and stating in the grounds that, there was '*insufficient judicial appreciation'* or the judge or tribunal *'fell into error'* etc. Such judgments may stand to be contrary to law. In *Ganthokoru Mangamma and Others v Dulla Paidayya and Others AIR 1941*

Madras 393, the Court relying on the Judicial Committee's decision of *Hemantha Kumari Debi v Jagindra Nath Roy Bahadun 10 CWN 630* stated:

> *"In other, words, this is a case to which the observations of their Lordships of the Judicial Committee in 16 MLJ 272 at p. 274 would apply, namely that the judgment in appeal does not come to close quarters with the judgment which it reviews and indeed never discusses or alludes to the reasoning of the trial Judge. In such a case their Lordships observed that this characteristic of the appellate Court's judgment 'seriously invalidates its authority'."*

(i) Where the decision of the Special Commissioner is appealed to the High Court by way of case stated, the burden lies on the appellant (i.e. the Inland Revenue) to satisfy the court that the Special Commissioner's decision was based on the misconception of the law or their conclusion cannot be supported by the primary facts, and that conclusion on the mixed facts and law in this case was such that no reasonable Special Commissioners could have reached it if they had correctly directed themselves [see *Director-General of Inland Revenue v Hypergrowth Sdn Bhd [2008] 4 CLJ 250*]. The test is much stricter for appellate interference in contrast to *Clarke's* case or *Lee Ing Chin's* case.

(j) It is well settled that the appellate court generally recognises the special position of the Special Commissioners. The appellate court can only disturb the finding of fact in a limited circumstance. In *Edwards v Bairstow & Harrison 36 TC 207*, the High Court and the

Court of Appeal asserted that the question whether or not the transaction was an adventure in the nature of trade is one purely of fact and that finding by Special Commissioners cannot be disturbed on appeal. However, the House of Lords in that case created limited exception to this principle. Lord Viscount Simonds opined:

"Before, however, examining the authorities in any detail, I would make it clear that in my opinion, whatever test is adopted, that is whether the finding that the transaction was not an adventure in the nature of trade is to be regarded as a pure finding of fact or as the determination of a question of law or of mixed law and fact, the same result is reached in this case. The determination cannot stand: this appeal must be allowed and the assessments must be confirmed. For it is universally conceded that, though it is a pure finding of fact, it may be set aside on grounds which have been stated in various ways but are, I think, fairly summarised by saying that the Court should take that course if it appears that the Commissioners have acted without any evidence or upon a view of the facts which could not reasonably be entertained."

(k) In the same case Lord Radcliffe stated:

"I think it possible that the English Courts have been led to be rather overready to treat these questions as "pure questions of act" by some observations of Warrington and Atkin, LJJ, in Cooper v. Stubbs 10 TC 29 If so, I would say, with very great respect, that I think it a pity that such a tendency should persist. As I see it, the reason why the Courts do not interfere with Commissioners' findings or determinations when they really do involve nothing but questions of fact is not any supposed advantage in the Commissioners of greater experience in matters of business or any other matters. The reason is simply that by the system that has been set up the Commissioners are the first tribunal to try an appeal and in the

interests of the efficient administration of justice their decisions can only be upset on appeal if they have been positively wrong in law. The Court is not a second opinion, where there is reasonable ground for the first. But there is no reason to make a mystery about the subjects that Commissioners deal with or to invite the Courts to impose any exceptional restraints upon themselves because they are dealing with cases that arise out of facts found by Commissioners. Their duty is no more than to examine those facts with a decent respect for the tribunal appealed from, and, if they think that the only reasonable conclusion on the facts found is inconsistent with the determination come to, to say so without more ado."

(l) In the Malaysian context it must not be forgotten that Special Commissioners are appointed under *Section 98* of *ITA 1967* and are expected to be specialised in the scope of the adjudication process they are entrusted with under the Act [see *Ngee Tai Shipping Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2007] 6 CLJ 724*]. That section reads as follows:

"Section 98. *The Special Commissioners and the Clerk*

(1) For the purposes of this Act there shall be three or more Special Commissioners of Income Tax and a Clerk to the Special Commissioners.

(2) The Special Commissioners shall be appointed by the Yang di-Pertuan Agong.

(3) The Special Commissioners shall include such number of persons with judicial or other legal experience (that is to say, experience as an advocate, as a member of the judicial and legal service or as the holder of an office to which the Judges Remuneration Act 1971 [Act 45], applies) as may be necessary for the purposes of paragraph 1 of Schedule 5; and, if

the Yang di-Pertuan Agong considers it expedient to do so, he may appoint from amongst those persons a Chairman and such number of Deputy Chairman of the Special Commissioners.

(4) Each Special Commissioner -

(a) shall hold office for such period and on such terms (including terms as to remuneration and allowances) as may be specified by the Minister; and

(b) shall be deemed to be a public servant within the meaning of section 21 of the Penal Code [Act 574].

(5) The office of the Clerk shall be a federal public office."

(m) There is much merit in the appellant submission that facts found by Special Commissioners cannot be assailed by the High Court. And if the High Court attempts to do so it necessarily must take cognizance of the strict test laid down by the Privy Council in *Chua Lip Kong* which referred to the case of *Edwards v Bairstow*. And the grounds of judgment must deal with the three criteria stated above for the judgment to be sustained.

(n) On the factual matrix of the instant case, we are in total agreement with the submission of the learned counsel for the appellant that the finding of facts of the Special Commissioners does not warrant appellate interference by the High Court.

[15] On the issue of penalty, we take the view that the learned judge was right to sustain the decision of the Special Commissioners though we do not think it is necessary to dwell on the legal reasoning behind the said decision.

[16] For reasons stated above, the appeal is allowed. The cross appeal is dismissed. The SCIT's decision is reinstated. The respondent to pay the appellant costs in the sum of RM10,000.00. The appellant to pay allocatur before the extraction of order for costs. Deposit to be refunded.

We hereby order so.

Dated 10th January 2013

SGD
(DATUK DR. HJ. HAMID SULTAN BIN ABU BACKER)
Judge
High Court
Kuala Lumpur

Date: 10.01.2013
Note: Grounds of judgment subject to correction of error and editorial adjustment etc.

For Appellant:
Arjunan Subramaniam
Messrs Shanker & Arjunan
Kuala Lumpur

For Respondent:
Abu Tariq Jamaluddin with Marina Ibrahim
Deputy Revenue Solicitors & Revenue Counsel
Cyberjaya