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July 6, 2009

Dear Stig,

EFRAG Draft Comment Letter on IASB Exposure Draft Income Taxes

Enclosed is our response to the IASB Draft ED 2009/2 from 31. March 2009. We agree with your criticisms because, in our opinion, the proposed changes will not result in any improvement to the "old" IAS 12 rules.

Because we are **not** convinced of the merit of the exposure draft in many respects, we reject the IASB proposals and suggest leaving the previous provisions of the IAS 12 unchanged. Our **criticisms** apply in particular to the following areas:

- Elimination of "backward tracing" and presentation of all tax rate changes in the statement of income
- Restrictions to the exceptions for the recognition of deferred taxes to foreign subsidiaries and joint ventures ("outside basis differences")
- Uncertain tax positions and concomitant additional disclosure requirements in the notes
- Additional details in disclosures (primarily in para. 46b "Roll Forward of Deferred Taxes" and para. 48d "Intercompany Sales")
- Elimination of initial recognition exception.

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We **justify** our criticisms as follows:

Revision of IAS 12 was made primarily with the following goals in mind:

- Convergence with the US provisions on tax accounting, in particular with respect to FAS 109 and
- Simplification of IAS 12 by means of elimination of exceptions and a return to a more "principle based" approach.

In our opinion, these objectives have not been achieved, or at least not to a sufficient degree. In particular, a whole range of new provisions lead to increased complexity and expense in the determination and entry of deferred taxes. The application of the new standards will not be simpler but – quite the opposite – will be more complex and time consuming, yet will not achieve significant improvements in tax accounting. The assumption of US GAAP provisions should not be an end it itself, but should only take place where this makes sense. At any rate, we consider the elimination of backward tracing as unjustified in principle as this leads to inexplicable tax load effects, especially in connection with AfS securities, not only in the year of the change in tax rate but also in the year of disposal of the security. Whatever the case, the exposure draft will not lead to full convergence with the US GAAP provisions (e.g. no assumption of EITF 98-11 or FIN 48).

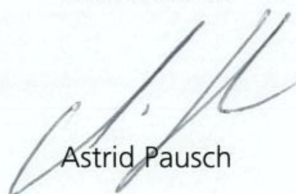
In addition, we also doubt that those using the financial statements will be provided with more useful or otherwise better information than has been the case up to now as a result of the proposed new rules. In fact, the information given is more likely to confuse than benefit the user on grounds of its complexity or sheer abundance.

Last but not least, we would also like to add that legibility and understanding suffers significantly as a result of comprehensive referencing with Appendix B and the Basis for Conclusions.

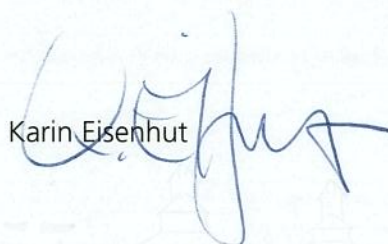
Should you have any questions, please don't hesitate to contact either Mrs Pausch or Mrs Eisenhut.

Yours sincerely,

DZ BANK AG



Astrid Pausch



Karin Eisenhut

DZ BANK

Annex to Letter from 3. July 2009

1. Elimination of 'backward tracing' and presentation of all tax rate changes in the statement of income

The new arrangements can substantially influence current tax ratio and introduce the need for clarification and explanation as a result. These tax ratio effects are not limited to the year in which tax rates change, but can also appear in subsequent fiscal years "from nowhere", as it were, and with opposite effect upon disposal of the position.

The new rules also involve additional data requirements for accounting systems. Each AfS asset, for instance, must be "labelled" with the tax rate applicable to temporary differences and tax rate changes must be traced. For credit and financial institutions especially, this means increased workload given that they have many AfS assets to account for. As a result, adherence to the provisions would be more time-consuming and would involve increased technical effort for no marked improvement. Rather, tax effects would occur which are difficult to explain; a result which would stand diametrically opposite to the objective of providing more useful information to the users of financial statements.

For the above reasons, we **emphatically reject** the proposal put forward by the IASB to do away with backward tracing.

2. Restrictions to the exceptions for the recognition of deferred taxes with respect to foreign subsidiaries and joint ventures (outside basis differences)

In particular with respect to the multi-level group, we feel that the new arrangements have two critical weaknesses:

(i). When is a (subsidiary) company to be classified as domestic or foreign?

(ii). How can the (proportional share of) equity in a subsidiary be measured as reference value to the carrying amount for tax purposes?

Alongside these theoretical questions, practical problems also become increasingly important in the measurement of outside basis differences. Above all in a multi-level group, (new) reporting processes must be installed in order to secure the collection of information through the parent group, which in our opinion would mean a considerable extension to existing reporting requirements. We doubt that, with respect to a multi-level group, this information (e.g. which companies hold investments in which others, proportionate IFRS equity, shareholder's tax balance sheet values etc.) would be capable of being obtained at all - through the parent company in general, and at any time close to the end of the reporting period in particular.

Further, we also find it difficult to understand why the exception has been completely repealed for associated companies. In our practical experience, obtaining such information is just as difficult, if not impossible, as is the case for foreign investments – especially since in the case of participations in associated companies there is no majority influence which can be used to satisfy the information need. It is also doubtful whether all associated companies compile their financial statements in accordance with the IFRS accounting system. Comprehensive collection of information makes measuring outside basis differences time-consuming and therefore costly. It would seem that a company would not be able to escape the (costly) installation of an IT-based system or secure the automation of the measurement process in order to exclude time delays in the preparation of income statements and to safeguard adherence to (publication) deadlines.

In addition, we ask ourselves how far the accounting treatment of deferred taxes on outside basis differences offers an improved information basis for (potential) investors and other stakeholders. Outside basis differences are to anticipate the tax consequences of any distribution of dividends. In addition, they reflect real differences in the net assets of the associated company. These temporal differences generally do not reverse until sale of the holding (or distribution of dividends), which in the case of strategic investments does not occur until the very distant future and may never occur. To represent deferred taxes here would mean including tax consequences on balance sheets which from the perspective of the reporting period will probably never materialise. Where outside basis differences lead to deferred tax liabilities, this is particularly unsatisfactory insofar as there can be no set-off with deferred tax assets to form other balance sheet differences or loss carryforwards because the taxable temporary differences will reverse later.

Given the above comments, we do **not** agree with the proposals put forward in the ED. We support an exception which applies equally to both domestic and foreign companies and therefore suggest that the currently applicable rule in IAS 12 be retained.

3. Uncertain Tax Positions

Although in the opinion of the IASB, only those tax risks are concerned which have material effect on the amounts recognised and which affect known disputed events (cf. BC 63), IFRS accountants are still faced with the additional burden of determining and documenting tax risks. After all, auditors and, where necessary, the DPR must be provided with documents for assessment of management of tax risk and determination of the probability of its materialisation. In order to prove that all recognisable tax risks are completely and appropriately covered in tax risk reserves, checklists or similar aids must be used.

In this regard, it should be noted that tax risks do not only affect current tax. There are also consequences for deferred taxes to be taken into account insofar as temporary differences or loss carryforwards are affected as a result. This point too makes the determination and

adjustment of "uncertain tax positions" very time-consuming as "risk adjusted tax balance sheets" are required.

Although it is generally to be welcomed that the IASB has turned its attention towards closing the regulatory loophole in IAS 12, we **cannot agree** with the concrete proposals put forward in the exposure draft. The proposals result in a considerable increase in the documentary burden and require time-consuming periodic updates. Above all, the procedure for the calculation of risk reserves in the amount of an expected value without threshold should be questioned because the various scenarios for possible agreements with the financial authorities are in practice impossible to determine. As a result, it is our opinion that the quality of the reserve is not improved by the application of this system despite the considerable increase in burden involved.

4. Additional Details in Disclosures

- Indications on uncertain tax positions (paragraphs 41b and e, 49)

In particular with respect to tax risks, details are to be given in the notes. Effects of a re-evaluation on aperiodical current and deferred tax expense or income should be presented separately where the effect on current tax is compensated by the effect of deferred taxes. Uncertain estimates are to be identified as such; relevant details given and possible financial implications with expected entry date indicated.

The more comprehensive and detailed the requirement for explanation in the notes, the more critically the duty of disclosure is to be judged. It cannot be acceptable that the state tax audit is presented with sensitive information on the tax risk situation of a company on a baking tray, as it were. The financial authority, as one of many intended users of company financial statements is afforded preferential treatment to the detriment of the company and its shareholders. It is further questionable whether shareholders or potential investors really are given a better impression. After all, the additional information will not put them in a position to critically analyse the company's risk assessment.

For this reason, we reject the new arrangements for disclosures, even though we would accept abstract reporting on tax risks where particular details and concrete allocation to the company group are omitted. After all, there is the danger that the financial authorities would view the documentation on determination and presentation of tax risks as data falling under principles of data access and verifiability of digital documents and thus demand access to such.

- Numerical reconciliation ("Index") of deferred taxes (paragraph 46b)

Under the new proposals, not only the level of deferred tax and its change from the last reporting period is to be disclosed, but for each type of temporary difference, a reconciliation from the initial amount to the final amount with separate indication of the individual

components of tax expense as well as those components independent of operating result is to be presented.

It is questionable whether, because of the provisions on distribution of tax expense, an exact breakdown of individual components is possible. In addition, it is to be questioned whether this information is of any use to the user of financial statements at all or rather, whether it is more likely to cause confusion given its volume.

- Disclosure of deferred taxes from elimination of profits (paragraph 48d)

We reject disclosure as the benefit of the information to the user of financial statements is minimal and the collection of data complicated and time-consuming.

The argument put forward by the IASB that disclosure is required for the avoidance or the transparency of accounting measures (avoidance of earnings management) is not convincing. Investors and rating agencies generally judge company performance on the basis of pre-tax results. Accounting measures for the purpose of influencing the levels of deferred taxes would be "too expensive" from the perspective of the company preparing financial statements. Transactions of the above described type thus always have economic substance.

5. Elimination of initial recognition exception

Recognition of the transaction amount as the IFRS carrying value is, as we understand it, without tax advantage. It is questionable though, how tax advantages or disadvantages in connection with an acquisition are to be defined in order that they be calculated from the transaction amount. As investments are subsidised in many ways through taxes (e.g. "government subsidies" for acquisition costs, increased assessment bases for writedowns etc), this can lead to differences in interpretation and application by the IFRS user.

There is also the practical question of how the carrying amount without tax advantage of the acquired asset or liability is to be determined – especially as the IASB rejects the idea that carrying amount should be fair value (cf. BC 29), which at any rate can only be relatively simply determined for marketable assets. In practice then, the EITF 98-11 calculation seems to be easier: the "adjusted" carrying amount can be calculated mathematically where the acquisition costs and applicable tax rate is known. Yet the IASB rejects the US GAAP method because in exceptional cases it can lead to the recognition of a "deferred credit".

As obviously neither EITF 98-11 nor the proposals contained in ED 2009/2 lead to a satisfying solution, it is our opinion that the present rule on exceptions should be kept. This applies in particular when one considers that the consequences of the proposed new arrangements are to be identical with the consequences of the initial recognition exception.

In our opinion, elimination of the exception would lead to an unnecessary complication of IAS 12. In our opinion, the additional complication arises not only from the difficulty in measuring

the tax-advantage-adjusted acquisition costs of the asset or liability, but also from the fact that the magnitude of the deferred taxes and the balancing item (allowance or premium) may not necessarily be the same. This results in additional complications in subsequent reporting periods as not only the further development of the deferred taxes but also that of the balancing item must be followed.