

Tax position E-Plus from an IFRS perspective

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This paper provides further explanation on the tax position at E-Plus in Germany from an IFRS perspective, as referred to in the press release of KPN's Full Year Results 2007.

For Dutch tax purposes, E-Plus is regarded as a permanent establishment as from 2002, allowing KPN Mobile to offset a EUR 11.5bn loss related to E-Plus against its Dutch results subject to recapture of this loss as from 2002. For more details regarding the 'E-Plus recapture' we refer to the tax paper published by KPN on February 6, 2007 with the press release of our Full Year Results 2006.

Background

In the years until and including 2006, E-Plus incurred tax losses of some EUR 5bn and EUR 16bn for trade tax and corporate tax purposes respectively. Trade tax and corporate tax are the two types of corporate income tax levied in Germany at about 31% effectively for the two types combined. The amount of tax losses can vary as a result of tax filings and discussions with the tax authorities. Under current German law, tax losses incurred in the past can be used to offset against future positive taxable income without any time limit ('tax loss carry forwards'). However, taxable income in a certain year can only be offset for 60% of the taxable income against tax loss carry forwards. Trade tax and corporate tax have to be paid over the remaining 40% of taxable income.

IFRS vs. fiscal accounting

Taxable income is calculated in accordance with the rules as laid down in the German tax legislation, resulting in a potential difference from income under IFRS. Firstly this is the result of non-taxable and non-deductible items (referred to as 'permanent differences', for example business expenses that are not or only partially deductible due to a specific provision in tax legislation) and secondly a result of taxable and deductible temporary differences ('temporary differences'). Temporary differences are expenses or profits that are recognized for tax purposes in a different period than for IFRS purposes. For example, impairments recognized under IFRS in a certain period that are not recognized for tax purposes, leading to a higher amortization in subsequent years for tax purposes than for IFRS purposes.

Taxable income is calculated as follows:

IFRS income	A
Permanent differences	B
IFRS base for calculating tax expense/gain	C (=A-B)
Temporary differences	D
Taxable income	E (=C-D)

In the years 2001 and 2002, E-Plus recorded impairments under IFRS on goodwill and the UMTS license. These impairments were not allowed for tax purposes and, together with other valuation differences, caused a temporary difference in the book value of goodwill and the UMTS license for tax purposes and for IFRS purposes. In subsequent years, the amortization on the UMTS license was higher for tax purposes than for IFRS purposes, which resulted in a lower taxable income than IFRS income. In addition, the amortization of goodwill for tax purposes resulted in a lower taxable income than IFRS income.

At 31 December 2007, the book value of goodwill and the UMTS license for tax purposes at E-Plus was still higher than under IFRS. This difference will disappear over time, as a higher amortization of the UMTS license and amortization of goodwill will be recorded for tax purposes. Eventually a deferred tax liability will arise when the tax book value of goodwill becomes lower than the IFRS book value as a result of continued tax amortization.

Valuation of tax loss carry forwards and temporary differences

Under IFRS, a deferred tax asset (DTA) for tax loss carry forwards should only be recognized to the extent that it is probable that future taxable profit will be available against which these tax loss carry forwards can be utilized. A DTA should also be recognized for deductible temporary differences between book value for tax purposes and for IFRS purposes (such as the goodwill and the UMTS license at E-Plus), to the extent that positive IFRS income (see line C in the calculation shown above) will be available against which these deductible temporary differences can be utilized.

Until 2006, most separate taxable entities in the E-Plus group had a history of losses under IFRS. Therefore, at 31 December 2006 the amount recorded as a DTA was limited to EUR 136m. This reflected the realization of deductible temporary differences (being the higher amortization of the UMTS license and goodwill for tax purposes) for a limited number of years at certain taxable entities in the E-Plus group. No DTA was recorded for the loss carry forwards, as no future taxable income was projected at 31 December 2006.

Status

As the year 2007 progressed, it became clear that some separate taxable entities in the E-Plus group would achieve positive IFRS and taxable income over 2007, related to improved business performance and financial restructurings. Projections of IFRS income for 2008 and beyond prepared in Q4 2007 showed that the positive trend in income at E-Plus is expected to continue. This resulted in a EUR 1.2bn increase in the DTA in Q4 2007 to EUR 1.3bn at 31 December 2007. The amount of DTA at 31 December 2007 includes EUR 1.0bn for the realization of a higher amortization of the UMTS license and amortization of goodwill for tax purposes and EUR 0.3bn expected savings of tax payments due to available loss carry forwards.

Not all available tax loss carry forwards and temporary differences at E-Plus have been recognized for the calculation of the DTA. IFRS requires that tax loss carry forwards and temporary differences are only recognized for DTA purposes to the extent that it is probable that future IFRS and taxable income will be available against which the tax loss carry forwards and temporary differences can be set off. Factors taken into account in assessing the probability of the availability of sufficient future income are, amongst others, the expiration of the UMTS license in Germany and the fact that uncertainty of estimated future income increases with the length of the future period that is taken into consideration.

Going forward

As of 2008, E-Plus expects to report a tax expense in line with the normal effective tax rate of around 31% under current German tax law for trade tax and corporate tax combined. The DTA at E-Plus will decrease over time with the utilization of tax loss carry forwards and the reduction of temporary differences. The DTA will be re-assessed at each year-end for available evidence regarding recoverability and during the year, in case events take place which could have a material effect on future income. These re-assessments can result in a decrease or increase of the DTA and consequently in additional tax charges or gains. E-Plus expects tax payments for the medium term that are not significant and which are currently estimated at EUR 30-50m per year. The tax payments are the result of the realization of timing differences and the use of tax loss carry forwards as described in this tax paper.



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Tax Paper

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