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BBA | Semester 6 | UK6DSCMGT304

Business Tax Planning

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Module 5: International Taxation and Double Taxation Relief

Source vs Residence, DTAA, MLI, Sec 90/91 Relief, GAAR, and APA Mechanisms

Chapter 1: Foundational Architecture of International Taxation

1.1 The Globalization of Commerce and Cross-Border Tax Jurisdiction

In an integrated global economy, multinational corporations, institutional investors, and digital enterprises routinely deploy capital, technology, and labor across sovereign borders. Because sovereign states possess autonomous legislative authority to impose taxes within their territorial boundaries, international taxation does not constitute a separate body of global law enacted by a supranational parliament. Rather, international taxation refers to the complex body of statutory provisions, bilateral tax treaties, and multilateral conventions that govern how sovereign nations assert taxing rights over cross-border transactions and resolve conflicting claims over the same taxable economic base.

Every sovereign tax system asserts its right to levy income tax based on two fundamental connecting factors:

- **The Principle of Residence (Worldwide Taxation):** Under the residence principle, a sovereign state claims jurisdiction to tax an individual or corporate entity on their **worldwide income**, regardless of where that income was earned or sourced. The justification rests on the socio-political allegiance of the resident and the public infrastructure, legal protection, and state benefits enjoyed by the entity within the state of residence. In India, a resident domestic company is taxed under Section 5(1) of the Income Tax Act on its entire global income accrued, arisen, or received anywhere across the globe.
- **The Principle of Source (Territorial Taxation):** Under the source principle, a sovereign state asserts taxing rights over any income that originates, accrues, arises, or is deemed to accrue or arise within its geographic borders, regardless of the tax residence, citizenship, or domicile of the recipient. The fiscal rationale is that the source country provided the economic marketplace, resources, consumer base, or legal protections that enabled the economic value to be generated. In India, Section 5(2) read with Section 9 asserts source taxation over all income accruing or arising in India to non-resident entities through a business connection, property, asset, or source of income located in India.

1.2 Clash of Principles and International Tax Models

When the residence principle of one country intersects with the source principle of another country regarding the same cross-border income stream, a jurisdictional conflict inevitably arises. To harmonize these overlapping claims, international tax practice relies on two primary model conventions:

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- **The OECD Model Tax Convention:** Developed primarily by capital-exporting, industrialized nations, the OECD Model places greater emphasis on the **residence principle**, restricting the taxing rights of the source country over passive income (interest, royalties, dividends) and establishing high thresholds for taxing business profits (requiring a physical permanent establishment).
- **The UN Model Double Taxation Convention:** Designed specifically to protect the interests of capital-importing developing economies (such as India, Brazil, and South Africa), the UN Model accords substantially greater taxing rights to the **source country**. It lowers the threshold required to constitute a Permanent Establishment (e.g., shorter duration for construction sites and supervisory services) and permits higher withholding tax rates on royalties, fees for technical services (FTS), and capital gains.

Chapter 2: The Double Taxation Phenomenon: Economic vs. Juridical Double Taxation

2.1 Conceptualizing Double Taxation

Double taxation represents one of the most formidable obstacles to international trade, cross-border investment, and technological transfer. If foreign profits were subject to unmitigated corporate tax in both the host (source) nation and the home (residence) nation, the combined effective tax rate could easily exceed 50% to 70%, rendering international ventures financially non-viable. Fiscal jurisprudence recognizes two fundamentally distinct forms of double taxation:

Analytical Dimension	Juridical Double Taxation	Economic Double Taxation
Core Definition	Imposition of comparable taxes in two (or more) sovereign states on the **very same taxpayer** in respect of the **same taxable subject matter** for identical tax periods.	Imposition of income taxes on **two different legal taxpayers** in respect of the **same underlying economic income or profit base**.
Classic Example	An Indian resident company earns technical fees in Germany. Germany levies 10% withholding tax at source, while India levies 25% corporate tax on the resident's global income. The identical entity is taxed twice on the same gross fee.	A subsidiary company in Japan earns commercial profits and pays corporate income tax in Japan. When residual post-tax profits are distributed as dividends to its Indian parent company, India taxes the dividend income in the parent's hands.
Primary Relief Mechanism	Bilateral Double Taxation Avoidance Agreements (DTAAs) via Tax Credit (Article 23B) or Exemption Method (Article 23A), and Section 91 Unilateral Relief.	Domestic participation exemptions, underlying tax credits, and inter-corporate dividend deductions under Section 80M.

2.2 The Sovereign Imperative for Relief Mechanisms

To eliminate these distortions, governments negotiate formal bilateral treaties or enact unilateral relief provisions. The elimination of double taxation guarantees tax neutrality—ensuring that business decisions regarding foreign investment are guided by underlying commercial efficiency rather than confiscatory double levies.

Chapter 3: Double Taxation Avoidance Agreements (DTAA) and the Multilateral Instrument (MLI)

3.1 Objectives and Legal Character of DTAAs

A **Double Taxation Avoidance Agreement (DTAA)** is a formal bilateral treaty executed between two sovereign states under public international law. While popularly referred to as double tax avoidance treaties, modern DTAAs pursue multifaceted statutory objectives:

- **Allocation of Taxing Rights:** DTAAs systematically divide taxing jurisdiction between the source country and the residence country across specific classes of income.
- **Prevention of Fiscal Evasion:** Establishing automatic and spontaneous mechanisms for exchange of banking, ownership, and financial information between national tax authorities (Article 26).
- **Assistance in Tax Collection:** Authorizing cross-border recovery of unpaid tax claims (Article 27).
- **Non-Discrimination Guarantees:** Ensuring that foreign enterprises from a contracting state are not subjected to more burdensome taxation than domestic enterprises in identical circumstances (Article 24).
- **Dispute Resolution:** Providing a structured forum for tax administrations to resolve treaty interpretation disputes through the Mutual Agreement Procedure (MAP - Article 25).

3.2 Key Treaty Articles Governing Commercial Income

DTAAs follow a standardized structural architecture governing major business streams:

- **Article 5 (Permanent Establishment - PE):** Defines the threshold of physical or agency presence required before a source country can tax the business profits of a foreign enterprise. A PE includes a fixed place of business (branch, factory, workshop, office), construction or installation projects exceeding a specified duration (e.g., 6 months under the UN Model), or dependent agents who habitually exercise authority to conclude contracts on behalf of the foreign enterprise.
- **Article 7 (Business Profits):** Business profits of a foreign enterprise are taxable **exclusively in its country of residence**, unless the enterprise carries on business in the other contracting state through a Permanent Establishment situated therein. If a PE exists, the source state may tax only so much of the profits as are directly attributable to that PE.
- **Articles 10, 11, and 12 (Passive Investment Income):** Dividends (Article 10), Interest (Article 11), and Royalties / Fees for Technical Services (Article 12) are typically subject to shared

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taxation. The residence country retains full taxing rights, while the source country is restricted to levying a capped withholding tax (customarily 5%, 10%, or 15%), provided the recipient is the beneficial owner of the income.

- **Article 13 (Capital Gains):** Allocates taxing rights on asset dispositions. Gains from the alienation of immovable property are taxed in the country where the property is situated. Gains from the sale of shares in companies whose value is derived predominantly from immovable property are likewise allocated to the source state.

3.3 The Multilateral Instrument (MLI) and BEPS Action 15

Historically, modifying bilateral tax treaties required bilateral renegotiations that could span decades across India's network of nearly 100 DTAAs. To overcome this inertia, the OECD and G20 introduced the **Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI)** under BEPS Action 15. India signed the MLI in 2017 and ratified it with effect from Assessment Year 2020-21.

The MLI automatically amends existing bilateral Covered Tax Agreements (CTAs) without requiring bilateral renegotiations, embedding robust anti-abuse provisions:

- **Principal Purpose Test (PPT):** Under Article 7 of the MLI, a treaty benefit (such as a reduced withholding tax rate or capital gains exemption) shall be denied if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that tax benefit was **one of the principal purposes** of any arrangement or transaction that resulted directly or indirectly in that benefit.
- **Limitation on Benefits (LOB):** Strict qualifying rules preventing shell or conduit entities registered in low-tax jurisdictions from claiming treaty benefits unless they demonstrate substantial commercial substance, local expenditures, and active business operations.
- **Anti-Abuse for Permanent Establishments in Third Jurisdictions:** Prevents enterprises from routing income through low-tax triangular branch structures to avoid source and residence taxation.

Chapter 4: Statutory Relief Mechanisms under the Indian Income Tax Act

4.1 Bilateral Relief under Section 90 and Section 90A

Section 90 of the Income Tax Act empowers the Central Government of India to enter into bilateral agreements with foreign governments for granting relief in respect of doubly taxed income. Section 90A confers identical powers regarding agreements entered into with specified non-sovereign associations (such as agreements with Taiwan).

4.2 The Principle of Treaty Override (Section 90(2))

One of the most powerful provisions in Indian direct tax jurisprudence is **Section 90(2)**. It establishes that where the Government has entered into a DTAA, the provisions of the Income Tax Act shall apply to the assessee only to the extent they are **more beneficial** to that assessee:

> $$\text{Applicable Tax Rule} = \min(\text{Domestic Income Tax Act Provisions, DTAA Treaty Provisions})$$
>
> **Treaty Override Rule:** The taxpayer possesses the legal option to elect either the domestic Act or the tax treaty, whichever results in lower tax liability and greater relief.

Statutory Preconditions to Claim Treaty Benefits: Under Section 90(4), a non-resident assessee cannot claim relief under a DTAA unless they obtain a valid **Tax Residency Certificate (TRC)** issued by the government of their home country, containing prescribed particulars (Name, Address, Status, Tax Identification Number, Period of validity) and electronically submit Form 10F.

4.3 Methods of Granting Bilateral Double Tax Relief

Bilateral treaties deploy two distinct mathematical methodologies to eliminate double taxation:

- **Exemption Method (Article 23A):** The residence country completely excludes foreign-sourced income from its domestic taxable base. The income is taxed solely in the source country. (In Exemption with Progression, the foreign income is exempt, but is included to determine the applicable graduated tax slab for remaining domestic income).
- **Tax Credit Method (Article 23B):** The residence country includes the foreign income in the taxpayer's worldwide taxable base, but grants a statutory credit (deduction against tax payable) for the income tax paid in the source country. India predominantly follows the **Ordinary Credit Method**, where the credit is restricted to the lower of the actual foreign tax paid or the Indian income tax attributable to that foreign income.

4.4 Foreign Tax Credit (FTC) Mechanics under Rule 128

To operationalize foreign tax credits, the Central Board of Direct Taxes (CBDT) notified **Rule 128 of the Income Tax Rules, 1962**:

- **Eligible Taxes:** Credit is available for any foreign tax covered under the relevant DTAA, or any income tax levied by a foreign jurisdiction where no treaty exists. No credit is allowed against interest, fee, or penalty.
- **Proportionate Country-by-Country Restriction:** FTC is computed separately for each foreign country and for each specific head of income. The allowable credit cannot exceed the Indian tax payable on that specific income.
- **Procedural Requirement (Form 67):** The resident assessee must furnish a certificate of foreign tax paid in **Form 67** electronically on or before the end of the assessment year relevant to the previous year in which the income is offered to tax.

4.5 Unilateral Relief under Section 91

Where an Indian resident derives income from a foreign country with which **India does NOT have any DTAA**, the resident is protected from confiscatory double taxation through **Unilateral Relief under Section 91**. The relief is granted as a statutory deduction from Indian tax payable.

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Mandatory Conditions Precedent for Section 91 Relief:

- The assessee must be a **resident in India** during the relevant previous year. (Non-residents cannot claim Section 91 unilateral relief).
- The income must have accrued or arisen to the assessee outside India and must not be deemed to accrue or arise in India under Section 9.
- The income must have been subjected to income tax in the foreign country in the hands of the assessee.
- The assessee must have actually paid tax in that foreign country on the doubly taxed income.
- There must be **no bilateral agreement (DTAA) under Section 90** between India and the foreign country for the relief or avoidance of double taxation.

Mathematical Computation of Section 91 Relief:
The amount of unilateral relief granted is calculated as follows:

$$\text{Section 91 Relief} = \text{Doubly Taxed Income} \times \min(\text{Indian Average Tax Rate}, \text{Foreign Average Tax Rate})$$

Formula Breakdown: *Indian Average Tax Rate* = Total Indian tax before relief ÷ Total Indian taxable income. *Foreign Average Tax Rate* = Total foreign tax paid ÷ Total foreign income.

Chapter 5: General Anti-Avoidance Rules (GAAR) Framework

5.1 The Evolution from Judicial Anti-Avoidance to Statutory GAAR

Historically, tax avoidance was addressed through judicial doctrines evolved by courts (such as the "substance over form" doctrine articulated in *McDowell and Co. Ltd.* and refined in *Vodafone International Holdings B.V.*). However, sophisticated international tax structures involving layered conduit entities and hybrid mismatches exposed the limitations of case-by-case judicial intervention. In response, India codified **Chapter X-A (Sections 95 to 102)** of the Income Tax Act, known as the **General Anti-Avoidance Rules (GAAR)**, operationalized from Assessment Year 2018-19.

5.2 Definition and Tests of an Impermissible Avoidance Arrangement (IAA)

Under Section 96(1), an arrangement is declared to be an **Impermissible Avoidance Arrangement (IAA)** if it satisfies two cumulative tests:

- **The Main Purpose Test (Gateway Criterion):** The main purpose, or one of the main purposes, of the arrangement is to obtain a **tax benefit**; AND
- **The Tainted Element Tests (Any ONE of the following four):**
  1. **Non-Arm's Length Dealings:** It creates rights, or obligations, which would not normally be created between persons dealing at arm's length.
  2. **Abuse or Misuse of the Act:** It results, directly or indirectly, in the misuse or abuse of the provisions of the Income Tax Act.

3. **Lack of Commercial Substance:** It lacks commercial substance or is deemed to lack commercial substance under Section 97, in whole or in part.
4. **Non-Bona Fide Manner:** It is entered into, or carried out, by means, or in a manner, which would not normally be employed for bona fide business purposes.

5.3 Circumstances of Deemed Lack of Commercial Substance (Section 97)

Under Section 97, an arrangement is deemed to lack commercial substance if:

- The substance or effect of the arrangement as a whole is inconsistent with, or significantly differs from, the legal form of its individual steps.
- It involves **round-trip financing** (where funds are transferred through a series of transactions with no substantial commercial purpose other than tax avoidance).
- It accommodates an **accommodating party** or includes elements that have the effect of offsetting or cancelling each other.
- It involves an asset, transaction, or location whose primary purpose is to disguise the source, nature, location, or ownership of rights.

5.4 Consequences of Invoking GAAR (Section 98)

If an arrangement is determined to be an IAA, the tax authorities are vested with extraordinary powers to disregard, look through, or recharacterize the entire arrangement:

- Disregarding or combining any step in the arrangement or recharacterizing the whole arrangement.
- Treating the arrangement as if it had not been entered into or executed.
- Denying treaty relief under a DTAA (GAAR overrides DTAA provisions under Section 90(2A)).
- Recharacterizing debt as equity or equity as debt, or reclassifying capital expenditure as revenue expense.
- Relocating the place of residence of an entity or the seat of management.

5.5 Statutory Safe Harbours and Procedural Safeguards (Rule 10U & 10UC)

To prevent arbitrary harassment of genuine commercial enterprises, GAAR is circumscribed by robust safeguards:

- **Monetary Threshold:** GAAR cannot be invoked if the aggregate tax benefit arising to all parties from the arrangement in the relevant financial year **does not exceed Rs. 3,00,00,000 (Rs. 3 Crores)**.
- **Exemption for Foreign Portfolio Investors (FPIs):** Non-resident FPIs investing under SEBI regulations are exempt from GAAR if they do not claim treaty benefits.
- **Grandfathering Protection:** Investments made prior to 1st April 2017 are explicitly grandfathered from GAAR provisions regarding capital gains.

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- **Two-Tier Approving Panel:** An Assessing Officer cannot invoke GAAR independently. The proposal must be approved by the Principal Commissioner and formally sanctioned by an independent **Approving Panel** headed by a retired High Court Judge.

Chapter 6: Dispute Resolution Mechanisms and Advance Pricing Agreements (APA)

6.1 Mutual Agreement Procedure (MAP) under Article 25

The **Mutual Agreement Procedure (MAP)** is an established government-to-government dispute resolution mechanism enshrined in Article 25 of DTAAs. Where an enterprise considers that actions of tax authorities result or will result in taxation not in accordance with the treaty (such as economic double taxation from transfer pricing adjustments), it can invoke MAP. The **Competent Authorities (CA)** of both sovereign states engage directly in bilateral negotiations to eliminate double taxation by adjusting transfer prices or allowing corresponding tax relief.

6.2 Advance Pricing Agreements (APA) Framework (Sections 92CC and 92CD)

To eliminate transfer pricing litigation proactively, India established the **Advance Pricing Agreement (APA)** program under Section 92CC:

- **Nature and Types of APAs:** An APA is a formal, legally binding agreement between the Central Board of Direct Taxes (CBDT) and a taxpayer determining in advance the transfer pricing methodology (TPM) and arm's length price for specified future international transactions:
  - **Unilateral APA:** Executed between the taxpayer and the Indian CBDT alone. Fast and cost-effective, but does not bind foreign tax administrations.
  - **Bilateral APA:** Executed between the taxpayer, the Indian CBDT, and the foreign tax authority under the MAP provisions of the DTAA, eliminating double taxation in both countries.
  - **Multilateral APA:** Involves three or more sovereign tax jurisdictions for integrated global supply chains.
- **Duration and Validity:** An APA is valid for a statutory term of up to **5 consecutive future previous years**.
- **Rollback Provisions:** Under Section 92CC(9A), an APA can be extended backward ("rolled back") to cover up to **4 previous years immediately preceding the first year of the APA period**, providing up to 9 consecutive years of complete transfer pricing certainty.

Chapter 7: Comprehensive Worked Numerical Problems in International Tax Planning

7.1 Worked Problem 1: Computation of Unilateral Relief under Section 91

Dr. Rajesh Menon, an Indian resident individual, maintains a consultancy practice in Kochi. During the Financial Year 2025-26 (Assessment Year 2026-27), he reports the following income streams:

- Income from profession in India: Rs. 18,00,000.
- Gross professional fees earned in Country X (a foreign nation with which India has **NO DTAA**): Rs. 8,00,000 (converted at SBI TT buying rate).
- Tax paid in Country X on foreign income: Rs. 1,60,000 (effective foreign tax rate of 20%).
- Contribution to Public Provident Fund (PPF) in India: Rs. 1,50,000 (claimed under Section 80C under the old tax regime).

Compute Dr. Menon's net tax payable in India after allowing Unilateral Double Taxation Relief under Section 91.

Step-by-Step Resolution:

Step 1: Compute Total Worldwide Taxable Income in India:

Particulars	Amount (Rs.)
Income from Profession in India	18,00,000
Income accrued in Country X	8,00,000
Gross Total Income	**26,00,000**
Less: Deduction under Chapter VI-A (Section 80C)	(1,50,000)
Total Taxable Income in India	**24,50,000**

Step 2: Compute Indian Tax Liability before Relief:
Applying regular slab rates (Old Tax Regime):
- Up to Rs. 2,50,000: NIL
- Rs. 2,50,001 to Rs. 5,00,000 (5%): Rs. 12,500
- Rs. 5,00,001 to Rs. 10,00,000 (20%): Rs. 1,00,000
- Above Rs. 10,00,000 (30% on Rs. 14,50,000): Rs. 4,35,000

Basic Tax = Rs. 12,500 + Rs. 1,00,000 + Rs. 4,35,000 = Rs. 5,47,500.
Add: Health and Education Cess at 4% = Rs. 21,900.
Total Indian Income Tax before Relief = Rs. 5,69,400.

Step 3: Compute Average Rates of Tax:

$$\text{Indian Average Tax Rate} = \frac{5,69,400}{24,50,000} \times 100 = 23.24\%$$

$$\text{Foreign Average Tax Rate} = \frac{1,60,000}{8,00,000} \times 100 = 20.00\%$$

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Step 4: Compute Section 91 Unilateral Double Taxation Relief:
Under Section 91, relief is granted at the lower of the Indian rate (23.24%) or the foreign rate (20.00%):

$$\text{Applicable Relief Rate} = \min(23.24\%, 20.00\%) = 20.00\%$$

$$\text{Section 91 Relief} = 8,00,000 \times 20.00\% = \text{Rs. } 1,60,000$$

Step 5: Compute Net Tax Payable in India:

$$\text{Net Tax Payable} = 5,69,400 - 1,60,000 = \text{Rs. } 4,09,400$$

Relief Outcome: Full credit of Rs. 1,60,000 paid in Country X is absorbed against Indian tax liability, shielding Dr. Menon from double taxation.

7.2 Worked Problem 2: Foreign Tax Credit (FTC) under DTAA (Section 90 and Rule 128)

Malabar Global Software Ltd. (an Indian domestic corporate assessee paying tax under Section 115BAA at **25.168%**) derives business profits and royalty income from two foreign treaty partner countries, Country A and Country B, during FY 2025-26:

Particulars	Domestic (India)	Country A (DTAA)	Country B (DTAA)	Total Consolidated (Rs.)
Business Profits	3,00,00,000	1,00,00,000	80,00,000	4,80,00,000
Foreign Withholding Tax Paid Abroad	—	Rs. 28,00,000 (28%)	Rs. 16,00,000 (20%)	Rs. 44,00,000

Step-by-Step Resolution under Rule 128:

Step 1: Compute Total Indian Tax Liability before FTC:

$$\text{Total Taxable Income} = \text{Rs. } 4,80,00,000$$

$$\text{Total Indian Tax} = 4,80,00,000 \times 25.168\% = \text{Rs. } 1,20,80,640$$

Step 2: Country-by-Country Foreign Tax Credit Limitation:
Under Rule 128, credit cannot be pooled across countries; it must be calculated independently for each foreign stream:

Country	Doubly Taxed Income (Rs.)	Indian Tax Attributable at 25.168% (Rs.)	Actual Foreign Tax Paid (Rs.)	Permissible FTC under Rule 128 (Rs.)
Country A	1,00,00,000	25,16,800	28,00,000	**25,16,800** (Capped at Indian Tax)
Country B	80,00,000	20,13,440	16,00,000	**16,00,000** (Actual Foreign Tax)
Total Allowable Foreign Tax Credit (FTC)				**Rs. 41,16,840**

Crucial Tax Finding: For Country A, the excess foreign tax of Rs. 2,83,200 (Rs. 28,00,000 – Rs. 25,16,800) is permanently forfeited. Rule 128 prohibits carrying forward unabsorbed foreign tax credits or offsetting them against Indian tax on Country B income.

Step 3: Net Corporate Tax Payable in India:

$$\text{Net Corporate Tax Payable} = 1,20,80,640 - 41,16,840 = \text{Rs. } 79,63,800$$

Compliance Mandate: The company must electronically upload Form 67 along with official tax receipts from Country A and Country B to sustain this credit.

Chapter 8: Strategic Cross-Border Tax Governance Matrix

8.1 Multi-Tiered International Tax Risk Assessment Matrix

Corporate management expanding into international markets must systematically evaluate overseas structures against treaty and anti-avoidance parameters:

Operational Exposure	Governing Provision / Article	Managerial Safeguard & Strategic Protocol
Permanent Establishment (PE) Risk	DTAA Article 5 / SEP Sec 9(1)(i)	Limit physical duration of overseas technical personnel; restrict local authority of agents to strictly promotional activities; avoid signing contracts in host territory.
Transfer Pricing Audit Disallowance	Sections 92C, 92D, Form 3CEB	Execute advance bilateral APAs; maintain contemporaneous benchmarked documentation; ensure profit split aligns with real value addition and IP ownership.
Treaty Benefit Denial (PPT / GAAR)	MLI Article 7 / Section 96 (GAAR)	Ensure intermediate holding companies possess real commercial substance (independent board of directors,

Operational Exposure	Governing Provision / Article	Managerial Safeguard & Strategic Protocol
		qualified local employees, physical offices, local operational expenses).
Foreign Tax Credit Forfeiture	Rule 128 / Form 67	Obtain legalized Tax Residency Certificates (TRC) upfront; reconcile withholding certificates before filing annual returns; ensure foreign taxes fall within treaty definitions.

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