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Foreign Tax Credit Pooling System: Is It Always Better? (Part 1 of 3)

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FOREIGN TAX CREDIT POOLING SYSTEM

Is It Always Better? (Part 1 of 3)

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Foreign income when received in Singapore from outside Singapore is subject to tax unless otherwise exempted. To provide relief for the burden of double taxation, foreign tax credit may be granted to resident taxpayers for foreign tax paid (FTP) in the country of source against the Singapore tax payable (STP) on the same foreign income. As a resident individual is not taxed on all foreign income received in Singapore except when foreign income is received through a partnership in Singapore, this article will hence focus on the grant of foreign tax credit to a resident company.

Presently, there are two systems under which the foreign tax credit can be granted subject to satisfying certain conditions:

- Foreign tax credit source-by-source and country-by-country system (SCS), and
- Foreign tax credit pooling system (PS).

Under the SCS of computing the foreign tax credit, the excess of FTP over the STP[1] on one type of foreign income (say, dividend income) from a foreign country cannot be used to offset against the excess of STP over the FTP on any other foreign income.

Under the PS, any excess of FTP over the STP on one type of foreign income from a foreign country can be offset against the excess of STP over the FTP on any other foreign income either from the same or different foreign country. This is achieved by a resident company electing to aggregate the FTP on all items of foreign income, provided such foreign income satisfies all the following four conditions (hereinafter termed as "elected income"[2]):

1) Income tax must have been paid on the foreign income in the foreign jurisdiction from which the foreign income is derived;
2) At the time the foreign income is received in Singapore, the headline tax rate of the foreign jurisdiction from which the foreign income is derived is at least 15%;
3) Singapore tax is payable on the foreign income, and
4) Resident person is eligible for the foreign tax credit claim on the foreign income under the Singapore Income Tax Act.

Under the SCS, foreign tax credit will be granted based on the lower of the FTP and the STP for each item of foreign income. Under the PS, the amount of foreign tax credit granted will be the lower of:

- Pooled FTP on all the elected income, and
- Pooled STP on all the elected income.

As the foreign tax credit is granted before taking into account the 30% corporate tax rebate, the rebate is therefore not relevant in this article.

Intuitively, the PS seems to be the preferred choice as any "excess of the FTP over the STP" on one type of foreign income can be used to offset against the excess of STP over the FTP on the same or another type of foreign income. Hence, this article examines whether the claim of foreign tax credit is always better under the PS than the SCS.

ILLUSTRATION

Company A, a tax resident company in Singapore, derives a local trade income of $300,000 and receives in Singapore the following elected gross taxable incomes:

- Foreign interest income of $30,000 (where FTP @ (i) 10% or (ii) 15%);
- Foreign royalty income of $200,000 (FTP @ 5%), and
- Gross foreign dividend income of $500,000 which qualifies for tax exemption under the foreign-sourced income tax exemption (FSIE) regime.

Table 1 shows the tax computations of Company A under the following five scenarios:

- Column A: No foreign income remitted;
- Column B1: Including taxable foreign income (SCS);
- Column C1: Including taxable foreign income (SCS);
- Column B2: Including taxable foreign income (PS);
- Column C2: Including taxable foreign income (PS).

[1] Based on the Singapore effective tax rate, which is the average rate of tax

[2] Under section 50C(2) of the Singapore Income Tax Act

Table 1 Tax computation for Company A receiving foreign income

		A	B1	B2	C1	C2
		No FI	SCS	PS	SCS	PS
			Foreign tax rate for interest income			
			10%		15%	
		$	$	$	$	$
Local trade income		300,000	300,000	300,000	300,000	300,000
Foreign income:						
Interest income (FTP @ 10%, that is, $3,000)		-	30,000	30,000		
(FTP @ 15%, that is, $4,500)		-	-	-	30,000	30,000
Royalty income (FTP @ 5%, that is, $10,000)		-	200,000	200,000	200,000	200,000
Dividend income (exempt under the FSIE regime)		-	-	-	-	-
Normal chargeable income before Partial tax exemption	X	300,000	530,000	530,000	530,000	530,000
Less: Partial tax exemption		152,500	152,500	152,500	152,500	152,500
Normal chargeable income after Partial tax exemption		147,500	377,500	377,500	377,500	377,500
Tax @ 17% before FTC	Y	25,075	64,175	64,175	64,175	64,175
Less: FTC - lower of FTP and STP (SCS)						
- Interest Income			(3,000)[4]		(3,633)[5]	
- Royalty Income (lower of $10,000 and {$200,000 x 12.11%#}) = $10,000			(10,000)		(10,000)	
			(13,000)		13,633	
Less: FTC - lower of pooled FTP and pooled STP				13,000[6]		14,500[7]
Net tax payable		25,075	51,175	51,175	50,542	49,675
Less: Tax payable (column A)			25,075	25,075	25,075	25,075
Additional tax payable due to inclusion of foreign income			26,100	26,100	25,467	24,600
#Singapore effective tax rate - (Y/X)			12.11%	12.11%	12.11%	12.11%
Interest income						
FTP $30,000 @ 10% for column B1; 15% for column C1			3,000		4,500	
STP $30,000 @ 12.11%			3,633		3,633	
Excess of FTP over STP disregarded			-		867	
Royalty income						
FTP $200,000 @ 5%			10,000		10,000	
STP $200,000 @ 12.11%			24,220		24,220	
Excess of STP over FTP			14,220		14,220	

FI: Foreign income
FTC: Foreign tax credit

Analysis of Table 1

1) With the inclusion of the foreign income in columns B and C, net tax payable in columns B and C is higher than that in column A (excluding the foreign income) regardless of whether the foreign tax credit granted is under the SCS or the PS.

2i) Where the foreign tax rate for interest is 10%, the net tax payable of $51,175 is the same for columns B1 and B2 as their total foreign tax credit granted ($13,000) is the same. As both the foreign tax rates (10% for interest and 5% for royalty) are lower than the Singapore effective tax rate of 12.11%, the total foreign tax credit granted is the sum of their FTP, which is the same under the SCS and the PS. The PS will be more tax beneficial than the SCS provided there is an excess of the FTP over the STP on one type of elected income that can be utilised against the excess of the STP over the FTP on other types of elected income. This is not so in this case since both types of elected income have an excess of STP over the FTP.

2ii) Another circumstance where the PS is not more tax beneficial than the SCS is when the FTP is greater than the STP for *each* of the elected incomes. The total foreign tax credit granted under the SCS will therefore be the sum of the STP for each elected income. Under the PS, the total foreign tax credit granted is also equal to the sum of STP (being the lower of the pooled FTP and the pooled STP).

3) Where the foreign tax rate for interest is 15%, the net tax payable under the PS is $867 ($50,542 - $49,675) lower than that under the SCS. This is because under the PS, the excess of FTP over the STP (that is, $867) in respect of the foreign interest income can be offset against the excess of STP over the FTP (that is, $14,220) in respect of the foreign royalty income, thereby reducing the overall tax payable by $867. Hence, electing to pool the FTP under the PS in such a circumstance will be more tax beneficial to Company A than under the SCS.

[3] Applicable only for YA 2013 to YA 2015

[4] Lower of $3,000 and $3,633 (that is, $30,000 x 12.11%)

[5] Lower of $4,500 and $3,633 (that is, $30,000 x 12.11%)

[6] Lower of pooled FTP ($13,000) and pooled STP ($27,853, that is, {30,000 + 200,000} x 12.11%)

[7] Lower of pooled FTP ($14,500) and pooled STP ($27,853, that is, {30,000 + 200,000} x 12.11%)

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CONCLUSION

Foreign tax credit granted will be the same for both the PS and the SCS under the following two circumstances:

- For *each* and every elected income, the FTP is greater than the STP, or
- For *each* and every elected income, the FTP is less than the STP.

Electing to pool the FTP under the PS will be more tax advantageous than claiming the foreign tax credit under the SCS when the FTP is:

- Greater than the STP for one type of foreign income, and
- Less than the STP for another type of foreign income.

In this article, we claim the tax exemption on the foreign dividend income under the FSIE regime. In the next article, we will examine whether claiming tax exemption for the foreign dividend income under FSIE is indeed beneficial to Company A. ISCA

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