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12 July 2012

Discussion Paper: Improving the Financial Reporting of Income Tax

Dear Mrs. Batista,

We appreciate the opportunity to comment on the EFRAG Discussion Paper "Improving the Financial Reporting of Income Tax".

SAP is one of the leading international providers of business software and one of the largest independent software manufacturers. Headquartered in Germany, we have more than 183,000 customers in over 130 countries and more than 55,000 employees in more than 75 countries worldwide. After we reported in parallel under both, U.S. GAAP and IFRS until 2009, we report only according to IFRS since 2010.

We welcome the Discussion Paper's aim to stimulate a discussion on the financial reporting for income taxes. Overall, we agree that there is room for improvement for the current IAS 12 as discussed in Part 1 of the paper. In detail, we support certain improvements on

- tax rate reconciliation; disclosure on losses carried forward (and other deferred tax assets); clarity on tax risk positions.

Conversely, we have serious concerns on the other suggestions made for improving IAS 12, namely

- disclosure of tax strategies and objectives; cash tax and future tax cash flows; explanation on difference between taxes paid and charge made in income statement; discounting of deferred taxes.

Our main concerns relate to the time and effort which would be necessary to obtain and/or explain the relevant data, especially in multinational groups of entities which operate in various countries, and the uncertainty associated with information that relates to the future. We question whether there is an additional benefit for the financial statement users which outweighs the necessary time and effort and the uncertainty issue.

Finally, we do not consider any of the four approaches discussed in Part 2 of the paper to be superior to the temporary difference approach of IAS 12. We doubt that it is reasonable to jeopardize the common understanding that has been gained in working with IAS 12 and we doubt that any of the new approaches provides a higher benefit to financial statement users.

Attached please find our detailed responses to the specific questions raised in the Discussion Paper. We would be pleased to discuss our comments at your convenience.

Best regards,
SAP AG

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Questions to constituents – General

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?

Overall, we support IAS 12 and its current principles. We do not consider IAS 12 to be fundamentally flawed. Since its introduction, preparers and users had time to become familiar with IAS 12. There is a common understanding and most areas are clear. Even though we support the current IAS 12, we agree that there are some issues which need to be resolved. We suggest amending the current standard. For more details on the amendments please see our answers to the questions below.

Upfront, we would like to point out two aspects that are relevant for all of our answers:

1. Complexity of income taxes

   Income taxes are a complex area with different tax laws in each jurisdiction. In our view it is a prerequisite for users to have certain basic tax knowledge in order to understand income taxes in financial statements. Otherwise, users will likely struggle with IAS 12 – even when taking the suggested amendments to IAS 12 into account – or with any other income tax approach.

2. Cash flow effects of income taxes

   According to our understanding of the Discussion Paper, one of the main topics relevant for users is to understand the cash flow effects of income taxes. This is one principle taken as a basis in our statement.

Questions to constituents – Part 1: Possible Amendments to IAS 12

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? (Paragraphs 1.15 to 1.18)

We do not agree that additional disclosure that would provide a reconciliation of the taxes paid and current tax expense would help in understanding the relationship between these two items. There is a wide range of items that cause the taxes paid and current tax expense to be different. "Taxes paid" mainly consists of current year prepayments based on current year expected taxable income of the group's subsidiaries and/or additional payments upon the filing of a prior year's tax return or the completion of a prior year tax audit. "Current tax expense" mainly consists of taxes for current year's taxable income, taxes for uncertain tax positions and prior year true-ups. To perform a reconciliation between the two items would be very time consuming and very complicated. Especially for multinational groups of companies located in numerous countries with different tax systems the complexity would significantly increase. Even if there are items in taxes paid and current tax expense that are similar in nature, respective amounts shown in the financial statements are often not identical in one year; however, throughout time the differences are neutralized.

To sum up, we understand that users may be interested in a reconciliation. However, considering the time and effort necessary for the preparation as well as the complexity of such a reconciliation, we deem the benefit to be lower than the effort. Thus, we do not support any additional disclosure.

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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 agree that additional information on the maturity and the total amount of unused tax losses and tax credits is of relevance for investors. This would give the investor an idea of when tax losses and tax credits are expected to be used at the latest. The information on the expiry date is currently required in the notes (IAS 12.81 (e)) for unused tax losses and tax credits for which no deferred tax asset has been set up, and is thus provided to users. Contrary, the same information is currently not available to investors for unused tax losses and tax credits for which a deferred tax asset has been set up. In our view, it would be possible to provide the information on the expiration dates with reasonable effort.

For the other additional information mentioned in EFRAG Part 1, paragraph 1.24 (geographical breakdown and further restrictions) we do not see any significant benefit for the investors. Geographic information is generally not required by IFRS for the tax data and we do not see a further value of such information. Further restrictions on the use of tax losses and tax credits are - in our opinion - already currently taken into account. The reason is that deferred tax assets may only be set up if the utilization of the respective tax losses and tax credits is probable. Thus, if there are restrictions on the usage and an entity does not consider it to be likely that it can utilize the tax losses and tax credits, a deferred tax asset may not be set up.

We would further recommend a clarification. When showing the amount and expiration date of unused tax losses, the case may be that there is not just a corporation tax but also a local/state/trade income tax applicable to businesses. In this case the tax losses may be relevant for the corporation as well as the local/state/trade tax possibly with different losses being relevant for corporation and local/state/trade tax. The question arises whether the amount of the relevant tax loss needs to be considered twice in the notes, once for the corporation tax and once for the local/state/trade tax. We would appreciate guidance on this matter. One option may be to provide the information for each type of unused losses and tax credits, if applicable and material.

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? (Paragraphs 1.8 to 1.24)

In our view, a prerequisite for users to understand income taxes in financial statements is to have certain basic tax knowledge. Taxes are a complex area due to the fact that one has to be familiar with the accounting and tax impacts as well as with different local laws, if an entity is engaged in more than one country (see also EFRAG Part 1, paragraph 2.40). Moreover, if the pre-tax case is complex (e.g. share-based payments), the tax which follows pre-tax will likely be complex, too. We see this as a given as long as IFRS rules and tax rules differ.

According to our understanding of the Discussion Paper, one of the main concerns is to provide more information on future tax cash flows. In our opinion, the current and - if available - forecasted effective tax rates which are given in the financial statements provide information which can be used (see also EFRAG Part 1, paragraph 1.22). In case an entity provides a forecasted effective tax rate, this rate is subject to uncertainty but any other information (e.g. discounting, information on reversal of temporary differences) would be as well, as it relates to future occurrences. Financial statements generally provide information based on past events. Unpredictable changes in business or tax legislation (as mentioned in EFRAG Part 1, paragraph 1.22) cannot be foreseen, neither for the pre-tax area nor for the tax area. We do not see how this can be solved by IAS 12 or a new standard.

For our input on the seven categories of tax information stated in EFRAG Part 1, please refer to our detailed answers below and above (Q1.1-Q1.8).

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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)

Regarding the tax strategy, according to our understanding, two general factors are important for companies. First, tax legislation is very complex, especially when doing business in a variety of countries. Thus, one major task is to observe all rules in place in order for the company to be compliant. Second, taxes are an important cost factor to companies. Thus, a company's goal is to keep such expenses low, always considering the regulations applicable in the various countries of business. In our view, this is common information and clear to a user with basic tax knowledge.

More detailed information, for example, on tax planning and transfer pricing policies is highly sensitive. Such information is case specific, difficult to present and could jeopardize the entity's positions towards the tax authorities. However, if there are tax uncertainties, current rules already oblige management to evaluate and consider such uncertainties when preparing the financial statements. Therefore, we do not see the value of additional general information to the users. We even believe that in reporting entities with global operations such disclosure would likely be limited to boilerplate due to the country-specific features of tax strategies. Instead, we see more benefit for users by providing certain disclosures with regard to uncertain tax positions as outlined in our answer to Q1.8. Besides that, if taxes have the potential to significantly impact the business, such a risk should already be included in the risk report of the management report.

As we do not support to include further information on the tax strategies and objectives in the financial report, we do not discuss the question on where to include it.

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 generally agree that the recommended seven main categories regarding the structuring of the tax rate reconciliation in the Discussion 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. As IAS 12 does not include a specific structure on how entities should disclose the reconciliation from the hypothetical income tax expense to the actual total income tax expense, each entity may use different terms in describing a similar reconciling item and each entity has different levels of details associated to a reconciling item. Therefore, standardization by grouping similar items to the recommended seven main categories could be helpful for the users to understand the difference between hypothetical income tax and the actual total income tax expense. We also agree to the described '5 per cent-rule' (see EFRAG Part 1, paragraph 2.34) which results in detailed information for the users regarding reconciling items within the main categories if the item is more than 5% of the amount computed by multiplying income before tax by the statutory tax rate.

However, we do not see much benefit to the user in the situation where the geographically weighted tax rate is applied in the reconciliation. The tax rate in such a situation varies each year according to the profit earned in each geographical territory. We do not expect that such a widely differing tax rate would reduce the user's confusion (see EFRAG Part 1, paragraph 1.20). In addition, it will also cost the preparer time and effort and may slow down the whole process of the preparation of the financial statements. Moreover, while a varying domestic tax rate can easily be explained, such an explanation is expected to be more complex for a geographically weighted tax rate. Furthermore, when using the domestic tax rate as a starting point, the resulting tax effect of the comparison between the domestic tax rate and the geographically weighted tax rate is generally shown in a separate reconciling item and thus is already available.

We also do not agree that it may be more meaningful to aggregate separate reconciliations prepared using the domestic rate in each individual jurisdiction for an entity operating in several jurisdictions (see

EFRAG Part 1, paragraph 2.29). Rather, in our opinion, according to IAS 12.85, the most meaningful rate is the tax rate applicable in the country in which the reporting entity is domiciled.

Overall, we agree that adopting standardization by grouping similar items together and by using the same terms for the main categories provide the users a more transparent and often more detailed information between the hypothetical income tax expense and the actual total income tax expense and that such standardization will allow the reconciliations to be more comparable.

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)

We agree that the amounts currently disclosed provide limited information about future tax cash flows, especially regarding the timing of the future tax cash flows. So far, IAS 12 includes future tax cash flows that are based on past transactions and events reflected in deferred tax assets and liabilities determined based on the temporary differences between current carrying amounts and tax bases of assets and liabilities. However, regarding the time of the reversal and the exact amount of the cash outflow, uncertainty exists. For example, for assets and liabilities which are accounted mark-to-market for IFRS purposes whereas historical cost accounting is used for tax purposes, the date of the reversal of the temporary difference may generally be known. But mark-to-market accounting can change values on the balance sheet frequently, as market conditions change. If market prices change unpredictably, the amount of the reversal of the temporary difference and therefore future tax cash flows are also not foreseeable. Similar issues may arise with regard to pension liabilities. For associated temporary differences this means that both the time as well as the amount of the cash outflow are subject to uncertainty. As a result, we see a high effort for the preparers to retrieve the appropriate information and at the same time only little value to the users of financial statements. Therefore, we do not support further disclosure requirements to be implemented in IAS 12.

Nevertheless, in order to improve the current standard we suggest to classify deferred tax assets and liabilities as either current or non-current as has been proposed in the Exposure Draft ED/2009/2 (same approach as under US GAAP). The classification of the deferred tax assets and liabilities should be based on the financial accounting classification of the related asset or liability for which a temporary difference exists. For example, temporary differences related to inventory and vacation accruals would be classified as current because these balances are also classified as current in the financial statements. Conversely, a temporary difference related to property, plant and equipment should be classified as non-current to reflect the classification of the underlying assets in the financial statements. The fact that a portion of the temporary difference may reverse in the current year as a result of depreciation would not affect the current/non-current determination. A deferred tax asset or liability that is not related to an asset or liability for financial reporting purposes, such as the deferred tax consequences related to an operating loss or a tax credit carryforward, would be classified in accordance with the deferred tax assets' or deferred tax liabilities' expected reversal or utilization date. We believe that such classification will provide users with at least a rough indication of the expected timing of the future cash flows.

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.

Deferred taxes are currently not discounted. Even though deferred taxes are utilized in different points of times in the future, this information is not taken into consideration. Consequently, interest and liquidity effects are disregarded when determining the effective tax rate. This applies to both, deferred tax assets as well as deferred tax liabilities.

From a general point of view, discounting would provide useful information to the investor as the time value of money for deferred income tax amounts would be taken into account and the amounts disclosed would serve as a basis for a cash flow analysis. However, in cases in which the carrying amount of an asset or liability has already been calculated on a discounted basis (e.g. pension liabilities), the resulting

deferred tax asset or liability is implicitly discounted and thus may not be discounted again. This also applies when local or tax values have already been calculated on a discounted basis while the carrying amounts were not discounted. Thus, in a first step, all balance sheet items would need to be analysed locally in order to determine whether either the IFRS or the local / tax values have already been discounted. This leads to an enormous additional administrative burden and requires time in order to check whether the preconditions for discounting of deferred taxes are met.

In cases, in which discounting of deferred taxes would be required, various additional information as well as time and effort would be necessary. One needs to set up detailed forecasts for each entity and every type of deferred tax asset and deferred tax liability. Especially in big enterprises with various subsidiaries the effort will be immense. Detailed analyses are necessary on when the deferred tax will be utilized. It is not possible to bundle deferred tax positions and discount them in one amount (as can sometimes be done with provisions of the same kind). Instead, at each entity the development of each deferred tax position needs to be examined separately based on local forecasts and tax rules. This implies detailed business forecasts in order to determine at what point of time tax loss carry forwards or other deferred tax assets can be used. It is likely that more skilled local personnel is necessary for the entities to prepare discount calculations as well as for the auditors to review discount sheets. Despite the effort, as the information relates to the future, it is subject to uncertainty. Thus, the longer the future period of relevance is, the more likely it is that the values are subject to uncertainty. As a result, the information is reliable only to a certain extent.

Furthermore, one needs to determine an appropriate interest rate as discount factor for the deferred tax positions. It would need to be decided whether this interest rate can be group specific or must be entity specific and when it is adjusted due to new information. The more precise the interest rate shall be, the more effort is necessary. At the same time a discount rate is also subject to uncertainty as it is an estimate.

Overall, although there is an additional value of using discounted deferred taxes if such information is reliable, it requires lots of time and effort and is subject to error-proneness which outweighs the benefit in our opinion. Therefore, in our view, discounting of deferred taxes should not be required.

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)

We generally agree that tax uncertainty in the financial statements is of interest to users and that they are interested in how tax risks are reflected in the financial statements. As such, we agree that certain information about an entity's uncertain tax positions should be disclosed.

However, the Discussion Paper does not state what is meant by "required information regarding uncertain tax positions should be disclosed". We believe that extensive disclosure requirements, e.g. as prescribed by US GAAP (formerly FIN 48 *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109 – currently ASC 740-10-50-15*) or suggested by the Exposure Draft ED/2009/2: Income Tax, might have negative impacts as they will increase the transparency on tax related transactions and events and might thus jeopardize the entity's position with regard to the tax authorities. Rather we think that the following disclosures provide an appropriate balance between the information needs of investors and the interests of the reporting entity on the current and future implications that income tax uncertainty may have on an entity's cash flows:

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(i) disclosures analogous to IAS 37.84 and 37.85 of all positions for which the taxpayer must establish a tax liability under IFRS (=> development of provisions) and

(ii) disclosures as currently required under IAS 12.88, i.e. analogous to IAS 37.86, of all other uncertainties regarding income taxes for which no liability is recognized, unless the possibility of an outflow of resources embodying economic benefits is remote (=> especially description of liabilities).

Following in general the approach of IAS 37, we are of the opinion that disclosure of tax positions for which the taxpayer must establish a tax liability under IFRS should be included either directly in the financial statements or in the notes to the financial statements. Further, disclosure of all other uncertainties regarding income taxes for which no liability is recognized should be included in the notes to the financial statements, unless the possibility of an outflow of resources embodying economic benefits is remote.

(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)

IAS 12 currently does not provide guidance on the accounting for uncertain tax positions. In order to address diversity in practice regarding the interpretation and the accounting treatment for any uncertain tax position, we believe that IAS 12 should be amended to incorporate principles for the recognition and measurement of uncertain tax positions.

However, we do not believe that the measurement should be based on a probability weighted method. The probability weighted method only leads to "mathematical correct" results in case of sufficiently large populations of outcomes, whereas tax items often include only two possible outcomes, e.g. acceptance by the tax authorities vs. non-acceptance and taxable vs. not taxable. Furthermore, uncertain tax positions generally include individual transactions and events that do not affect each other so that the population of outcomes is very restricted as different cases may not be mixed up. Therefore, we believe that the average weighted method could often lead to inconsistent results as there is no range of possible outcomes. Rather we deem that a two-step approach for the recognition and measurement of uncertain tax positions as currently included in IAS 37 would be more practicable and less error-prone than the probability weighted method. In such a two-step approach the recognition should be based on the determination of whether a tax position meets a certain recognition threshold (e.g. more likely than not) upon examination. If a tax position meets the recognition threshold, the measurement should be based on the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. This best estimate of the amount expected to be paid may be determined using different methods as described in IAS 37, e.g. where a single obligation is being measured, the individual most likely outcome should be the best estimate.

With regard to the detection risk we are of the opinion that measurement should not include the likelihood that the tax position will be reviewed by the tax authorities. To achieve comparable results and the overall goal of financial reporting, providing financial statement users with useful information for their resource allocation decisions, we believe it should be assumed that the tax authorities will examine all tax positions.

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?

Despite the suggestions made in the Discussion Paper which we support - i.e. certain improvements on tax rate reconciliation, disclosure on losses carried forward and other deferred tax assets, clarity on tax risk positions (see in more detail Q1.2, Q1.5, Q1.8) -, we see the following room for improvement and suggest the following amendments:

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Presentation and disclosure: Currently, rules which need to be observed with regard to income taxes are not only stated in IAS 12 but in other standards as well (e.g. IAS 1, IAS 7, IAS 37, IFRS 3). This increases complexity for preparers and provides the risk of errors if a relevant rule is overlooked. Thus, we recommend harmonizing the standard. One option would be to provide a clear link in IAS 12 to the relevant paragraphs in other standards. Another option would be to consolidate all income tax related rules in IAS 12.

Furthermore, the disclosure requirement of IAS 12.81 (g) could be clearer. Here, it would help to clarify what is meant by "each type of temporary difference" (EFRAG Part 1, paragraph 2.12). Does the "type" relate to positions in the balance sheet or the profit and loss statement?

Recognition and measurement: As has been proposed in the Exposure Draft ED/2009/2, we recommend changing the process for the recognition of deferred tax assets. Accordingly, we support to recognize deferred tax assets in full, in a first step, and then, in a second step, set up a valuation allowance, if applicable. This approach would be consistent with the requirements of other standards (e.g. IAS 36 with regard to goodwill accounting). Furthermore, we believe that users would obtain more transparent information on how a company determines its deferred tax assets.

Q1.10 What is your view on the exemptions that currently exist in IAS 12?

Current exemptions in IAS 12 are: initial recognition exemption; exemption for outside basis difference; exemption for goodwill in business combination. The effect is that deferred tax assets and liabilities are not recognized for these temporary differences. It is argued in EFRAG Part 2, paragraph 2.25 that exceptions to the standard make a standard complex and more difficult to understand the principles.

Initial recognition (IAS 12.15 (b) and IAS 12.24): According to IAS 12.15 (b) and IAS 12.24 neither a deferred tax asset nor a deferred tax liability may be recognized for temporary differences arising from the initial recognition of an asset or liability in a transaction which

(a) is not a business combination

(b) at the time of the transaction affects neither accounting profit nor taxable profit (tax loss).

Though the current regulation does not lead to any effects on the effective tax rate in the period of the initial recognition of assets / liabilities, large effects on the effective tax rate may result in the following periods, e.g. due to different depreciations for IFRS and tax purposes. Therefore, we deem it worth thinking about alternatives in order to reduce these effects.

Outside basis difference (IAS 12.39): We support the exception of IAS 12.39 with regard to outside basis differences for the following reasons:

- due to the indefinite time horizon, the amount of temporary differences is difficult to determine and subject to changes which cannot be predicted as of the relevant balance sheet date (e.g. tax rate in the future, different kinds of future strategies to retain money of investment and respective tax consequences);
- especially in groups of entities, it is an immense effort to determine not only all tax bases but to also determine the tax effects as every chain of entities needs to be examined (e.g. different levels of income flow in groups of entities, applicable withholding taxes, different tax systems in different countries in order to mitigate double taxation of income, different ways to retain money of investment);
- in case of the two conditions set out in IAS 12.39 (parent is able to control reversal and reversal is not probable in foreseeable future), it is not likely that the temporary difference associated with the investment will reverse in the near future. Thus, the real economic burden or benefit as of today is likely to be low (among others due to the time value of money).

Additionally, we recommend adding a clarification that such temporary difference only need to be disclosed if their determination is practicable. Otherwise disclosures should include a statement that the determination of respective temporary differences was not practicable (corresponding to the disclosure requirements under US GAAP regarding unrecognized deferred tax liabilities for temporary differences).

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Deferred tax liability for goodwill in business combination (IAS 12.15 (a) and IAS 12.21): We agree with the nonrecognition of deferred tax liabilities for goodwill in business combinations according to IAS 12.15 (a) and IAS 12.21. Even though this may cause a volatile effective tax rate, the exception seems necessary in order to avoid an iteration issue in calculating the goodwill in a business combination.

Overall, we see the practical benefits of the current exemptions in IAS 12. Even though these are exceptions to the principles, we generally support such a procedure. However, we deem it recommendable to think about alternatives for the initial recognition exemption according to IAS 12.15 (b) and 12.24.

Questions to constituents – Part 2: Alternative Approaches to accounting for income tax

Q2.1 If the development of a new standard for income tax, based on different principles from those used 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 do not consider it necessary to develop a new standard for income tax, based on different principles from those used in IAS 12. Rather, we prefer limited amendments to the existing standard as presented in the answers to Part 1 above.

There are several reasons why we prefer amendments to IAS 12 instead of developing a new standard:

General issues due to a change of principles: By now, preparers and users have become familiar with IAS 12. There is a common understanding and most areas are clear. If one would change the system, preparers as well as users would need time and effort to become familiar with the new system. This implies various cost and time consuming efforts e.g. trainings in order to have skilled personal, software updates or new software solutions for tax calculations, open issues due to lack of experience and a certain error-proneness in the beginning. Furthermore, in the year of the change, entities may need to explain deviations compared to the presentation of income taxes in prior years in order to provide transparency. This may imply that it is necessary to work with and analyze the effects of two systems for a certain period of time. Finally, we would like to point out that, in case of a new approach deemed to be advantageous in some areas, some practical difficulties which reduce potential advantages may become apparent only after the new approach is adopted.

Common issues applicable to the new approaches:

Additional value for financial statement users questionable: Despite the issues associated with a system change (see above), we question the benefit to users from a change from IAS 12 to a new approach to deal with income taxes in the financial statement. For more discussion on the different approaches please see below.

Fluctuating effective tax rate: Currently, with IAS 12 the volatility of the effective tax rate is kept low due to the presentation of deferred taxes. Among others, this implies a rather sustainable effective tax rate for both, preparers as well as users. We question whether this would stay the same with the other approaches in case deferred taxes are not included at all or only partially included.

Effective tax rate among multinational companies would be less comparable: Currently, with IAS 12 effective tax rates can be compared among multinational companies. This comparability could suffer, in our opinion, if we change to the proposed approaches, as discussed below.

In addition, changes of the current approach may lead to a wrong presentation of net assets and results of operations in the financial statements as tax items may be over- or understated: According to the current IAS 12, deferred tax assets and liabilities are generally recognized in the financial statements and deferred tax assets are only posted to the extent that their utilization is probable. As a result, under the current IAS 12 financial statements provide a complete picture of net assets and results of operations as all tax effects related to any transaction realized at the balance sheet date are considered. Conversely, if according to one of the new approaches deferred tax assets and liabilities are not shown at all or only to a limited extent, we see the risk that the total of assets and liabilities in the financial statement may either be over- or understated and thus the financial situation of a company.

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Specific issues with the new approaches:

Flow-through approach: The flow-through approach would no longer deal with the timing of taxes. We see this as inappropriate. Even though it seems an easy approach, it does not take future tax effects of current transactions into account as deferred taxes are not posted. We see no benefit of such an approach to users as the financial situation of entities would not be correctly stated in our view (see also comments above). Furthermore, forecasting the effective tax rate would need more time and effort and would still be subject to uncertainty and error-proneness. Thus, the tax factor would be a rather volatile factor for companies and users.

Partial tax allocation: We do not consider the partial tax allocation superior to the temporary difference approach. A lot of time and effort and subjective judgment is necessary in order to determine for each timing difference when and to what extent a future cash flow is expected. Furthermore, not all timing differences would result in deferred taxes to be posted. Thus, the financial statements would not provide a complete picture of the financial situation of a company but only a partial one and the effective tax rate would be volatile and difficult to compare to other companies.

Valuation adjustment: The valuation adjustment or net-of-tax method implies that taxes are not shown separately but instead affect the underlying asset or liability in the financial statement. In our view, showing the net amount of assets and liabilities alone would make balance sheets less transparent for users. Furthermore, for preparers this approach would be burdensome. First, more accounts would be needed. In order to keep track of tax related postings, sub accounts to the underlying asset and liability accounts for tax postings would need to be created. Second, as the amount of the underlying assets and liabilities would change due to tax postings, especially in bigger entities a closer collaboration between different departments would be necessary (e.g. department responsible for asset valuation and tax department). This may slow down the year-end / quarter-end process. Overall, we do not consider this approach superior to the temporary difference approach.

Accruals approach: Among others, this approach seems to have the benefit that exceptions currently included in IAS 12 would no longer be necessary (e.g. initial recognition exemption, see also Q1.10 above). However, we see it critical that certain tax effects that would not immediately affect profit and loss would not be shown. We especially criticize that no tax effects would be recognized in purchase price allocations of business combinations. This would mean that at the time of the acquisition assets and liabilities would be stepped up without an effect in profit and loss whereas tax effects related to resulting temporary differences would be disregarded. This is not consistent as the tax treatment would no longer follow the pre-tax treatment and even could have severe effects on the acquirer's profit. We further do not support that changes in tax bases are disregarded, as this will lead to effects on future effective tax rates. Finally, the example of a sale in the EFRAG Part 2, paragraph 6.2 seems to imply that current tax in IFRS and tax may not need to be identical with regard to timing. If this would be the case, tax accounting would get more complex compared to the current system (due to the duplication of efforts).

Overall, we do not consider any of the four approaches superior to the temporary difference approach of IAS 12.

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?

Q2.3 Are there any approaches that are not discussed in Part 2 that should be considered?

Q2.4 In your view should a combination of approaches be considered? If so, which approach should be used in what circumstances?

Q2.5 Do you have any further comments on the discussion of the various approaches in Part 2?

To summarize Q2.2-Q2.5, we do not consider any of the four approaches or a combination of the approaches superior to the temporary difference approach of IAS 12. We doubt that it is reasonable to jeopardize the common understanding that has been gained in working with IAS 12. We doubt that any of the new approaches provides a significant benefit to financial statement users. Furthermore, a system change would imply high costs and efforts of transformation for the preparers as well as for the users. Instead, we prefer limited amendments to the existing standard. With regard to the limited amendments, we refer to our explanation under Q1.1 – Q1.10.