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By email: commentletters@efrag.org

Discussion Paper *Improving the Financial Reporting of Income Tax*

Dear Mme Flores,

Siemens Aktiengesellschaft very much appreciates the opportunity to comment on the proposals and questions set out in the Discussion Paper *Improving the Financial Reporting of Income Tax*. We are a publicly listed corporation organised in the Federal Republic of Germany and employed an average of 402,000 people in approximately 190 countries worldwide during fiscal year 2011. As a preparer of IFRS financial statements, we have a keen interest in the debate on how to achieve high-quality, globally-applied accounting standards and convergence in the capital markets.

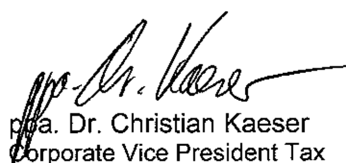
Accounting for income taxes is highly complex. We appreciate the users' need to receive reliable information, but we are concerned that the proposed changes for the accounting for income taxes may add further complexity that would not improve the relevance of published information and the decision's usefulness. Finding and determining the most suitable approach and the corresponding rules for the accounting for income taxes is a huge challenge, because of the need to satisfy the users' need for information while also taking into consideration the constraints on the preparers' ability to collect data and generate useful information.

In the comment letter, EFRAG posed several different questions concerning the accounting for income taxes. Please find our detailed comments on the questions in the appendix to this letter. If you would like further clarification, please contact Mr. Juergen Sieber (juergensieber@siemens.com), Head of Tax Accounting and Tax Compliance, or Mr. Alfred Simlacher (alfred.simlacher@siemens.com), Director Tax Accounting Principles and Strategies.

Yours sincerely

Siemens Aktiengesellschaft

ppa. Dr. Jochen Schmitz
Corporate Vice President & Controller



ppa. Dr. Christian Kaeser
Corporate Vice President Tax

Appendix

Q0.1

Do you consider that there are **deficiencies in IAS 12** that should be addressed? If so, should they be addressed through limited amendments to the standard or by developing a new standard based on different principles?

IAS 12 is based on the Temporary Concept. Although some aspects of this approach are criticised by some users, preparers and other constituents, we are convinced that it is preferable, as it is the best and most reliable way to account for income taxes. Conceptually, this approach has no fundamental deficiencies that need to be addressed.

Moreover, accounting in general and also accounting for income taxes should be principle-based. Such accounting rules will help ensure that rules and regulations from many different tax jurisdictions can be applied consistently, and will enable preparers to comply with IAS 12.

Fundamental changes in the concept of accounting for income taxes (e.g. implementation of the accruals approach) would add further complexity. For example, the application of the accruals approach implies that no deferred taxes are recognised for temporary differences in a business combination. In subsequent periods, temporary differences of the acquired assets and liabilities must be divided into two separate categories (i) already existing at acquisition date/initial consolidation and (ii) subsequently resulting. Such fundamental changes and the resulting complexity would increase the error rate in the worldwide process of collecting the necessary information.

Q1.1

Under current IAS 12 a difference between the tax paid and the current tax expense reported in the income statement leads to misunderstandings of these relationships.

Do you agree that additional disclosure that would provide a **reconciliation** of the **taxes paid** and **current tax expense** will help in understanding this relationship? (Paragraph 1.15 to 1.18)

We do not agree that an additional disclosure requirement should be added to provide a reconciliation of the taxes paid and current tax expense. There are two main reasons:

1. A reconciliation explains the difference between the taxes paid and the current tax expense/income for the *current* (or preceding) period(s). As users are interested in *future* cash inflows and *future* cash outflows of the income from continuing operations, they cannot derive relevant cash information for future periods from the reconciliation proposed in the Discussion Paper (DP). Concerning information about future tax cash flows, see our explanations in Q1.6.

2. Moreover, providing of such information is quite *burdensome and incurs additional costs* for the preparers. We think that the benefits derived from the proposed additional disclosure would not exceed the cost of providing it. As stated in the *Conceptual Framework for Financial Reporting 2010*, it is not possible to provide all the information that every user finds relevant (QC37).

Instead, we propose to use clear language so that the users clearly can understand the content of the published information.

Q1.2

Do you agree that additional more **detailed disclosures** regarding deferred tax assets, especially unused tax losses and unused tax credits are necessary and useful? (Paragraphs 1.23 to 1.24)

We do not agree that additional more detailed disclosures regarding deferred tax assets are necessary and useful.

The following information about unused tax losses, deductible temporary differences, and unused tax credits has been disclosed currently in the notes to the financial statements:

a) the amount of the deferred tax asset recognised in the statement of financial position (IAS 12.81 (g) (i)),
b) the amount of the deferred tax income or expense recognised in profit or loss, if this is not apparent from the changes in the amounts recognised in the statements of financial position (IAS 12.81 (g) (ii));
c) the amount of (and expiry date, if any) deductible temporary differences, unused tax losses and unused tax credits for which no DTA is recognised in the statement of financial position (IAS 12.81 (e)) and
d) the nature of the evidence supporting the recognition of DTA, when the utilisation of the DTA is dependent on future taxable profit and the entity has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax assets relate (IAS 12.82).

Moreover, Siemens voluntarily discloses the complete amount of the existing tax losses of the Siemens Group.

Based on the existing rules of IAS 12, the extent and level of information concerning DTA is already quite precise and gives insights into details. In our view, the proposed additional information is either already provided (such as restrictions concerning the expiration), is closely associated with already-provided information (such as maturity schedules), or is not helpful for users (such as geographical breakdown). We are also convinced that too much disclosure can result in an information overload and therefore does not support users in making decisions.

Instead, we propose reviewing the current disclosure requirements to ensure that all published information in the notes is useful to users in making decisions. Non-relevant disclosure requirements should be deleted.

Q1.3

Do you agree with the identified **users' information needs** in Chapter 1 of Part 1? Do you have any suggestion for additional information requirements regarding reporting of income taxes? (Paragraph 1.8 to 1.24)

We appreciate the users' needs and the requirement to provide useful information for resource allocation decisions. In defining the required information that should be published, the following factors should be considered:

1. *Cost–benefit relationship*
   The benefit derived from published information must exceed the costs of providing the information (*Framework for Financial Reporting 2010, QC35)*. This principle implies that the question should be asked whether the usefulness of information justifies the – sometimes enormous – costs of providing it. Consequently, it is not possible to provide all the information that every user finds relevant (*Framework for Financial Reporting 2010, QC37)*.

2. *Future-based information*
   In our view, the objective of preparing useful information about income taxes should not create an expectation of providing information about future income tax cash flows. As taxation of future income depends on different variables, a company's management cannot reliably predict future tax cash inflows and outflows. Instead, accounting for deferred income taxes should provide indicators of future effects on the taxation of the consolidated entities. For further arguments, please see Q1.6.

3. *Complexity of taxation and accounting knowledge*
   Accounting for income taxes is highly complex as the underlying issue, the taxation of a multi-national company, is quite complicated. The objective of accounting rules is not to transform the taxation complexity into an accounting simplicity. Instead, users of financial statements need profound knowledge about the worldwide taxation itself and also about the rules to account for income taxes.

Q1.4

Do you agree that **tax strategies** to accommodate user information needs should be disclosed in the management commentary and not in the financial statements? Why or why not? (Paragraphs 1.8 to 1.9)

General information (if any) about the tax strategies should be disclosed in the management commentary and not in the financial statements. Information (if any) about tax strategies can only comprise existing risk factors and the general dealing of the company with these circumstances.

Q1.5

The reconciliation of the actual tax charge to the charge on profit at the statutory tax rate (**tax rate reconciliation**) is quite complicated and leads to some misunderstandings.

Do you agree that the suggestions made in the paper are helpful by clarifying the explanation why the current tax charge is not equivalent to the standard rate of tax applied to the accounting profit? Why or why not? (Paragraphs 1.19 to 1.20 and 2.21 to 2.34)

We agree that the suggestions made in the DP (paragraph 1.19 to 1.20 and 2.21 to 2.34) that a tax rate reconciliation should be standardized. In contrast to the suggested approach, we prefer not to split the tax rate reconciliation between current and deferred income tax effects for the following reasons:

1. *Allocation:*
   There should be no split between current and deferred income tax effects as there exist issues that cannot be allocated to one of the categories. Example: In preceding periods, a company assumed that no DTA for a tax loss carry forward had to be recognized. In the current period, the full tax loss was utilized. The question would arise whether a part or even the full amount should be recognized as DTA. Alternatively, it also could be argued that no DTA (and therefore no deferred tax income) is recognized but a current tax effect has to be shown.

2. *Incompleteness:*
   In case of an split in current and deferred income tax effects, the suggested tax rate reconciliation is incomplete as corresponding items are missing. Example: A change in the income tax rate could have an effect on both current and deferred income taxes (and not only on deferred income taxes).

Q1.6

The amounts currently disclosed provide limited information about **future tax cash flows**. How would you suggest the disclosures in IAS 12 be improved to provide better information about future cash flows? (Paragraphs 1.13 to 1.14 and 2.35 to 2.40)

The reliable prediction of future tax cash flows is not the objective of income tax accounting and also not the responsibility of a company's management. Deferred taxes indicate possible future effects on the income tax assessment basis, but do not reflect future tax payments or tax refunds. The main reason for the implicit difficulty in making reliable predictions of future tax cash flows is the fact that the taxation of future income depends on many external factors (e.g. national tax laws and regulations; double tax conventions) that are highly dynamic and not within the control of the reporting company. Therefore, the company's management cannot transform this external uncertainty into reporting figures that predict future tax cash flows with certainty.

In our view, expected future tax payments should be derived from a reliable indicator that best reflects the relationship between future income and expected tax cash flows, not only in a single period but in the middle and long run. For this purpose, the sustainable part of the effective tax rate (effective tax rate adjusted for one time effects) is the most reliable way to predict future tax cash flows. Therefore, we support a standardised and well-structured numerical reconciliation between actual tax expense/income and the expected tax expense/income (product of accounting profit multiplied by the applicable tax rate). We also refer to our statement to Q1.3.

Q1.7

The possibility of **discounting** deferred tax balances is discussed in paragraphs 2.44 to 2.50. In your view, should discounting deferred tax amounts be required? Please explain.

In our view discounting should not be required, for three reasons:

1. *Systematic fault*
   In IFRS financial statements, a significant number of amounts are discounted. Standards explicitly address the discounting, or the measurement using fair values implicitly requires the discounting of the underlying amounts. If Deferred Tax Assets (DTA) and Deferred Tax Liabilities (DTL) are generally discounted, it could result in the systematic fault of double discounting. It is common sense that DTA and DTL should not be discounted if the underlying carrying amount is already discounted in the IFRS financial statements.

2. *Complexity; management judgment*
   Accounting for income taxes is already highly complicated. Discounting of DTA and DTL would add further complexity that would not be in line with the objective of making published information concerning income taxes more understandable. As an effect of adding further complexity, further disclosures (like explanations in the tax rate reconciliation) would be necessary. Moreover, discounting would require assumptions and therefore further management judgments would need to be made as part of the process of accounting for income taxes, although most such judgments are with respect to external factors that management cannot control and which therefore should be assessed by the users themselves. As financial statements should be comparable, a high degree of objectivity should be assured.

3. *Practical aspects*
   Thirdly, discounting DTA and DTL would add enormous complexity to the internal processes of accounting for income taxes. Internal processes would have to be adopted that would cause high one-time costs (e.g. avoiding double discounting, see point *systematic fault*), and also additional operating costs. In a world of tight and ambitious

timelines, further complexity threatens the viability of current processes to publish financial statements in a timely and high-quality manner.

Q1.8
Currently IAS 12 neither provides explicit guidance for accounting for **uncertain tax positions** nor contains any specific disclosure requirements regarding the tax risk position.
(a) Do you agree required information regarding uncertain tax positions should be disclosed? If so, which of the following do you prefer:
Alternative 1: Disclosure requirements should be included in management commentary.
Alternative 2: Disclosure requirements should be split in two parts. Part 1 would include disclosure of all positions for which the tax payer must establish a tax provision under IFRS and will be disclosed in notes to the financial statements. Part 2 would include all other uncertainties regarding income taxes for which no provision is recognised. (Paragraphs 1.10 to 1.12)
(b) Do you agree that IAS 12 should address the recognition and measurement of uncertain tax position? Why or why not? If you agree, should the measurement be based on the most likely outcome or a probability weighted method? Should measurement include the likelihood the tax position will be reviewed by the tax authorities or should that review be assumed? (Paragraph 2.51 to 2.59)

(a) We do not agree that information regarding uncertain tax positions should be disclosed separately. There are two main reasons:

1. *Sensitive information*
   Siemens (like many other preparers) operates in various tax jurisdictions and therefore has to determine tax positions under respective local tax laws and tax authorities' views. Although the income tax calculation is fully compliant with external rules and therefore avoids or mitigates tax risks, tax exposures can exist in certain circumstances, as local tax laws can be complex and subject to different interpretations of taxpayers and local tax authorities. Information about current (or even in future expected) disputes with tax authorities is sensitive and published information can even raise tax risks. As such information is very sensitive and highly confidential, we do not agree with the proposal to disclose such information either in the management commentary or as notes to the financial statements. Instead we prefer the principle that certain legal proceedings information (including income tax proceedings) is not disclosed if the company concludes that the disclosure can be expected to seriously prejudice the outcome of the litigation (see IAS 37 par. 92).

2. *Recognition of tax liabilities and notes to the financial statements*
   Uncertain tax positions are recognized as liabilities if they meet the conditions therefor. All tax-related contingent assets and contingent liabilities are disclosed in accordance with IAS 37 Provisions, contingent liabilities and contingent assets (IAS 12 Par. 88). According to the existing accounting rules, uncertain tax positions are taken into account either by recognizing a liability or by disclosing information in the notes. We see no requirement for further disclosure.

(b) We do not agree that recognition and measurement of uncertain tax positions should be addressed in IAS 12. Recognition and measurement of uncertain tax positions should not contradict the recognition and measurement principles that are applicable for liabilities in general. We think that the rules concerning the recognition and measurement of uncertain tax positions should be considered in light of the principles of IAS 37. Otherwise it would not be plausible that

the accounting for a risk arising from a non-tax proceeding should differ from the accounting for a risk from a tax proceeding. As we already addressed in our comment letter to the IASB referring to the *ED/2010/1 Measurement of Liabilities in IAS 37*, we do not support the probability-weighted method for the accounting of single obligations.

Q1.9

Are there any **issues** with IAS 12, which are **not addressed in Part 1**, that would significantly improve the standard? What amendments would address these issues?

In our view, there are no issues that are not addressed in Part 1 and that would significantly improve the standard.

Q1.10

What is your view on the **exemptions** that currently exist in IAS 12?

We are convinced that principle-based accounting is favourable. Nevertheless there exist facts and circumstances that require exemptions, e.g. in cases where there is a huge administrative burden to prepare the information, a negative cost-benefit relationship or where the resulting information is misleading assuming a going concern.

The existing exemptions of IAS 12 are often criticized as they are not in line with a principle-based standard. As the relevance and complexity of the existing exemptions varies significantly, we cannot give a general answer whether the existing exemptions are necessary or not. We would like to distinguish between and refer to the following exemptions:

1. *Outside basis differences* (IAS 12 Par. 15 and 39; IAS 12 Par. 24 and 44)
   The full recognition of deferred taxes on outside basis differences would cause enormous calculation problems for groups with a) a vast number of investments in subsidiaries, b) many levels of subsidiaries (direct and indirect) and c) tight reporting timelines. In case of a complete recognition of DTA and DTL for investments in subsidiaries, the calculation must be carried out in two steps. In the first step, all DTA and DTL with respect to the inside basis differences would be calculated and recognised. The recognition of the DTA and DTL within the subsidiary (inside basis differences) usually results in a change of the subsidiary's equity. In the second step, all DTA and DTL concerning the outside basis differences would have to be calculated. For this purpose, the net carrying amount within the entity must 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 a great deal of time, especially if there is a vast number of subsidiaries on many consolidation levels within a group or subgroup. As these procedures would cause enormous calculation problems, the existence of the exemption is very important and should not be deleted. Our preference is to recognise deferred taxes for outside basis differences when the reversal of the temporary difference is expected (e.g. in case of the disposal of a subsidiary).

2. *Discounting* (IAS 12 Par. 53):
   According to the rules of the standard, DTAs and DTLs are not discounted. As already explained in Q1.7, we prefer not to discount them and to retain the current exemption in IAS 12 Par. 53. In our view, this aspect is highly relevant for preparers.

3. *Goodwill* (IAS 12 Par. 15 (a))

There exists an exemption not to recognize a DTL based on the initial recognition of goodwill. In contrast, no corresponding exemption is applied for a DTA concerning the initial recognition of goodwill. For most preparers and users of financial statements, this different treatment seems illogical and leads to some misunderstanding. As the amount of reported goodwill (with corresponding taxable goodwill) could be significant, the current exemption should be reviewed and discussed.

4. *Initial recognition exemption* (IAS 12 Par. 15 (b) and Par. 24):
   In our view, the initial recognition exemption has no significant impact on the accounting for income taxes and the published information. Therefore, the current exemption could be deleted in a further step.

Q2.1

If the development of a new standard for income tax, based on different principles from those use in IAS 12 is to be considered, which of the approaches discussed in Part 2 seem to have most merit and should be considered as a basis for further development?

We are convinced that the temporary difference approach has the most merit and is the best and most reliable way to account for income taxes. Moreover, it fits best with the existing disclosure requirements that mainly focus on the balance sheet.

Q2.2

Do you think that there are any specific practical difficulties with implementing the approach(es) that you favour in practice? If so, how can those difficulties be addressed?

As the temporary difference approach underlies IAS 12 and therefore is applied currently, there are no practical difficulties expected.

Q2.3

Are there any approaches that are not discussed in Part 2 that should be considered?

No.

Q2.4

In your view should a combination of approaches be considered? If so, which approach should be used in what circumstances?

There should be no combination of two or more approaches as the temporary difference approach is the most favourable.

Q2.5

Do you have any further comments on the discussion of the various approaches in Part 2?

No.