

Tax position E-Plus from an IFRS perspective

This paper is an update of the tax paper published in 2007 and provides further explanation on the tax position at E-Plus in Germany from an IFRS perspective, more in particular the valuation of the deferred tax asset, as referred to in the press release of KPN's Full Year Results 2009.

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 income vs. taxable income

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 taxable income	C (=A-B)
Temporary differences	D
Taxable income based on tax rules	E(=C-D)

In the years 2001 and 2002, E-Plus recorded impairments under IFRS on goodwill and in the year 2004 an additional impairment of the UMTS license. These impairments were not allowed for tax purposes and, together with other valuation differences, caused a difference in the book value of goodwill and the UMTS license for tax purposes and for IFRS purposes which is temporary and will be reversed due to differences in amortisation. 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 2009, the book value of goodwill and the UMTS license for tax purposes at E-Plus was still higher than under IFRS. This difference will reverse over time, as a higher amortization of the UMTS license and amortization of goodwill will be recorded for tax purposes.

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Valuation of tax loss carry forwards and temporary differences

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

In assessing the probability of future income, greater care is needed if losses were incurred in prior years. Until 2006 most separate taxable entities in the E-Plus group had a history of losses. Therefore, at 31 December 2006 the amount recorded as a DTA was limited to EUR 136m.

DTA 2007 and 2008

In 2007 some taxable entities in the E-Plus group generated positive income due to improved business performance and financial restructurings. Projections of IFRS income and taxable income for 2008 and beyond showed that the positive trend in income at E-Plus was expected to continue. This resulted in an increase of the DTA of EUR 1.2bn to EUR 1.3bn at 31 December 2007 for loss carry forwards and deductible temporary differences. Factors taken into account in assessing the probability of future income were amongst others the increased uncertainty over time that estimated future income will be realized and the expiration of the UMTS license in Germany. At 31 December 2008 and the first three quarters of 2009, the DTA was based on the methodology as at 31 December 2007 whereby the DTA decreased over time to EUR 1.0bn at 30 September 2009. The decrease was recorded as a tax expense and reflects the shorter period in which future income was considered probable, in which consideration special emphasis was given to the expiration of the UMTS license which was taken into account for the valuation of the DTA.

Reassessment DTA 2009

The valuation of the DTA was reassessed at 31 December 2009. The reassessment was prompted amongst others by an improvement of the profitability track record of E-Plus (in 2008 and 2009 the positive trend in income continued) and by a review of E-Plus' business opportunities taking the forthcoming auctions into consideration as well as the possibilities to continue the operations of E-Plus without licenses. As a result of this review, lesser weight was assigned to the expiration of the existing UMTS license. Our estimates of future probable taxable income, and thus the possibility to utilize loss carry forwards and temporary differences in the future, take into account the increased uncertainty over time about whether estimated future income will be realized. This resulted in an increase of the DTA at E-Plus with EUR 0.7bn to EUR 1.7bn at 31 December 2009. If all available tax loss carry forwards and deductible temporary differences would have been valued, the DTA would have amounted to approximately EUR 5.0bn at 31 December 2009.

Tax charge in 2010 and later years

In 2010 and later years, the DTA will be based on the same methodology as at 31 December 2009. The tax expense in 2010 and later years will consist of the actual tax payable in Germany, i.e. trade tax and corporate tax payable over the 40% of taxable income which cannot be offset against losses carried forward, and the net increase or decrease of the DTA. Due to the methodology adopted for the calculation of the DTA in 2009 and later years, in which the length of the period in which future income is considered probable is not automatically reduced, the DTA will no longer automatically decrease as under the old methodology. Ultimately the net increase or decrease in the DTA will depend on estimated future taxable income for E-Plus as well the risk associated with the realization of these forecasts.

This will result in a lower tax expense and effective tax rate (tax expense as a percentage of C in the table above) for E-Plus and the KPN Group in 2010 and later years than was expected based on the DTA valuation methodology as at 31 December 2007 and 2008. Under the latter methodology the DTA decreased due to the reduction in length of the period in which future income was considered probable.

Tax Paper

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