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Friday Tax Alert

Madras High Court holds that TP adjustment based on ALP estimation cannot by itself trigger 'misreporting' penalty under section 270A of the Income Tax Act, 1961 unless it involves deliberate concealment

Facts of the case:

- The taxpayer, a corporate entity, filed its return of income for fiscal year (FY) 2019-20 and benchmarked its international transactions using the Transactional Net Margin method and Comparable Uncontrolled Price (CUP) method as per Rule 10B of the Income Tax Rules, 1961 (IT Rules).
- During the assessment proceedings, a reference was made to the Transfer Pricing Officer (TPO) under section 92CA(1) of the Income Tax Act, 1961 (the Act). The TPO rejected certain comparables adopted under the CUP method and conducted an independent search under section 92C3(1) and (2) of the Act and concluded that the taxpayer's margin was outside the permissible range, resulting in an upward transfer pricing (TP) adjustment in the software development, testing and support services segment. In relation to the said TP adjustment, the tax officer initiated penalty proceedings for misreporting of income under section 270A of the Act.
- Thereafter, the taxpayer filed an application seeking immunity under section 270AA of the Act. However, the tax officer rejected the application for waiver of penalty on the grounds that immunity under section 270AA of the Act is available only where the assessment does not involve misreporting of income.
- Aggrieved, the taxpayer filed a writ petition before the Madras High Court.

Observations of the Hon'ble Madras High Court:

- The immunity under section 270AA of the Act is available only in cases of 'under-reporting of income' simpliciter and is barred where such under-reporting is in consequence of 'misreporting of income' as contemplated under section 270A(8) and (9) of the Act.
- Misreporting represents an aggravated form of under-reporting, involving deliberate misrepresentation, suppression, or falsification falling within the ingredients enumerated in section 270A(9) of the Act. In the case of taxpayers, there is no scope to infer an aggravated form of under-reporting that is characterised by a deliberate and willful attempt to evade tax.
- The penalty proceedings were founded solely on the transfer pricing adjustment proposed in the draft assessment order, which by its nature involves estimation and determination of ALP and cannot be equated with concealment or misrepresentation so as to attract section 270A(9)(a) of the Act.
- Further, the taxpayer maintained prescribed documentation under section 92D of the Act, disclosed all international transactions under Chapter X of the Act and complied with statutory requirements. The ingredients necessary to establish 'under-reporting of income as a consequence of misreporting of income' are absent.
- Therefore, the taxpayer's case squarely falls within the exception carved out under section 270A(6)(d) of the Act, which expressly excludes such cases from the ambit of under-reporting.
- Unless there are clear and categorical incriminating facts to infer deliberate and conscious concealment or furnishing of false particulars, it cannot be said that there was "under-reporting of income as a consequence of misreporting of income" which is completely absent in the present case
- Income under-reported was represented by an addition made in conformity with the arm's length price determined by the Transfer Pricing Officer. In addition, the taxpayer had maintained information and documents prescribed under Section 92D and had declared the international transaction under Chapter X and disclosed all the material facts relating to the

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international transaction. Therefore, the petitioner was entitled to immunity under section 270AA of the Act.

Verizon Data Services India Private Limited v. DCIT, W.P.No.18377 of 2024 and .M.P. Nos. 20189 & 20190 of 2024 (Madras High Court)

Chennai Tax Tribunal holds that market study expenses paid to AE for business expansion cannot be disallowed by determining ALP at 'Nil'

Facts of the case:

- The taxpayer is a company engaged in the business of manufacturing and selling tractors, engineering plastic components & batteries and trading in related parts and attachments.
- The taxpayer made a payment to its Associated Enterprise (AE) in Turkey for a market study to expand operations and sales in Turkey.
- The tax officer referred the international transactions to the TPO to determine ALP.
- The TPO disallowed the amount paid to AE for the market study, stating that the information was generic and publicly available.
- The tax officer incorporated TPO's adjustment in the final assessment order.
- Aggrieved, the taxpayer filed an appeal before the First Appellate Authority, which upheld TPO's adjustment.
- Aggrieved by the same, the taxpayer filed an appeal before the Chennai Tax Tribunal.

Decision of the Hon'ble Chennai Tax Tribunal:

- Relying on the Delhi High Court's decision in the case of *EKL Appliances Ltd. [2012] 24 taxmann.com 199 (Delhi High Court)*, wherein it is held that it is not necessary for the taxpayer to show that any legitimate expenditure incurred by him was also incurred out of necessity or for the purpose of business carried on by him, has resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred 'wholly and exclusively' for the purpose of business and nothing more.
- Payments were made as part of business expansion in Turkey and there was a subsequent increase in investment and sales of tractors, which substantiates the benefit arising from the payments made towards market study.
- ALP determination should focus on methodology and comparables, not prudence or necessity of expense. TPO was not justified in determining ALP at Nil for market study expenses without independent benchmarking.
- Hence, commercial prudence cannot be a basis for disallowance under provisions of Chapter X of the Act, read with Rules 10A to 10E. Accordingly, TPO's adjustment for market study expenses is reversed by the Hon'ble Chennai Tax Tribunal.

Tractors and Farm Equipment Ltd. v. ITO, I.T.A. No. 2054/Chny/2025 (Chennai Tax Tribunal)

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