

Survey Actions for TP - Discreet to Transparency

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On 17 Feb 2023, the Income-tax Department ('ITD') [announced\[1\]](#) that a survey action under section 133A of the Income-tax Act, 1961 ('ITA') was carried out at the business premises of group entities of a prominent international Media Company at Delhi and Mumbai. The following were allegedly revealed, in addition to instances of non-payment of taxes by foreign entities and non-compliance with withholding tax provisions by the group:

- a. That despite substantial consumption of content in various Indian languages (apart from English), the income/profits shown by various group entities is not commensurate with the scale of operations in India.
- b. That there were several discrepancies and inconsistencies about transfer pricing ('TP') documentation. Such discrepancies relate to level of relevant Function, Asset and Risk ('FAR') analysis, incorrect use of comparables which are applicable to determine the correct Arm's Length Price ('ALP') and inadequate revenue apportionment, among others.

This was amongst the few instances where a survey was conducted to assess compliance with transfer pricing regulations. Does the survey action provide relevant information for a TP matter? What should the taxpayer consider to make the response appropriate and effective?

Taxpayer anxiety & cooperation - how to balance?

'This is proprietary and confidential information. How is it relevant to Transfer Pricing?' Torn in this conflict, taxpayers are typically discreet. Fear and scepticism - about the motives - serve to harden taxpayer stance.

The survey is rarely viewed as an impartial exercise designed to gather facts leading to a considered assessment. Survey teams are aggressively inquisitive - intuitive, even - in obtaining information. To reduce the possibility of measured responses, which may obfuscate the facts, and to prevent any cover-up actions by taxpayer personnel, they make urgent demands that appear unreasonable, if not irrelevant. The tone, the tenor, the rigour, and the frequency of demands are designed to disrupt the taxpayer personnel into inadvertent revelations.

Since a taxpayer cannot plead confidentiality, they are typically unsure about the nature and quantum of information that is to be furnished during a survey. To face a survey action effectively, it's important to understand the officer's power to gather transfer pricing information, the attributes of the information gathered, preparedness of the team and the actual ALP assessment process.

Gathering information and computation of the ALP - distinct functions under the ITA

Section 133A of the ITA empowers the jurisdictional assessing officer ('JAO') to conduct survey actions with prior approval from the specified authority. The officer can enter any business premise, inspect books, verify stocks or assets, and gather relevant information that may be useful in any ITA proceeding, present or future. Based on the information gathered during the survey action, the JAO can obtain copies of information, impound books of accounts or other documents (after recording reasons), and record statements of anyone who may be relevant to an ITA proceeding.

In contrast, a Transfer Pricing Officer ('TPO') can undertake a survey only if a TP assessment proceeding is initiated (that is, once a matter is referred to him for computation of the ALP). In other words, a TPO must initiate a transfer pricing proceeding u/s 92CA to undertake a survey action. On the other hand, the JAO does not have such fetters and can undertake a survey to obtain information for future proceedings as well, even though the JAO is not empowered to compute the ALP.

It could be argued that the JAO u/s 133A includes the TPO. However, even if he does initiate a survey, he cannot compute the arm's length price until the matter is referred to him by the JAO u/s 92CA.

Understanding the key attributes of the information gathered in a survey

Before conducting the survey, the ITD is typically known to conduct due diligence on the information available with them and in the public domain to form a broad strategy for the survey. It is likely that the survey team involved in multinational enterprise ('MNE') cases comprises officers from the ITD's specialized wings for International Taxation and Transfer Pricing matters. As such, it can be expected that there is diligence prior to a survey.

Reliability of the information

A transfer pricing assessment requires an understanding of the value creation, through the functional analysis, and hence, this requires an assessment of the role performed by all the participating entities (associated enterprises) in the entire value chain - not merely the entity that is subject to the survey action. The survey team's actions are restricted to the physical location subject to survey, i.e., any information gathering can only take place at the place of survey and with the people available at the time of survey. Where during a survey, the team obtains information from only one entity, this would not reflect the value creation chain holistically. Further given the paucity of time, the taxpayer may not be able to organise a complete and firm response to the ITD's queries during the survey. As such, the information obtained during the survey would not be comprehensive.

Evidentiary value of the information

Whether or not information gathered in a survey constitutes evidence admissible in a quasi-judicial proceeding is also a point worth evaluating. Even in typical search and survey actions, court rulings have held that diary entries and jottings in loose sheets are not sufficient evidence. Similarly, sworn statements, if disproved with elaborate facts, do not constitute evidence.

Contemporaneity of the information gathered

Moreover, in the context of transfer pricing, the survey action would typically result in information gathering (particularly if it pertains to the FAR) that would be more relevant for a current period. Where current information is sought to enquire the factual positions of earlier years,

- Either the taxpayer would be required to demonstrate that the current factual position is different from earlier years and therefore, the current transfer pricing positions are not comparable to that in the earlier years, or

- The ITD should demonstrate that the information gathered in the current year also reflects the positions in the earlier years.

On this point, in our view, the taxpayer's plea could be on a stronger footing if it is able to demonstrate the functional similarity / dissimilarity through evidence, such as documentation, agreements, email trails, responses to elaborate functional interview questionnaires of earlier years.

Robust preparedness for a survey action

Strength of the existing documentation

A holistic view of the MNE business is typically found in the business model and functional analysis explanations that form part of the TP documentation and master files. These components should be robustly captured after thorough discussions with the key personnel of the MNE (and not merely the finance team) and also close analysis of the intra-group contractual documentation. These should also be aligned with the MNE's media representations. Select areas include:

- Awareness of the key income items in the affiliates' P&L and its context with the MNE's value chain.
- What are the transactional documentation underlying these – agreements, invoices etc.
- Do the transactional documents align with the operational understanding of these arrangements?

MNE taxpayers should note that any dissonance in form and substance could be viewed adversely and would aggravate the already aggressive inquisitiveness of a survey proceeding. Periodic internal orientations and documentation reviews for testing alignment in the transactional documents and operational processes is highly recommended. A stronger alignment can lead to easier explanations to the survey team and more importantly, during the assessment, it would help highlight any inconsistent statements as unreliable and incorrect constructions.

Orientation to Senior Management

When tax officials visit the premises of the taxpayer, it is important that the interactions are preferably driven by senior members of the team. This is because, senior members are more likely to have a comprehensive perspective of the business model and the role of various participants. The probability that there would be inconsistencies in the representations by senior personnel are lower, thus leading to good quality disclosure during a survey.

On this point, it is not advisable for the MNEs to adopt a defensive or reactive approach. The fact that the ITD has undertaken a survey for gathering information related to the TP matters, it is but obvious that they are pursuing something that is not there in the TP documentation. While it indeed a tough ask to expect the senior members to be aware of the finer areas of finance and compliance, it is important that they are aware of these matters at a macro-level.

Communications with the affiliate entities

The nature and intensity of activities of the overseas affiliate is another area of focus during a survey action for TP information. These are reflected not only in formal documents, such as inter-company agreements, vendor contracts but also in emails and WhatsApp messages of key personnel. Email and WhatsApp conversations could indicate the nature of the activities in far greater detail than that which emerge from formal documents. The evidential value of this information source is linked to the robustness in the documentation, internal policies, and the delegated authority matrix within the team.

Ease of access to information

One of the important areas during a survey is the ease of access to critical documents without being bogged down by the volume of business information. It is important that senior personnel and the finance team are given access to an easy-to-use repository which has key transactional information, and the compliance related documentations. The scepticism which arises when relevant information is not provided or is evasive leads to more intrusions and enquiries.

Further, any approach which leads to higher efforts for the survey team in gathering information is incorrect. This is because TP matters are inherently subjective. Where good quality information is proactively furnished to the survey team, it would surely result in a better outcome to the survey both for the MNE taxpayer and the survey team.

As stated earlier, section 133A restricts the power of survey action to the physical premise. However, when the survey team enters the premise and to access information, it requests for information that is physically not stored at the premise but is digitally stored on cloud or servers controlled by the MNE group entities outside India, the question is whether this is permitted. Given the widely worded provision to 'furnish such information as he may require...', a better view would be to construe this as empowering the authorities to access data, so long as it is accessible from the place of business. This is also because the context of 'place' in section 133A(1) is to restrict the authority from acting outside his designated jurisdiction per section 120 of the Act and not to disempower sourcing of taxpayer's information which is outside the physical jurisdiction.

In conclusion

Just as legislative, executive, and judicial transparency is an important topic of discussion, it is but natural for this to be looked for from taxpayers as well, what with increasing international focus on corporate responsibilities and obligations, particularly from a global tax standpoint. In this background, organizational awareness of tax positions and its robust and transparent articulation to tax authorities should be an important theme in a taxpayer's strategy.

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[1] See PIB press release [here](#)