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**EFRAG Draft Comment Letter on IASB Exposure Draft Income Tax**

Dear Mr. Enevoldsen,

Siemens Aktiengesellschaft very much appreciates the opportunity to comment on the EFRAG's comment letter concerning the Exposure Draft Income Tax (in short: ED) issued by the IASB. We are a publicly listed corporation organised in the Federal Republic of Germany and employed an average of 427,000 people in approximately 190 countries worldwide during fiscal year 2008. As a preparer of IFRS financial statements, we have a keen interest in the debate on achieving high-quality global accounting standards and convergence in the capital markets. This letter outlines our views concerning the main issues of the ED.

Overall, we agree with EFRAG's significant concerns regarding the proposals included in the ED. Regarding your questions on pages 19, 23 and 28 of your draft comment letter we have the following comments:

- Your question on page 19 (related to the IASB Question 10): We support the view expressed in (b) and disagree with the proposal in the ED. The proposed rules lack an underlying conceptual basis and are complicated to apply in practice.

- Your question on page 23 (related to the IASB Question 13c): In our view, the alternative approach provides useful information. It complies with the temporary approach not only on the first time recognition but also in subsequent periods. An entity shall recognize subsequent changes in the amounts previously recognized as tax expense in the same component as the tax expense was originally recognised. In cases where 'backwards tracing' is not practicable, we generally consider applying another appropriate method as a reasonable way to allocate tax expense in a way consistent with the applicable tax jurisdiction. Therefore we support the general allocation rule in par. 29A. On the other hand, we think, that the detailed allocation rules (e.g. par. 34A) are not necessary. In our view, a more principle-based approach would be preferable.

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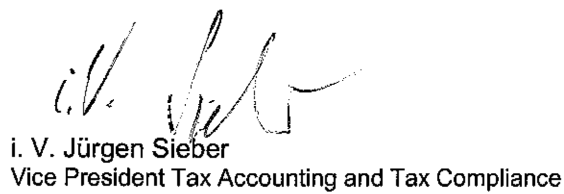
- Your question on page 28 (related to the IASB Question 18): We generally support the retrospective application if backwards tracing applies. If the Board prefers no backwards tracing, the allocation rules should in no case apply retrospectively. Such a retrospective application would cause enormous calculation problems.

In addition to the questions raised by the EFRAG, we would also like to point out further concerns that are not clearly addressed within the EFRAG comment letter. Please find our further and detailed comments to question 4 and question 17 in the appendix to this letter. If you would like additional clarification of the points raised in this letter or in the appendix, please contact us.

Yours sincerely

Siemens Aktiengesellschaft



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Appendix

**Question 4 – Investments in subsidiaries, branches, associates and joint ventures**

IAS 12 includes an exception to the temporary difference approach for some investments in subsidiaries, branches, associates and joint ventures based on whether an entity controls the timing of the reversal of the temporary difference and the probability of it reversing in the foreseeable future. The exposure draft would replace these requirements with the requirements in SFAS 109 and APB Opinion 23 Accounting for Income Taxes—Special Areas pertaining to the difference between the tax basis and the financial reporting carrying amount for an investment in a foreign subsidiary or joint venture that is essentially permanent in duration. Deferred tax assets and liabilities for temporary differences related to such investments are not recognised. Temporary differences associated with branches would be treated in the same way as temporary differences associated with investments in subsidiaries. The exception in IAS 12 relating to investments in associates would be removed. The Board proposes this exception from the temporary difference approach because the Board understands that it would often not be possible to measure reliably the deferred tax asset or liability arising from such temporary differences. (See paragraphs BC39–BC44 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not? Do you agree that it is often not possible to measure reliably the deferred tax asset or liability arising from temporary differences relating to an investment in a foreign subsidiary or joint venture that is essentially permanent in duration? Should the Board select a different way to define the type of investments for which this is the case? If so, how should it define them?

We disagree with the proposal. The application of the proposed rules implies numerous problems.

Conceptual lack of consistency

The ED proposes that a deferred tax liability or asset for all temporary differences associated with subsidiaries and interests in joint ventures[1] has to be recognised. An entity shall not recognise a deferred tax asset or liability for a temporary difference between the carrying amount and the tax basis of an investment in a foreign subsidiary, if certain conditions are met (B5). As a result, for investments in foreign subsidiaries the existing exception rule will be retained (in a modified way). The Board justified the retention for foreign subsidiaries due to calculation problems, therefore the retention of the existing exception for foreign subsidiaries is reliable. In terms of the removal of the existing exception rule for domestic subsidiaries, the Board's argumentation does not convince us, as the same calculation problems would apply for domestic subsidiaries. From a conceptual point of view, there is no reason to treat foreign and domestic subsidiaries in a different way. Instead, a principle-based standard requires that similar issues should be accounted for in the same way and based on the same principles. As there are severe calculation problems for foreign and domestic subsidiaries, the existing exception rules should be retained for both foreign and domestic subsidiaries.

Calculation problems

An entity shall recognise deferred tax liabilities or assets for all temporary differences associated with investments in subsidiaries. The recognition of all deferred tax liabilities or assets comprises the temporary differences within the subsidiary from its individual assets and liabilities (*inside basis differences*). Moreover, as the recovery of investments in subsidiaries, branches,

[1] The wording of the ED refers to investments in subsidiaries and interest in joint ventures. In the following paragraphs the term "investment in subsidiary" or "subsidiary" is used, whereas "interests in joint ventures" resp. "joint ventures" shall also be included.

associates and joint ventures may give rise to tax consequences (in addition to those arising from the recovery or settlement of the individual assets or liabilities within those investments), these additional tax consequences must also be taken into account in the consolidated financial statements of the parent company (*outside basis differences*).

For consolidation purposes, deferred tax liabilities or assets for investments in subsidiaries have to be determined in two steps. In the first step, all deferred tax assets and liabilities concerning the inside basis differences are to be calculated and recognised. The recognition of the deferred tax liabilities and assets within the entity (inside basis differences) usually results in a change of the net carrying amount within the subsidiary (and therefore of the subsidiary's equity). In the second step, all deferred tax assets and liabilities concerning the outside basis differences have to be calculated. For this purpose, the net carrying amount within the entity has to be compared with the tax basis of the shares in the subsidiary. As the calculation of the outside basis differences requires the completion of the deferred tax calculation of the subsidiary, the determination of all temporary differences in the consolidated financial statements has to be done successively. This step by step calculation requires much time, especially if there is a huge number of successive steps within a group or subgroup. This will cause enormous calculation problems.

Qualification problems

The distinction between foreign and domestic subsidiaries will cause application problems. Based on a general accounting principle, accounting rules have to be applied in sight of the respective level of consolidation. This implies that an entity can be foreign and domestic, dependant on the consolidation level. For example, a parent company P, located in country A, has an investment in subsidiary S1, located in country B. S1 holds all shares in the consolidated subsidiary S2, also located in country B. In the consolidated statements of P, entity S1 and S2 are foreign entities. Assuming that all conditions in B5 are met, P shall not recognise a deferred tax asset or liability for temporary differences in the investment in S1 (and indirectly also for S2) since both entities are foreign. If an obligation exists in country B to publish consolidated financial statements for subgroups, S1 has to recognise a deferred tax asset or liability for temporary differences for the investment in S2, as S2 is a domestic entity and the application of the exception rule is not possible. As a result, S1 has to make sure, that the "investment status" of S2 is reclassified in the subgroup consolidated financial statements. Moreover, S1 (or even P for the entire group) has to ensure, that a well-structured IT system and EDI software exist to enable a switch from a "foreign status" to a "domestic status" of investments in subsidiaries. In our view, such an accounting requirement would cause enormous additional costs for the preparers.

Further qualification problems will arise, if double cross-border structures exist. For example, a parent company P, located in country A, has an investment in subsidiary S1, located in country B. S1 holds all shares in the consolidated subsidiary S2, located in country A. In the consolidated financial statements of P, entity S1 is definitely a foreign entity whereas it is not clear for the investment in S2. The ED does not address this matter. On one hand, it is located in the same tax jurisdiction as P and therefore it could be argued, that it is a domestic entity. On the other hand, in the subgroup financial statements of S1 it is a foreign entity. Based on this fact, for the shares in S2, the calculation problem for foreign subsidiaries also exists in the consolidated financial statements of P. It could therefore also be argued that S2 is a foreign subsidiary.

Editorial aspects

We also have concerns regarding the revised criteria for the exception stated in paragraph B5, as the adoption of the term 'essentially permanent in duration' introduces an undefined time concept from FAS 109. The currently existing criterion in IAS 12 para. 39 'is able to control [...]' is clear, since this criterion is also relevant in case of IAS 27 and in any case has to be applied consistently within the consolidated financial statements. Thus, the proposed revision will

presumably result in open questions and increased complexity regarding how to interpret 'essentially permanent in duration'.

Regarding the second criteria in section B5 b) the wording 'it is apparent [...]' introduces a term that has not been included in the IFRS Framework so far. From our point of view it remains unclear if 'apparent' requires a higher level of certainty than the previously used term 'probable' in IAS 12 par. 39 b) (or the proposed 'more-likely-than-not' criterion). Moreover, the question arises if there are situations where the first criterion of B5 is met, but not the second. In contrast, the current criteria in IAS 12 para. 39 and para. 44 complement one another and therefore are clear.

Disclosure requirements

We refer to our comments of question 17.

**Question 17 – Disclosures**

The exposure draft proposes additional disclosures to make financial statements more informative. (See paragraphs BC104–BC109 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?

The Board also considered possible additional disclosures relating to unremitted foreign earnings. It decided not to propose any additional disclosure requirements. (See paragraph BC110 of the Basis of Conclusions.)

Do you have any specific suggestions for useful incremental disclosures on this matter? If so, please provide them.

We greatly appreciate that the Board critically reviewed the current disclosure requirements, based on the general principle, that the benefits derived from information should exceed the cost of providing it. We also reviewed the current and proposed disclosure requirements and disagree with some of the proposals. We propose to reconsider the following issues:

Tax Uncertainties (Par. 41(b); 41(e); 49)

The ED requires a separate disclosure of the effect of tax uncertainties on current tax of prior periods (par. 41(b)) and on deferred tax of prior periods (par. 41(e)). Moreover, Paragraph 41 requires further disclosures of the components of tax expense recognised in profit or loss. We agree that a disclosure of main components of tax expense is useful information which enables the users of financial statements to better understand the tax situation of an entity. Nevertheless, we consider the specific disclosures of paragraph 41 sufficiently comprehensive even without a deeper breakdown into 'thereof'-components resulting from tax uncertainties. We believe that such additional disclosures do not provide helpful information in general and do not increase decision usefulness. In case of material effects, a separate disclosure of material single effects could be decision useful and in these cases, a disclosure requirement already exists in IAS 1 par. 97.

The Board also proposes in Par. 49 detailed information about tax uncertainties (e.g. major source, description of the uncertainty, timing). These proposed disclosures reveal sensitive information to the public. We are convinced that there is no necessity to publish this information, as all tax liabilities that meet the recognition criterions are taken into account within the financial statements. Therefore, all recognised tax liabilities fairly reflect future tax outflows and inform users about the future cash effects.

Some may argue, that entities disclose aggregate amounts and required information refers to consolidated financial statements. It could therefore be argued, that published information is not sensitive and cannot reveal secret facts and circumstances. This argument is not valid. Firstly, consolidated financial statements are based on information of single entities that has to be calculated, documented and booked in local accounts, which are usually the basis for tax audits. As a consequence there is an overall risk, that the tax authorities get sensitive information leading to severe economic losses for entities. Moreover, entities could be obliged or have the choice to publish individual or separate financial statements. In Germany (and even in numerous other countries worldwide), entities may (or are obliged to) publish separate financial statements in accordance with IFRS instead of filing financial statements based on German (resp. local) GAAP. In this case, information published in terms of tax uncertainties refers to the single entity, not to a consolidated group or subgroup.

We are convinced that users should be informed about material effects concerning tax risks and benefits. Based on the current rules of IAS 1 par.125 ff, preparers are already obliged to publish information about the future and other major sources of estimation uncertainty at the end of the reporting period, that have significant risks resulting in a material adjustment to the carrying amounts of asset and liabilities within the next financial year. We therefore think there is no need for further disclosure requirements as proposed in the ED.

Numerical analysis of deferred tax assets and deferred tax liabilities (Paragraph 46 (b))

Paragraph 46(b) requires a detailed 'roll-forward' of deferred tax liabilities and deferred tax assets for each type of temporary difference and for each type of unused tax loss and tax credit. Basically, the main components of this information are already included in other disclosure requirements, even if on a higher level of aggregation. For example, separate disclosure of deferred taxes recognised in the income statement is required (par. 41); deferred tax liabilities and deferred tax assets have to be disclosed for each type of temporary difference, unused tax losses and tax credits (par. 46 (a)). Eventually, par. 45 results in a disclosure of taxes recognised in other comprehensive income and equity. Hence, in our view, a further disclosure of a detailed 'roll-forward" of deferred tax liabilities and deferred tax assets would provide very limited additional value to the user of the financial statements or, due to an increased flood of information, could even decrease the benefit for the users. Moreover, this requirement would enormously increase the administrative cost for the preparers. We believe that the costs of generating this information would not be commensurate with the resulting benefit for users of the financial statements.

Analysis of valuation allowance (Par. 47)

According to the ED, an entity would be required to disclose the amount of any valuation allowance, any change in the valuation allowance, and a description of any event or change in circumstances that causes that change (par. 47). Instead of disclosing information of all changes, we propose to describe material single effects in the notes. Users of the financial statements would be informed about material aspects that support them in making decisions. Apart from that, entities already have to provide information of substantial changes of assets and liabilities in any case if the information is not provided elsewhere in the financial statements (IAS 1 par. 112(c)).

We therefore do not support the disclosure requirement to describe the events or changes in circumstances causing a change of a valuation allowance.

Investments in subsidiaries and interests in joint ventures (Par. 48(c))

According to the proposed rule in Par. 48(c), an entity has to disclose the aggregated amount of temporary differences associated with investments in subsidiaries and interests in joint ventures for which deferred tax liabilities have not been recognised.

We disagree with the proposal. As we already explained in our comments to question 4, the determination of the temporary difference is very complicated and nearly impossible to manage within tight reporting deadlines. The Board should therefore refrain from the proposed disclosure requirement. Moreover, the proposed rule refers to deferred tax liabilities, but not to deferred tax assets. Based on a systematic point of view, there is no justification as to why the ED refers just to deferred tax liabilities.

Based on the same arguments as explained above, we also propose the elimination of the existing requirements to disclose the aggregate amount of temporary differences associated with investment in subsidiaries, branches, associates and interests in joint ventures for which deferred tax liabilities have not been recognised (IAS 12 par. 81 (f)).

Intercompany Sales (Par. 48(d))

The elimination of intra-group balances and transactions as well as intra-group profit and losses resulting from intra-group transactions is inherent for consolidated financial statements. The calculation of the corresponding deferred taxes as proposed by the ED is conceptually in line with the temporary approach and already part of the current tax accounting procedures of IFRS.

As the Board noted concerns about possible perceptions of earning management (BC 108), the ED proposes additional disclosure requirements concerning deferred taxes arising from such intra-group transfers, i.e. the net effect on tax expense either for all transfers or for transfers of which timing and terms are customary. We completely disagree with the Board's concerns that intra-group transactions are caused by earnings management. Firstly, intra-group transactions are a customary part of the ongoing business of global groups. Secondly, for IFRS consolidation purposes, the intra-group balances and profit and losses are eliminated with the result that there are no effects on the balance sheet nor on the income statement. As there is no room for earning management, we see no necessity for further disclosure requirements.

Moreover, the proposed disclosure requirement would lay a major administrative burden especially on globally acting entities. We are convinced, that costs incurred by generating these disclosures would not be commensurate with the resulting benefit for users of the financial statements.