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Citation for final published version:

Edgley, C. R. and Holland, K. M. 2021. 'Unknown unknowns' and the tax knowledge gap: power and the materiality of discretionary tax disclosures. *Critical Perspectives On Accounting* 81 , 102227. 10.1016/j.cpa.2020.102227

Publishers page: <http://dx.doi.org/10.1016/j.cpa.2020.102227>

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# **“Unknown unknowns” and the tax knowledge gap: Power and the materiality of discretionary tax disclosures.**

## **Abstract**

Material misstatements in corporate tax disclosures have widespread economic and social impacts. Our study investigates how disciplinary power flows through communication channels between institutional investors and senior executives to normalise understandings of tax disclosures as an instrument of social control. Adopting a governmentality approach, we analyse interview data, in the UK and Australia, to query how power guides the willing subjectivity of senior executives to provide an account of tax performance that is aligned to institutional investor information expectations, given tax complexity. At this interface between financial reporting and tax regulation, disciplinary power, when combined with regulatory fear, routinises the production of simplified, plausible but sanitised stories. This provides institutional investors with what they need to know while avoiding the risk of attracting the attention of the tax regulator but limits the value of the information flow. Furthermore, mutually consensual, self-disciplining dramaturgical rituals between executives and institutional investors allow complex tax issues to be glossed over to focus on other more comfortable, productive areas of corporate performance. Power works in a subtle way to reproduce beliefs that complex tax details are less material and should be kept below the radar. This creates a tax knowledge gap with the potential for material ‘unknown unknowns’ to exist.

## **“Unknown unknowns” and the tax knowledge gap: Power and the materiality of discretionary tax disclosures.**

*“We are ‘trusting’ the companies to give us everything we need to know... you couldn’t necessarily say analysts always want more on key risks of tax outflows...but it comes back to Donald Rumsfeld...known unknowns, unknown unknowns,” (Interviewee 8-Equity Analyst-UK).*

### **1. Introduction**

A curious incident took place in the world of tax in 2002. Earlier in 1999, One2One, a telecoms company owned jointly by Cable and Wireless (C&W) and MediaOne, was sold to Deutsche Telekom. MediaOne reported its share of the resulting gain as \$6.01bn with a corresponding tax charge of \$2.3bn (£1.5bn).<sup>1</sup> In contrast, C&W stated their share was disposed of for £3.45bn giving rise to a profit on disposal of £3.4bn.<sup>2</sup> No information was disclosed about a tax liability. However, in 2002, triggered by a downgrading of its credit rating, C&W announced that it had indemnified Deutsche Telekom for £1.5bn to cover any potential tax liability on C&W’s share of the gain. On the day of this announcement, the C&W share price plunged by 40%. Following the share price collapse, the Association of British Insurers demanded a regulatory inquiry.<sup>3</sup> No investigation took place even though a successful class action was pursued in the US.<sup>4</sup> Legal action by investors in the UK against C&W was unsuccessful.<sup>5</sup>

This story was a striking example of a lack of reflexivity about tax matters in communication channels<sup>6</sup> between senior executives and institutional investors<sup>7</sup> and motivates our current study. We are particularly curious how governance failures arose in *both* the giving

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<sup>1</sup> See [www.sec.gov/Archives/edgar/data/732718/000091205700013208/0000912057-00-013208.txt](http://www.sec.gov/Archives/edgar/data/732718/000091205700013208/0000912057-00-013208.txt)

<sup>2</sup> Cable and Wireless public limited company annual report and accounts for the year ended 31 March 2000, *Note 10 exceptional items*.

<sup>3</sup> “C&W’s partner paid tax on sale of One 2 One stake,” as reported in The Times, December 14, 2002. [www.thetimes.co.uk/article/candws-partner-paid-tax-on-sale-of-one-2-one-stake-c0z806xj6xt](http://www.thetimes.co.uk/article/candws-partner-paid-tax-on-sale-of-one-2-one-stake-c0z806xj6xt)

<sup>4</sup> Cable & Wireless Plc Securities Litigation 2002, United States District Court, Eastern District of Virginia, No. 02-1860-A. Available at <http://securities.stanford.edu/filings-case.html?id=102662>

<sup>5</sup> Hall v Cable and Wireless Plc [2009] EWHC 1793 (Comm) (21 July 2009).

<sup>6</sup> By communication channels we refer to arrangements (around the time of the publication of accounts) for performance evaluation; these are described in the Financial Conduct Authority (FCA)’s Handbook of rules and guidance as statements, public announcements and analyst briefings. Communication is typically made through disclosures within the accounts or at a presentation/road show or briefing meetings with analysts (FCA, 2018).

<sup>7</sup> Using the Office for National Statistics (ONS) categorisations, Institutional investors are defined as Unit trusts, other financial institutions, Insurance companies, Pension funds, Investment trusts and Banks. Institutional investors operate as an epistemic community of professional investors who invest on behalf of their members (including endowment funds, commercial banks, mutual funds, hedge funds, pension funds and insurance companies). Institutional investors hold 72.3% of UK quoted shares (ONS, 2014).

*and* the receiving of an account of tax conduct in published financial statements. First, senior executives failed to internalise user information needs by reporting a chargeable gain without disclosing the tax consequences. The future tax liability was considered contingent and immaterial<sup>8</sup> for complex reasons (discussed later in this paper). Second, the subsequent ‘revelation’ that tax was due on a large gain should hardly have caught professional investors by surprise; they neglected to assimilate the tax implications of the original disclosure. Rather than ask why this happened (as it was by no means an isolated oversight), our study seeks to query *how* the respective understandings of institutional investors and senior executives of tax disclosures can be imagined as a social problematic. How do their performances around the discussion of tax conduct influence the flow of information about the corporation tax arrangements of large companies into the public domain? Prior qualitative research, to the best of our knowledge, provides us with few insights on this subject.

Our study is positioned within an extensive research domain (mainly quantitative in approach) that has explored the influence of institutional investors over corporate performance as a corporate governance mechanism. There are fewer qualitative studies but these point to the salience of exploring the disciplinary effects of meetings between institutional investors and senior executives (Roberts et al. 2006). Our study is located at this regulatory site, with a novel focus on how power shapes routines that produce and evaluate tax disclosures, particularly voluntary (or discretionary) tax disclosures. Discretionary disclosures are valuable for users as they can provide deeper insights into the ethicality of corporation tax planning and into future, more uncertain, tax positions (Kvaal & Nobes, 2013). Companies are encouraged to provide discretionary disclosures in reporting guidance (Financial Reporting Council (FRC), 2016) but do not always do so (PricewaterhouseCoopers (PwC), 2015). Thus, the influence of institutional investors over senior executive routines in formulating tax disclosures is a meaningful subject for research.

Our study links research on institutional investors, as a governing authority, to a second area of qualitative tax literature on the regulation of senior executive tax behaviours. Academics have investigated beliefs that shape tax practices and tax compliance (including studies by Braithwaite, 2003, 2007; Murphy, 2008; Murphy et al. 2009; Henderson, 2005; Kirchler et al. 2008; the workings of power in the relationship between taxpayers and the regulator, Doyle et

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<sup>8</sup> Information is immaterial if not considered material where the latter refers to an item where omitting, misstating or obscuring it could be reasonably expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, as outlined in International Accounting Standard (IAS) 1, (IASB, 2007).

al. 2009; Likhovski, 2007; Boll, 2014; tax as a social practice, Boden et al. 2010; and how the role and practices of tax professionals are increasingly imbued with morality, Radcliffe et al. 2018). However, the role of investor groups, as another group of actors who can hold senior executives to account for tax conduct, has received less attention.

Our study is salient at a time of escalating concern about the poor quality of tax reporting and controversial tax planning practices among large listed companies. This is a global malaise (Radcliffe et al. 2018) and has prompted government policy makers and non-governmental organisations (NGOs) to take steps to modernise tax systems. This work is ongoing and includes measures to improve the public reporting of tax information internationally. Progress is being made (OECD, 2018a) but is slow in many areas. NGO's continue to call for more research that examines "the world's broken tax system," (Oxfam, 2016). Our study responds to this call and we seek to broaden the scope of ongoing critical discussions about tax governance.

To frame our research questions, we mobilise Foucault's concept of governmentality (Foucault, 1984, 1991). Our study maps onto the work of Roberts et al. (2006) who first interpreted meetings between investor groups and senior executives as a medium through which disciplinary power flows to guide the willing subjectivity of the latter in providing an account of financial performance. We are innovative in examining, at an important interface between financial reporting and tax regulation, how institutional investors (working on the evaluation side of corporate tax disclosures) guide senior executive subjectivity and routines (working on the production side) as a mechanism of social control. We probe their respective understandings of tax disclosures as an instrument of accountability and how this guides their performances around the discussion of tax conduct. We also examine how, as self-disciplining subjects, both groups of actors exercise certain freedoms (Viale et al. 2017) in knowledge exchanges. The objective of a governmentality approach is to map how disciplinary power works as an invisible power/knowledge nexus and to query how deliberative actions have social consequences and for whom.

Another novel aspect of our study is that we probe how beliefs about tax complexity affect discussions around tax conduct. Quantitative studies suggest that professional analysts do fail to assimilate tax information in financial statements as the complexity of data increases (Plumlee, 2006, p.275) and as the complexity of tax planning increases (Francis et al. 2019). We adopt a qualitative approach to probing the richer story behind these observations<sup>9</sup> and examine how beliefs about tax complexity influence processes of social control.

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<sup>9</sup> We are particularly grateful to an anonymous referee here for extremely helpful insights and ideas that we have worked with in this paper.

To this end, we analyse qualitative interview data obtained from corporate actors (including chief financial officers (CFOs), tax and audit partners in Big 4 firms, and institutional investors) about their lived experience of routines in producing and evaluating tax disclosures in large, listed companies, particularly corporation tax disclosures.<sup>10</sup> We conducted interviews in the UK and Australia. This allowed us (without setting out to compare country by country reporting on tax issues) to gather data in diverse sites. The UK has long been a meaningful site of research on corporate governance (Aguilera, 2005; Brennan & Solomon, 2008; Solomon, 2007) and tax as a social practice (Oats, 2012). Australia is a significant site for tax research because the Australian Tax Office (ATO) is recognised internationally as taking a firm deterrence approach to aggressive tax avoidance (Murphy, 2004; D’Ascenzo, 2015). The timing of our interviews in 2011-12 (part of a broader study<sup>11</sup>) was fortuitous, just as “aggressive” tax avoidance was gaining traction as an international governance issue. Our interviewees spoke with a candour that we would be unlikely to elicit now. Our study thus provides an invaluable reference point in time as scholarship begins to explore ongoing tax modernisation initiatives and the outcomes.<sup>12</sup>

Our study makes three distinct, and meaningful contributions to critical scholarship on tax governance. First, we highlight how, in our data, disciplinary power managed tax complexity by normalising routines that simplified tax information. At the same time, routines operated within a web of regulatory arrangements to balance satisfying investor group preferences for simplified stories about tax while also cleansing data to avoid attracting regulatory attention. Such rituals limited the value of the information flow about tax matters for all governing authorities and not just tax regulators. A second contribution draws attention to how dramaturgical, mutually consensual self-disciplining practices routinised behaviours that skimmed over more technical tax issues to avoid loss of face in meetings. This constrained possibilities for deeper reflexivity about tax conduct. The over-simplification of disclosures potentially absorbed and obscured important matters which could later manifest as tax surprises.<sup>13</sup> Possibilities for a gap in public tax knowledge thus potentially exist alongside the known financial tax gap (between budgeted

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<sup>10</sup> With other taxes, such as VAT or income tax/national insurance, companies may pay significant amounts of tax but largely function as a vehicle for tax collection and payment. Companies do pay payroll taxes – employer NI for example but the main assessment on corporate profits is corporation tax

<sup>11</sup> Funded by the Institute of Chartered Accountants in England and Wales, Charitable Trusts.

<sup>12</sup> We believe that underlying beliefs and attitudes are unlikely to have changed significantly since the interviews were conducted or individuals would perhaps be less open about their views now.

<sup>13</sup> We use the term “surprise” when referring to disclosures of new tax relevant information. In contrast, the popular press often refers to such events as “tax scandals”.

and actual government tax revenues). This tax knowledge gap is a material concern from a public interest and social justice perspective.

Our theoretical contribution lies in utilising the Johari window approach (Luft & Ingham, 1961) to give visibility to Foucault's ideas about the nuanced effects of governmentality on knowledge production but also "*façade*" and what is not said (Foucault, 2002, pp. 84-85; Hase et al. 1999). The Johari window facilitates the analysis of communication exchanges between groups and provides insights into the performance of truth games that open or close down windows in knowledge production<sup>14</sup> (Hase et al. 1999). Through this approach, the disciplinary effects of meetings between investor groups and senior executives can be imagined as areas of interplay where subjectivities influence how windows in communication channels open and close in subtle ways to produce tax knowledge. However, there can be unintended consequences for governing authorities.

The paper is constructed as follows. Section two focuses on the institutional background for the paper. Section three outlines our theoretical framing and relevant tax scholarship. Section four covers the methods adopted. Section five discusses the findings. We conclude in section six with a discussion and summary of the findings.

## **2. Institutional background**

### *2.1 Tax Modernisation*

The wider context for our study is the ongoing global modernisation of tax systems. Regulatory pressure to improve the quality of corporate tax disclosures is intensifying. A long series of high-profile corporate tax scandals has highlighted how poor tax disclosures can obfuscate controversial tax practices, with serious social impacts (Houlder, 2018; Radcliffe et al. 2018). Where shortfalls arise between expected and actual tax receipts (the so-called financial tax gap) governments must either cut back on public services or shift the tax burden to others. In the UK, the gap is estimated to be £33 billion (HM Revenue and Customs (HMRC), 2018). £7 billion of this gap arises in part from the aggressive tax management practices of large corporations and their advisers (Sikka & Hampton, 2005; Sikka & Willmott, 2010). The impact of the tax gap on

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<sup>14</sup> Foucault was interested in how mechanisms of power produce, and reproduce, different types of knowledge. Knowledge gathered about the activities of individuals further reinforces how power works. In our study, the Johari window approach provides insights into how disciplinary power flows through communication channels between institutional investors and senior executives to influence knowledge production. Our use of the term knowledge production refers to how mechanisms of power guide the formulation and evaluation of corporation tax disclosures, particularly voluntary disclosures, and in turn shape our public knowledge about corporate tax performance and behaviours.

poorer countries, particularly in Africa, is even more devastating, amounting to at least \$100 billion every year (Oxfam, 2019).

At the request of the G20, the Organisation for Economic Co-operation and Development (OECD) is initiating new soft law measures such as the Base Erosion Profits Shifting plan (BEPS) to improve tax regimes and tax reporting across over 100 countries and jurisdictions and address imbalances where reported profits are geographically divorced from corporate activities (OECD, 2018a, 2018b). The UK Government now requires large companies to publish an annual tax strategy (HMRC, 2016). The Financial Reporting Council (FRC) is encouraging Boards to adopt a thematic review of tax disclosures and any uncertain tax positions. The European Union (EU) has introduced country by country reporting (EU, 2016).

To improve the quality of tax reporting senior executives can provide voluntary disclosures over and above mandatory tax disclosures. Voluntary disclosures offer possibilities for disclosing uncertain, future issues such as the likely consequences of material tax disputes with a regulator or details on tax policies or refer users to its country-by-country report for more details on tax strategy (Institute of Chartered Accountants in England and Wales (ICAEW), 2017). An increasing number of companies make voluntary tax disclosures (two thirds of FTSE 100 companies disclose their approach to tax) but only eighteen companies provide a reconciliation of the cash tax (actual payments) to the tax charge (in the accounts) (PwC, 2015). There is considerable variability in the content of discretionary disclosures which is confusing for users (PwC, 2015). The disclosure of the reconciliation of the group tax charge to the nominal tax charge or effective tax rate (ETR) is useful for knowledgeable investors but there is no legal obligation currently in any tax jurisdiction to disclose a reconciliation of the group tax charge to the cash paid.<sup>15</sup>

On the one hand, as new initiatives develop, tax is increasingly being viewed as a social practice more deeply imbued with morality than before (Radcliffe et al. 2018). This is starting to change the moral boundaries within which tax practitioners and external auditors work. On the other hand, while improvements in international tax regulation and reporting are being seen (Avi-Yonah, 2017), the pace of change in some areas has been “glacially slow” especially in

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<sup>15</sup> Where companies engage in aggressive tax avoidance practices, this could be signalled by a low effective tax rate. Numerous schemes exist for shifting income and costs among group companies to take advantage of lower tax rates and favourable tax rules in diverse tax jurisdictions. The outward evidence of such practices may only be visible through a mismatch between the amount of tax paid, compared to revenue generated in a particular tax jurisdiction. Tax matters of a remote nature may be disclosed as a contingent tax liability in the notes to the accounts. This could include a disputed tax assessment or an interpretation of tax law that is contested, or a liability arising from a proposed future change in tax law.



the digital economy (Economist, 2018). This has resulted in challenges to the efficacy of BEPS through the spectre of unilateral action by The European Union.

Improvements are needed in the quality of disclosures rather than just the quantity (Blouin & Robinson, 2014). Freedman (2018) suggests that high levels of disclosure can be distracting and thus operate as a smokescreen for bad behaviours. Oats & Tuck (2019) emphasise how so-called transparency initiatives have limitations. There are considerable misunderstandings about the benefits of transparency, in publishing tax strategies for example. Information disclosed may be misinterpreted by users and transparency itself is a contested concept. Our study thus provides a reference point in time (as scholarship begins to explore ongoing tax modernisation initiatives). We seek to broaden critical discussions about tax governance by examining investor group influence over senior executive willing subjectivity in routines that produce disclosures.

## *2.2 The power of institutional investors*

Prior research has extensively explored the power of investor groups as an epistemic community of financial experts who govern corporate conduct. Since the 1970's, institutional investors have controlled much of the money that flows into capital markets. This has created an opportunity and a need to hold senior executives to account for corporate performance, especially with less liquid investments (Jung & Dobbin, 2012). Following past financial scandals, the influence of institutional investors over senior executive behaviours has increasingly attracted the attention of regulators as a useful corporate governance mechanism (Cadbury, 1992; Myners Report, 2001; Financial Reporting Council, 2018).

Mainstream research has tended to view institutional investor power as coercive through exercising votes at general meetings or where surveillance has an impact on internal governance linked to share price determination and value creation (Roberts et al. 2006). Extant research is mainly quantitative with a focus on developing models that explain financial market interactions (Verrecchia, 2001), including the economic consequences of increased disclosures (Leuz & Verrecchia, 2000; Lambert et al. 2007).<sup>16</sup>

More relevant to our study is qualitative research on the relationship between institutional investors and senior executives and their behaviours. Senior executives commit time to building close links (Pye, 2001). Both investors and companies draw value from these meetings which encourage congruence in their interests. Investors rank meetings as the most important source of information available to them for share price determination. (Barker, 1998; Holland 1998). Face

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<sup>16</sup> For an excellent literature review interested readers are directed to Roberts et al. (2006).

to face meetings, distinct from public meetings such as the annual general meeting, have encouraged senior executives to willingly discharge accountability in line with institutional investor expectations<sup>17</sup> in subtle ways, albeit it for the benefit of large rather than average shareholders (Roberts et al. 2006; Jung & Dobbin, 2012).

We have far less information about the influence of investor groups over tax conduct. Prior quantitative research provides some (but limited) insights suggesting that the ability of professional investors to assimilate tax information reduces as the data become more complex. Professional investors may manage complexity by adopting simpler strategies to complete a task (Plumlee, 2003, p. 279). Graham et al. (2012) and Bonsall et al. (2017) concurred. They found that analysts and credit agencies encountered difficulty in deciphering companies' tax disclosures. Bratten et al. (2016) reached a different conclusion that analysts do "pay attention" to taxes. As tax complexity increases, their own independent forecasts of effective tax rates (where they do not follow management assumptions) appeared more accurate. However, Francis et al. (2019) found that as tax planning becomes more complex, it becomes more difficult for analysts to forecast earnings and tax expenses and they do not properly adjust for these effects. We are curious to probe the story behind these findings and examine beliefs about how tax complexity influences discussions around tax conduct as a mechanism of social control.

### **3. Foucault, Governmentality and Tax Governance**

#### *3.1 Foucault and Governmentality*

We are drawn to Foucault's ideas about governmentality to problematise behaviours that evaluate tax conduct. His work provides insights into the regulatory context of neoliberal, economic and financial systems (Miller & Rose, 1990, 2017) and has strongly influenced critical accounting research (Gendron & Baker, 2005; Power, 2011). Governmentality focuses on how the art of liberal governing decentralises governance practices at the interface between the state, organisations and individuals to control populations and individual deliberative actions (Rose et al. 2006). In modern political and regulatory thought, power (referred to as disciplinary power) operates in a subtle way that is distinct from coercive or sovereign power. Disciplinary power works as an invisible power knowledge nexus and normalises discourses that are internalised by individuals to shape their behaviours as willing, self-disciplining subjects (Rose et al. 2006).

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<sup>17</sup> Although less so for analysts whose commission increases where market volatility affords opportunities for high frequency trading.

Roberts et al. (2006) were the first to suggest that mainstream research on the influence of investor groups over corporate performance, drawing on an agency theory lens, misunderstands how power works. Rather than being coercive, disciplinary power flows through meetings between senior executives and institutional investors as a mechanism of social control to guide routines in subtle ways. Power produces effectively by shaping subjectivities or responsabilised beliefs. Subjectivity guides how individuals act as self-disciplining individuals in willingly conforming to certain knowledge or regulatory systems (Foucault, 1975, Foucault, 1984, p. 210; Mennicken & Miller, 2012; Miller & Rose, 1990; Rose & Miller, 2010; Viale et al. 2017) for the security of society (Burchell et al. 1991). The willing subjectivity of individuals in their actions *is* the materialization or effects of power on the body (Ezzamel, Willmott, & Worthington, 2004).

Pivotal to the operation of disciplinary power are subtle forms of social control that provide insights into how governable persons administer practices in institutional settings. Instruments are developed, referred to as technologies of control (for example accounting disclosures) that provide insights into backstage arrangements within organisations so that they can be known as calculable spaces (Gendron & Baker, 2005; Power, 2011; Roberts et al. 2006; Raffnsøe et al. 2017). Expertises are developed by governing authorities to evaluate such technologies of control. Conclusions are drawn and rectifications made that over time give rise to new programmes of government (Miller & Rose, 1990 p. 29). This form of social control is described by Foucault as the conduct of conduct, derived from the original French phrase, “*L’exercice du pouvoir consiste “à conduire des conduites”*” (Foucault, 1994, p. 237). To conduct is also to lead ways of behaving within a field of possibilities (Foucault, 1994; Christie, 2006).

We mobilise Foucault’s ideas in our study to explore how institutional investors understand tax disclosures as an instrument of disciplinary power and the expertises that are drawn upon in this process within a broad system of tax regulation. We query how this guides senior executive behaviours. We ask who influences whose behaviours, for whose benefit and how the referent of disciplinary power is understood. We are curious to explore how power normalises routines.

An important aspect of governmentality, relevant to our study, is that individuals are free in their deliberative actions (Miller & O’Leary, 1987; Miller & Rose, 1990; Viale et al. 2017). Internalised beliefs influence our deliberative actions and how we willingly submit to others (Foucault, 1998, p. 461; Miller & O’Leary, 1987; Miller & Rose, 1990; Viale et al. 2017). Liberal governing thus works “in accordance with the grain of things ... to the end of securing the conditions for an optimal but natural and self-regulating function,” (Burchell, 1991, p. 127).

However, the way in which actors exercise freedoms can have unintended consequences for governing authorities (Dean, 1999).

In our study, senior executives exercise certain choices in how they formulate disclosures, particularly with the content of discretionary disclosures and how this information is communicated. Investor groups, in turn, exercise freedom in where and how they direct their gaze as a governing authority. Their own practices are critiqued from a distance by regulators if they fall short of expectations: for example, for failing to exercise voting rights (Myners, 2001; Company Law Review, 2001); for failing to scrutinise senior executive behaviours prior to the 2007-2008 banking crisis (Kay Review, 2011); and for their focus on short term rather than long term aspects of performance (Jung & Dobbin, 2012). Investor groups do respond to criticism and develop their own internal, codes of practice but nevertheless retain discretion in how they evaluate conduct (Wong, 2011). Regulators are currently seeking to set higher expectations for investor groups<sup>18</sup> in stewardship codes but these measures are deemed to lack substance (Wong, 2015). A governmentality framework thus helps us to unpack how freedoms are exercised in the conduct of tax conduct and the social consequences.

### *3.2 Tax as a social practice*

Our study links research on the power of institutional investors as a governing authority with qualitative tax scholarship on tax compliance as a social practice and tax complexity. We identify how our study opens a new avenue for qualitative tax research.

#### *3.2.1 Tax as a social practice*

In contrast to positivist and black letter law studies that dominate the tax field, two significant streams of tax scholarship have explored taxpayer conduct (Radcliffe et al. 2018). One stream, adopting a behavioural-psychology approach, has examined how diverse social and personal beliefs influence tax compliance practices and willingness to pay taxes. Taxpayers are influenced by factors such as trust, morals, values, beliefs about tax fairness and social norms (Hasseldine & Li, 1999). Tax administration is viewed as an ‘accommodating’ model of regulation rather than adversarial, where value is derived from building trust between tax authorities and taxpayers to encourage compliance (Braithwaite, 2003, 2007; Murphy, 2008; Murphy et al. 2009; Henderson, 2005; Kirchler et al. 2008). Many tax agencies throughout the world refer to taxpayers as ‘customers’ and provide ‘services’ to enable their customers to meet obligations.

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<sup>18</sup> [https://www.frc.org.uk/news/january-2019-\(1\)/frc-strengthens-stewardship-code](https://www.frc.org.uk/news/january-2019-(1)/frc-strengthens-stewardship-code)

Regulation is seen as a set of practices that rely heavily on effective knowledge sharing between tax regulators, accounting firms and companies (Hasseldine et al. 2011).

A second stream of critical tax research pays attention to the broader social structures, technologies and workings of power that shape tax compliance and create responsible taxpaying citizens. Tax is interpreted as a social practice involving complex socio-legal relationships (Boden et al. 2010; Lymer & Oats, 2019). Critical tax studies examine the creation but also the darker side of compliance where solutions to problems are not straightforward (Likhovski, 2007; Boll, 2014). In a special issue of *Critical Perspectives on Accounting* on taxation, Boden et al. (2010, p. 541) have called to researchers to probe the role of hidden powers over tax discourses and behaviours. Foucauldian inspired studies have observed how the state exercises power to create self-policing taxpayers. In the UK for example, HMRC have adopted a risk rating approach<sup>19</sup> to taxpayers and focus on relationship building as part of their Review of Links with Large Business to encourage discussion about the legality of potential tax avoidance schemes before implementation (Doyle et al. 2009). The risk rating approach has been criticised for failing to provide incentives to alter tax planning behaviours (Freedman, 2009) and the UK Treasury has been critiqued for being too accommodating in condoning profit shifting practices on US technology companies, including Amazon (Houlder, 2018).<sup>20</sup>

Boll (2014) and Radcliffe et al. (2018) have identified lacunae in extant qualitative tax research. Evidence-based, behavioural psychology studies are less concerned with the influence of broader social structures on compliance. In contrast, critical tax studies are better at examining how tax behaviour is enmeshed with wider organizational, institutional, political and societal phenomena but at the micro-level, the practices of actors involved in governance on the ground could be further explored.

Our study examines how institutional investors are a further group of actors who evaluate tax disclosures (PwC, 2015; Radcliffe, 2018). Institutional investors potentially exercise influence over senior executive behaviours at an important interface between financial reporting and tax regulation. In this we respond to Boll's (2014) call for more research that explores *where* routines and practices are performed in the tax field. Our study of institutional investor influence is particularly meaningful because the practices of other governing authorities within this web of governance have been critiqued. For example, tax authorities have been observed to lack

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<sup>19</sup> See Freedman et al. (2009).

<sup>20</sup> HMRC were criticised by the House of Commons Public Accounts Committee (PAC) over the process and amounts raised in agreeing settlements on large outstanding tax disputes. Although a subsequent review by National Audit Office (NAO, 2012) found the level of settlements were reasonable, concerns about the process were upheld.

consistency in how they use the additional tax data that companies disclose (Oei & Ring, 2018; Oats & Tuck, 2019). The role of external auditors has also tended in the past to be more of a reasonableness review rather than a rigorous scrutiny of tax disclosures.

### 3.2.2 Tax complexity

Our study problematises how beliefs about subject complexity affect performances around the discussion of tax conduct. Scholarship regards tax law as complex both in the UK and Australia (Mirrlees Review, 2010; Sawyer, 2013), requiring the equivalent of a university degree to understand (Kirchler, 2007). It is beyond the scope of this paper to explore why business tax law has become so complex (interested readers are directed to Edgley, 2010; Kirchler, 2007; Boden et al. 2010; and James, 2010). Rather, we focus on how ideas about tax complexity are social constructions. For example, discursive distinctions are made between different types of tax complexity that attach to different tasks including rule complexity (in making sense of and applying tax law) but also strategic complexity, in corporate tax-planning activities (Plumlee, 2003). Beliefs about complexity thus depend on the nature and context of the task that is being performed whether this is understanding, interpreting, enacting, or evaluating different aspects of tax law.

Complexity for institutional investors attaches to understanding information disclosed about tax performance at the *interface* between tax and accounting practices. Corporate tax computations are not reported in the public domain but remain private information known only to the tax regulator. Investor groups can only obtain information about tax performance *through the medium of accounting disclosures* in financial statements, as a form of interface between the reporting of tax and financial performance. Tax disclosures are thus complex instruments of social control where evaluation practices require both tax *and* accounting expertise. As tax payments vary significantly each year,<sup>21</sup> tax accounting practices are employed to smooth spiky cash flows and calculate an average tax charge over time. This obscures the actual tax rate. For example, under International Accounting Standard (IAS) 12, known future tax obligations (deferred tax) or prepaid tax must be accounted for under the “full provision method” (IASB, 1996). This requires making assumptions about future tax events to compute provisions.<sup>22</sup>

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<sup>21</sup> Spikey tax cash flows are caused by several factors including significant permanent and timing differences that arise because of the gap between accounting and taxable profits, and also stemming from legislation changes. Some timing differences between accounting and taxable profits are permanent (e.g. those arising from business expenditure that is not deductible for tax purposes) and others are temporary timing differences, where tax either will have to be paid in the future or has been effectively prepaid.

<sup>22</sup> For example, if deferred tax liabilities reduce or deferred tax assets increase, this affects the computation of the earnings per share of a listed company

Historically, management have had scope to fine tune these provisions to their best advantage (Holland & Jackson, 2004). This produces inconsistencies between companies in their reporting practices, to the extent that the International Accounting Standards Board (IASB) recently felt it necessary to issue more detailed guidance on this area (IASB, 2017).

Our study does not seek to add to professional literature on the technical content, or analysis, of disclosures, particularly voluntary tax disclosures (see for example PwC, 2015) or provide an answer to an elusive epistemological question that asks, “what *is* a material voluntary tax disclosure”? Rather, we ask what kind of information senior executives might anticipate that institutional shareholders are expecting and how this affects their subjectivity in selecting information for disclosure.

#### **4. Methods**

To gather data for our study we conducted semi-formal interviews with 18 individuals, including 3 Chief Financial Officers (FCOs) of large companies, working in influential, senior positions in 2011-2012. Given the sensitive nature of our study and the small number of professionals with expert knowledge in both tax and accounting (Evans et al. 2014) our pool of interviewees was limited. Interviewees were contacted through the authors’ professional networks. Our unit of analysis was the lived experience of our interviewees (Golden-Biddle & Locke, 2007).

Regarding sufficiency of interviews, the essential criterion was to gather informed insights from internal corporate actors involved in producing tax disclosures, external tax experts (Big 4 firm tax and audit partners) and institutional investors (with tax knowledge). Our four internal tax experts, at their level of seniority, had extensive experience of preparing disclosures and communicating with investor groups as well as personal and legal responsibilities in tax compliance.<sup>23</sup> Our tax and audit partners within Big 4 firms had all been involved, from a privileged but confidential position, in providing advice to large corporate clients on tax, and tax accounting matters. To examine institutional investor beliefs, we interviewed professional analysts employed by fund managers/investment banks (senior equity analysts, investor advisors, senior tax analysts) and representatives from industry trade bodies. Fund managers are an important class of professional investor who manage around \$30 trillion of assets globally

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<sup>23</sup> For example, the importance of personal responsibility in tax matters has been recognised by tax regulators, including HMRC and the ATO. Legislation passed with effect from 2009 requires UK resident companies above a specified size to appoint a named Senior Accounting Officer (SAO). The SAO is responsible for ensuring the company establishes and maintains appropriate tax accounting arrangements to ensure its tax liabilities are correctly calculated and tax positions disclosed. An earlier campaign in 2006 by HMRC, on tax in the boardroom, was designed to heighten directors’ senses of responsibility towards companies’ taxation decisions.

(Investment Company Fact Book, 2014). We cannot claim that the perspectives of our interviewees are exhaustive but between them, they were responsible for contributing to knowledge about tax matters in positions of power or oversight over public interest entities, with a contribution of many billions to treasury corporation tax receipts in the UK and Australia.

Before commencing each interview, steps were taken to reassure interviewees given the confidential nature of the subject matter. The interviewer outlined the aim of the research project and their own background and prior experience as a tax specialist, and former Big 4 firm employee. Interviewees were provided with a reminder of the strict research ethics that the interviewer would observe, and standard interviewee protocols (as set out in previous correspondence) including the right of the interviewee to revoke participation immediately and the right not to respond to every question asked. Particular emphasis was given to stressing the undertaking of anonymity of the individual and the employer. Finally, permission to record the interview was requested (and in all cases given).

Interviewee profiles are outlined in Table 1.

*Insert Table 1 here*

We conducted interviews in the UK and Australia to broaden the scope of our study. The regulatory culture in Australia is particularly strong. We queried how this affected communication between institutional investors and senior executives.<sup>24</sup> The Australian Tax Office (ATO) have adopted a firm deterrence approach (Murphy, 2004; D'Ascenzo, 2015) and are swift to refer disputes over unacceptable interpretations of tax law by taxpayers to the courts.<sup>25</sup> This encourages higher compliance among corporate taxpayers. For example, corporate tax managers are rewarded for their effective management of tax risk and improving accuracy in tax computations rather than minimising the tax liability (D'Ascenzo, 2015). Another marked difference between the two tax systems and a point of particular interest in our study is that Australia has a full dividend imputation system (which was terminated in the UK in 1999).<sup>26</sup> This system eliminates the double taxation of company profits, once by companies on taxable

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<sup>24</sup> Australia was among the first countries to introduce formalised continuous disclosure (CD) regulation in September 1994. Once an entity becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately give Australian Securities Exchange that information, (Seamer, 2014).

<sup>25</sup> This tough stance triggered an investigation into dispute practices by the Australian Government (Inspector-General of Taxation, 2012).

<sup>26</sup> Franking Credits also known as Imputation Credits are a type of tax credit. These franking credits are valuable to shareholders as they can be used to reduce income tax on dividends or can be used as a type of tax refund.



profits and again by shareholders when they receive and pay tax on dividend income. A tax credit is imputed to attach to dividend income for the recipient (relating to corporation tax already paid on the dividend income distributed – referred to as “franking”). These tax credits on franked dividends are highly valued by investors. Investors are assessed for tax on the gross dividend received (including the tax credit) but only need to pay the *net* difference between the tax already paid at the company level and their own tax liability on the dividend received.

We draw on the Johari window approach (Luft & Ingham, 1955, 1961) to analyse our empirical data. This approach to psychological reflexivity is used to explore communication within groups. When parties interact, they initiate a relationship through the exchange of information. Subject knowledge and extensive disclosure are essential to build and maintain relationships. These dimensions have been expressed in the form of a matrix, or window with four panes (see Figure 1, below), which we adapt for our study (Luft, 1969).

Insert Figure 1 here – The Johari Window

A facilitator/researcher probes how groups exchange information in the public arena (cell 1). Cell 1 represents an arena where open communication takes place. Information known by one party (in our study, what senior executives know about corporate tax performance and positions) is shared and known by the other party (in our study, institutional investors). The scope of discussions within the public arena can be expanded (to reduce the risk of misunderstandings or mistrust arising) depending on the willingness of actors to ask questions that prompt greater disclosure. Listening to feedback encourages reflexivity.

The scope of what is known in the public arena is thus contingent upon: how much information individuals have and are prepared to exchange in public (cell 1); what individuals within an organisation are prepared to learn about themselves from others which would otherwise remain in a blind spot (cell 2); how much individuals are prompted or encouraged to share with others which would otherwise remain hidden in the façade area (cell 3), and that which is unknown to any one (the area of ‘unknown unknowns’ in cell 4).

Where actors are willing to push back against constraints that limit discussion in the public arena, by asking questions and through greater disclosure (see figure 2), this encourages reflexivity and shared discovery. *Possibilities* for issues to remain ‘unknown’ among a group of actors (or ‘unknown unknowns’ in cell 4) reduce. In our study, ‘unknown unknowns’ refer to tax issues with material financial and/or social impacts, unknown to senior executives within a company and unknown to institutional investors. A critical, consensual engagement in

knowledge exchanges thus opens the boundaries for exploring what might otherwise remain unknown. This reduction cannot be measured or quantified but is a metaphor for moving towards a more dialogic knowledge exchange. If actors willingly extend how they exchange knowledge and this prompts reflection on previously held, taken for granted norms and ideas (Figure 2), this has emancipatory potential.

Insert Figure 2 here – The Johari Window Applied.

Without a willingness to engage with blind spots or façade (what we hide) the possibility for “unknown, unknowns” to arise increases.

The Johari window analytical approach has been associated with the work of sociologists including Derrida, Weber and Simmel as well as Foucault’s ideas about power/knowledge relationships and truth telling (Hopper, 2007; Robertson, 2016). We believe the Johari window complements a governmentality approach. It facilitates exploring how disciplinary power flows through communication channels to normalise rituals in knowledge exchanges and processes of self-disciplining.

To explore how disciplinary flows through communication channels to shape how knowledge is produced about tax performance and any constraints on these processes, we asked a series of open-ended questions (see Appendix 1). We queried who governs what; what the object of governance is understood to be; according to what rationales; using what techniques/expertises, with what end in sight and for whose benefit (Dean, 1999). We queried senior executive subjectivity in preparing for meetings (Roberts et al. 2006). We probed how subjectivities influenced question and answer routines to open or close down possibilities for knowledge exchanges in the public arena; how expertises were applied in discussions about tax matters; how issues might remain in the façade area and how blind spots might arise. We queried how beliefs about tax complexity and understandings of materiality shaped discussions about tax conduct. We probed how power flowed through meetings to open windows in communication, or where behaviours closed windows. We probed the wider social consequences of evaluation routines.

The software used to analyse our data was NVivo which adds rigour to the analysis of interview data and the coding process (Anderson-Gough, Edgley & Sharma, 2017). In constructing a coding framework, initial codes were developed, a priori, from relevant literature, and we developed additional descriptive categories that emerged from the data. Inductively derived categories provided deeper insights into our understanding of knowledge exchanges. We

repeatedly read our data sources to check that our interpretations of connections between data and our coding structure were authentic.

Dialogue was maintained between both authors about our interpretations of the data at all stages. Once the data were broken down, we reconstructed our findings. We found that our analysis built upon and corroborated themes that had emerged in our early discussions. This helped us provide a sense of trustworthiness (Lincoln & Guba, 1985) surrounding our analysis. We grouped the data to distinguish themes that related back to our research questions (Richards, 2009).

## **5. Findings and interpretation**

Our findings are presented around themes that emerged, analysed through the four areas of the Johari window. The interviewees commented on the salience of our research focus, “*I remain breathtakingly astonished that it has been looked at so little,*” (I1-CFO) and we justify the substantial number of interview quotes that we discuss because of the candid, rich nature of our data.

In section 5.1, we discuss how senior executives willingly internalised investor group information needs in advance of meetings. In 5.2, we analyse how respective subjectivities shaped knowledge exchanges in the public arena (cell 1). In 5.3 we discuss the willingness of institutional investors to ask questions, how senior executives willingly responded and the implications for addressing blind spots and façade zones in communication channels (cells 2 and 3). In 5.4 we assemble our meta-level analysis of our data and summarise our findings in a Johari window figure. We reveal and discuss the relevance of the area of cell 4 and “unknown unknowns” about tax matters to our study. In 5.5 we consider the macro-level implications of our findings and how this affects our public tax knowledge.

### **5.1 Preparing for the conduct of conduct**

Roberts et al. (2006) observed how senior executives internalised professional analyst information expectations in advance of face to face meetings. Likewise, our data suggested that power works in advance, before meetings, to shape senior executive assumptions about aspects of tax performance and tax management that institutional investors value. However, the giving of an account was *balanced* with the constraint that the tax regulator scrutinises the content of disclosures from a distance. Routines developed to produce disclosures that included information that investor groups needed but where the content was carefully cleansed. This was to avoid the risk that the content of disclosures might attract the attention of the regulator.

The following quote from a finance director suggested that senior executive subjectivity was attuned to investor group information needs:

*My understanding, which I've developed through osmosis rather than formal instruction...is that our shareholders are looking for stable and sustainable after-tax earnings per share and also stable growth in the after-tax earnings per share. And both the investors themselves and maybe more importantly the analysts will presumably be putting a tax rate into their model in order to derive the cash flows on which they'll build their valuation, (I1-CFO).*

The term osmosis we interpret as the subtle way in which disciplinary power normalises certain ways of knowing. Power in this sense is productive. The interviewee willingly accepted that investors were looking for evidence in disclosures of the effective management of sustainable after-tax cash flows. Their requirement was for data in a form that would “fit” their financial models for deriving company valuations. In this regard, sustainability was important as a matter of predictability for valuation purposes.

This norm in routines, where investors were mainly interested in information about the effective tax rate was also apparent in Australian data:

*In the Australian market...most analysts are primarily concerned with the effective tax rate, and franking. And I'm not entirely sure that a lot of analysts would go much deeper than that, (III-EA).*

Interestingly, this interviewee mentioned a second behaviour that analysts looked for in performance, and valued, which was the payment of franked dividends (an aspect of the Australian, not the UK tax system). Franked dividends provide a real tax cash flow benefit for investors (who only need to pay tax on the difference between their own tax charge on the dividend received and the underlying tax paid by the company on the profits out of which the dividend was distributed). This expectation was willingly responded to, even by companies with low profits, which accounting experts suggested made little sense (I18-Big 4-P-A). For companies with low profits, paying a franked dividend was not in the long-term interests of the company or employees. We interpreted this as disciplinary power working for the benefit of larger investors, rather than the company or other stakeholders. A professional investor commented:

*So, companies can pay franked dividends even when performance isn't great... I can't fathom why, but it's a matter of fact, that's what they like to do, which doesn't seem rational to me as an economist, but there you go! (I9-II).*

While senior executives were willingly attuned to investor group information expectations, they were also sensitive to how the content of tax disclosures was subject to the gaze (Foucault, 1976) of the tax regulator. Big 4 partners mentioned how even highly compliant clients were sensitive to regulatory risk, especially in Australia. A challenge by the regulator was damaging, with material financial penalties (I14-Big 4-P-A) but the “*number one risk...is reputational,*” (I10-Big4-T).

Regulatory fear produced another set of rituals that guided the cleansing and careful management of the content of disclosures. Responsibility for cleansing tended to be delegated. For larger, listed companies, tax disclosures underwent thorough internal examination before finalisation by a series of committees, “*The processes they'll go through, there'll be a disclosure committee...which will review the issues and decide whether disclosure is appropriate...the audit committee of the group will have a view as well,*” (I1-CFO). Routines were carefully managed and “*tend not to be run by tax people, they are run by marketing people, strange as that sounds,*” (I10-Big4P-T). The wording of disclosures was delegated to those with public relations expertises. Vague language, or a boiler plate disclosure, could be used to *tick a box* in disclosing information, especially with transfer pricing issues. One chief financial officer implied that such approaches, which we associate with impression management, were widespread:

*There's some very boiler plate language in both the SEC filing, and the financial report. So typically, a company will have a paragraph saying, “We carry on business in a number of countries, Revenue Authorities apply the laws in different ways, we don't always agree with them, and therefore there's a risk of additional tax liabilities arising. Terrible vague stuff, (I1-CFO).*

This quote demonstrates how information about exposure to a tax risk might be disclosed in general rather than any specific terms. The interviewee further commented that even where an actual tax dispute was at an advanced stage, disclosure of the matter would be vague and lack specific details until the matter was finally resolved (I1-CFO).

Beliefs about tax complexity also influenced processes of social control for producing tax disclosures. Our interviewees mentioned that, in their experience, most senior executives lacked confidence about their tax knowledge. If tax law was complex, producing accounting disclosures about tax matters was even more so (I1-CFO). Processes thus needed to be carefully managed. One senior tax manager explained how the Chairman of a disclosure committee would be briefed before a meeting on key tax issues and provided with a script to help answer likely questions:

*We will just take the Chairman through it, so that he can evaluate what's in front of him. So when he's actually in the formal session, it isn't a surprise to him; he has answers at his fingertips, he questions what he feels what the committee should be aware of what's required, or indeed if he thinks it is not significant, he will move on, (I3-STM).*

We asked audit partners about how they understood their own role as those who evaluate the content of voluntary disclosures. This was described as more of a reasonableness examination:

*As tax advisors, I think we would look, where we were given the opportunity, we'd look hard at what was being presented, to make sure that we were comfortable that promises were not being made that couldn't be kept, and that there was nothing that was ambiguous, but that would be the max that we would ever do. Yeah, (I2-Big 4-P-T).*

In this quote, the practitioner's approach was passive, seeking comfort that the content was not misleading rather than reflecting on the information value of the disclosure.

We also questioned Big 4 partners about how senior executives reached decisions about what might constitute a material tax issue for a discretionary tax disclosure (distinct from material items that must be disclosed). Drawing a line about the materiality of such items was considered far from straightforward. For example, while stakeholders might benefit from knowing about future, uncertain tax exposures and the uncertainty of the outcome (especially at the early stages of a dispute) might be viewed as reasonable grounds for non-disclosure, “*If you are in discussions with the commissioner about a potentially litigious matter, it probably would not be disclosed*” (I18-Big 4-P-A). Even as a dispute progresses, the financial impacts might be difficult to predict, even for tax partners, “*So it's not easy. If you were to talk to – pick a tax partner in any of the big four – they'll have four different views on the same issue, in a lot of the hairier instances,*” (I10-Big 4-P-T). An assurance partner further added:

*“You can have materially different answers to a particular exposure, and both will be correct. It’s just a question of how you assess the evidence. But I will have a different view of materiality, even to you, and so will you versus everyone else, so we don’t even know what that means. And on (name of a high-profile company deleted) - is it \$100 million, is it \$500 million, is it certainly more than \$500,000!*

*INT      Yes, you know what it isn’t!*

*RES      That’s right! Easy to describe but hard to define! It’s a bit like goodwill, (I18-Big 4 –P-A).*

Drawing these points together, our interviewees suggested that disciplinary power shaped senior executive willing behaviours to provide investor groups with aspects of tax information they valued, which was mainly reassurance about the effective management of post-tax future cash flows. At the same time, routines also worked to delegate responsibility for cleansing the wording of disclosures to avoid attracting regulatory attention. Beliefs about tax complexity further normalised the careful rehearsing and stage-management of processes that produced and reviewed the content of disclosures. We saw little willingness to disclose more information than investor groups needed and probed why in the following section. We also observed how tax positions might be highly uncertain in the background, but routines worked to provide reassurance about effective management.

## **5.2 Communication in the public arena**

In this section we discuss how the disciplinary effects of meetings shaped behaviours during knowledge exchanges where “the whites of the eyes can be seen” (Roberts et al. 2006, p. 288) in the public arena (cell 1 of the Johari window). Interviewees indicated that discussions adhered to highly stylised conventions which we interpreted as theatrical performances. We probed why.

Our interviewees suggested that information exchanges were constrained in meetings because actors felt vulnerable when discussing complex tax issues. They ran the risk of loss of face, if they appeared to be talking about matters that they did not fully understand, *“I think they (institutional investors) are scared of their lack of knowledge ... and it’s true internally as well, you know,”* (I7-CFO). To manage this risk, questions and answers followed certain formulaic, theatrical rules of the game. The flow of information moved in one direction (I5-EA; I8-EA) from senior executives (usually the Chairman, CEO and CFO) to institutional investors. Actors were more comfortable discussing the subject of effective tax rates, which was a known focus of interest for investor groups, but otherwise were content to gloss over more technical tax issues.

Communication tended to centre around the sustainability of the ETR. While investor group interest in the ETR has been observed in prior literature (Radcliffe et al. 2018), our data suggested that this was for deriving company valuations based on reasonable predictability about sustainable growth in post-tax cashflows. We were given the impression that investor groups preferred to be provided with information they needed to know rather than pro-actively question senior executives about detailed aspects of tax performance.

The Johari window approach considers the degree of willingness of groups to draw on their knowledge in asking and answering questions. According to interviewee I5-EA, communication channels would open more if the CEO was interested in tax, perhaps because of a prior negative experience with a tax regulator. The same interviewee further commented, “*Very few (CEOs) are (interested in tax), I think!*” (I5-EA). Institutional investors found senior executives to be willing to provide basic tax information but with little depth. They were apprehensive about disclosing too much. Institutional investors attributed this reluctance to talk about tax to a lack of confidence among senior executives in their technical tax knowledge, particularly in Australia, “*Tax people don’t normally get to the CEO or CFO role, there has been the odd exception but that tends to be the experience in Australia,*” (I13-TE).

Occasionally, senior executives might be more willing to talk about technical aspects of tax if an important matter might otherwise be misunderstood. However, such scenarios were carefully rehearsed. An equity analyst provided an example:

*If companies foresee a significant movement in their tax rate, they will often communicate about that, because they don’t want the market to be surprised. And if there’s a potential tax change that they are worried about, they may talk about that. Beyond that, I would say, it’s mostly relatively reactive, (I5-EA).*

Investor groups also attributed the reluctance of senior executives to disclose too much tax information to regulatory fear:

*What I would say is that companies are very, very concerned about the way in which they disclose, particularly tax exposures, because they don’t want to give more information than would be appropriate to the Revenue authorities, (I5-EA).*

One interviewee (a UK tax lawyer and professional investor) mentioned that tax regulators viewed aggressive tax avoidance behaviours among large companies as pervasive, “*and if it is a*



*tail, it is wagging the dog,*” (I4-TL). This suggested that investor groups understood why senior executives might be sensitive to regulatory fear of coercive power.

Given the cautious nature of discussions around tax performance we asked analysts if it would be easy for senior executives to hide a material issue. We refer to this as retaining information in the “façade” or hidden area of the Johari window. As one analyst explained:

*Yeah...they could fool me very easily because they've got a handle on the situation, they can run circles round me, because I just don't have the facts that they've got. Unless they fib on something that I've seen in an annual report, it's going to be very hard to catch them out, (III-EA).*

While senior executives were considered cautious in their willingness to disclose or discuss tax matters (I8-EA), we were surprised that institutional investors did not consider this to be a problem. We were told, by way of explanation, that professional analyst interests were not in “*the dirtier detail of how you kind of manage that in tax terms,*” (I4-TL). Analysts were content just to focus to data about average tax rates rather than other areas (I5-EA).

Analysts also empathised with why senior executives might not want to disclose too much:

*You wouldn't want to be advertising to the market, the public, the Government, or anybody, that your tax planning is particularly brilliant so that you are paying less than your fair share of tax or that your tax planning is particularly shoddy because you want to make sure you're paying everything you should be and maybe you're being stupid by doing so, (I6-II).*

This quote suggests that a greater level of disclosure about backstage tax practices increases vulnerability. If disclosures hinted that tax planning was poor, this would reflect badly on management reputation. If, however, disclosures drew attention to controversial tax planning arrangements, the consequences of being rated as a higher tax risk by the regulator were damaging, “*They are going to be audited to death...and are probably going to have to be twice as robust, and ready to counter... low intensity guerrilla warfare for a very long time,*” (I6-II). The term guerrilla warfare is interesting, suggestive of regulatory interventions that are difficult to anticipate, with long term serious impacts. Thus, the safer strategy was to disclose as little as possible.

Senior executives, on the other hand, provided us with quite different explanations for their apparently cautious behaviours. They openly agreed that they did not volunteer too much information. However, this was attributed to a willingness to please institutional shareholders by providing simple explanations about tax conduct. They internalised investor group expectations as a preference for straightforward stories about tax performance and not in too much detail (I7-CFO). Analysts did indeed appear satisfied with the account of tax performance that they receive, “*I’ve never come across analysts saying they wished they had more information,*” (I11-EA). It was suggested that if senior executives were to provide more information, this could open a can of worms:

*I think for companies, the challenge is to explain these things rather than opening Pandora’s Box, (I8-EA).*

If institutional investors preferred to be provided with a simple account of tax conduct and senior executives were happy to oblige, we interpret this as a substantial barrier to knowledge exchange. Opportunities for greater openness in disclosure appeared to be willingly closed down by institutional investors as much as senior executives.

In summary, we found that communication about tax in the public arena was constrained. This, for different reasons, suited both institutional investors and senior executives. To maintain mutually consensual self-disciplining practices and avoid loss of face, actors willingly adhered to a stylised form of theatre in meetings. Certain rules of the game, where actors were content to discuss average tax rates but not much else, were willingly internalised as producing sufficient knowledge. By keeping discussion centred around certain safe topics and ground, this limited scope for communication but there appeared to be little incentive to disrupt this status quo. We probed why.

### **5.3 Why do institutional investors not ask more probing questions?**

A Johari window approach recognises that to address blind spots in senior executive understandings of tax disclosures as an instrument of social control, investor groups need to ask questions. Yet, the latter appeared content with routines as they stood. Paradoxically, they acknowledged that they *could* encourage senior executives to disclose more. We probed our data to reflect on why they were not more pro-active. First, we asked senior executives about institutional investor subjectivity in how they queried corporate tax performance.

### 5.3.1 Internal corporate actor beliefs

Senior executives suggested that analysts were surprisingly passive in meetings. Even if important voluntary information were to be disclosed, the significance might be completely overlooked by investor groups:

*And we've disclosed a note to the accounts which talks about a range of between £0 to £4million in terms of potential impact of resolution. And to be honest, I've had surprisingly little discussions around it; they tend to be very brief...it's a one off, move on, type of situation, (I15-CFO).*

Another intriguing story was relayed about the disclosure of an unusual, large payment to HMRC, as a prepayment of a disputed tax assessment. This was purely sensible cash planning, the point being that HMRC charge 3% on outstanding tax assessments whereas the company could borrow at a far lower rate than this prior to hopefully resolving the issue in the company's favour:

*I said "Here we've paid over £x million to the Revenue as a sort of a protective payment against an outstanding matter" ... you know we said that in front of 80 people... you could expect some questions about "When will it be resolved?" "What does it relate to?", "Why?" "How can these matters arise"... You know, there's lots of questions you could follow up on. It didn't happen, (I7-CFO).*

Senior executives found this lack of curiosity intriguing and offered possible explanations. One finance director attributed a lack of engagement to a serious tax knowledge gap:

*Tax is quite difficult...and I question whether most of the analysts and investors understand it. So, either they need to upgrade their skills in that area, or they need to bring on board experts who can provide the missing knowledge, (I1-CFO).*

Other explanations were put forward. Engagement levels might depend on a mix of institutional incentives or disincentives, for example: whether analysts are on the buy or sell side of operations (where market volatility creates opportunities for earning commission or for fund management, stability may be valued); their clientele tax preferences; the quality of in-house training; geographic location and organisational culture; and institutional attitudes to tax risk

management and uncertainty (I3-STM). On perceptions of tax risk and how analysts respond, this might be more of a box ticking approach, among German institutional investors for example, or highly formalised, for example Japanese investor groups, (I7-CFO). Disciplinary power could thus be seen to impact upon senior executive behaviours but linked to the “source” of this power was a perception of investors’ weak competencies and tunnel vision.<sup>27</sup>

### 5.3.2 *The will of institutional investors to scrutinise tax data*

In contrast, investor group interviewees put forward quite different explanations for a perceived lack of engagement in critical reflection and scrutiny of tax matters. Apart from data about the ETR, tax was seen by capital markets as a low-priority area. Tax was boring:

*I think it is peculiar to tax to some extent...and it's also (this is perhaps slightly cynical to say this) rather a dull area!...It's a slightly depressing area to ask about, so I'm afraid the information you know, is sort of fairly limited. It doesn't get analysed a great deal, and we don't get that much information, (I5-EA).*

The complexity of tax was also considered to be a good reason for glossing over tax matters and spending time instead on other “equally useful” areas of corporate performance:

*I think a lot of people feel it's such a technical area, that it's very difficult to analyse...even if you've got the information which you typically don't... you know, if there's an equally valuable other area to analyse, why prioritise the tax ones? (I5-EA).*

Analysts appeared to value global industry knowledge more than technical tax knowledge and commented that “*the idea that you could possibly understand all the tax rules, a substantial part of the tax law, or code of those countries is unrealistic,*” (I8-EA).

Another interviewee mentioned, that in their own defence, analysts believed that spending time and resources on developing tax knowledge was not worthwhile. The reduction in global corporation tax rates over the last decade has made tax a less important area to focus attention. Also, institutional investors could diversify away tax risk through pooled funds (I11-EA).

One equity analyst mentioned, that although the public might expect analysts to be more engaged with tax, they lacked the expertise:

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<sup>27</sup> We are grateful for an editorial suggestion that this point be highlighted.

*So, one might expect analysts to be looking at geographic mix, financing structures at location of assets, at leasing, at intellectual property ownership, and at the phasing of tax amortisation and all sorts of other factors in determining where they think the rate should be. In practice, that is all completely beyond the investors, (I5-EA).*

It was thus more convenient not to dwell on tax issues. As one analyst mentioned, “*I suspect that in reality people will be quite happy for tax to stay in the background,*” (I16-II). Another interviewee mentioned:

*Tax is largely sort of below the radar, and belongs there, it’s probably the sort of more detailed stuff that the company as much as the analysts are happy to leave below the radar because on the whole, it usually will be, you know, it can be material in terms of the operation of the business. But is it material in terms of the results you expect? (I4-TL).*

The quote above from a tax lawyer demonstrates how analysts have materiality thresholds for tax data that are far higher than those of executives. While they have exposure to a form of tax risk, this is financial modelling risk. Tax risk for investor groups is localised and can be diversified away (I11-EA). Institutional investors appeared to have little interest in social responsibility aspects of executive tax conduct. This had implications for the area of interplay in communication in cell 3 of the Johari window. If senior executives were not encouraged to disclose more, there was a greater chance that important aspects of tax conduct could remain hidden in the façade area, known only to internal corporate actors.

## **5.4 The Johari Window**

In this section, we provide a meta-level analysis of our data to assemble a Johari window representation of our findings. We found the insights of Big 4 partners useful in this regard as tax and accounting experts but also confidential advisers to clients. In meetings between institutional investors and senior executives (in the public arena, cell 1) communication appeared to follow formulaic, theatrical routines where all actors internalised and adhered to certain rules of the game. Disciplinary power worked predominantly to open communication about the ETR, with simple explanations that pointed to effective management of stable after-tax cash flows.

Interestingly, we did not observe a *will* among analysts to query a low ETR. If senior executives were confident in *how* they disclosed a low ETR this was unlikely to be questioned

(I5-EA). Analysts were described as “*clueless*,” in this respect by a Big 4 partner because a low ETR could be the result of missing, material tax assessments (I18-Big 4-P-A).

Where senior executives willingly disclosed more tax information than usual, this appeared to be motivated by a wish to prevent misunderstandings about technical issues. Senior executives managed analyst information needs and expectations very carefully. We were told for example that an opportune time to settle and disclose a tax dispute with the tax regulator was during a period when corporate performance was disappointing, when analyst scrutiny would be directed elsewhere. The settlement would be less likely to attract attention, especially if a provision had previously been included to cover the dispute and could thus be released, with little impact on the bottom line (I1-CFO).

Where senior executives did disclose more voluntary information to demonstrate, for example, particularly effective tax planning practices, a Big 4 audit partner mentioned that analysts might not understand the relevance. An example was provided about a client that had managed investments in a legally tax effective way, with real cash flow benefits. Analysts did not know how to make sense of the information. They wrongly assumed that the data lacked predictability and were not sure how to make sense of the information. It did not appear to fit within their financial evaluation models:

*ES. Everyone said it was all too hard, “I can’t understand it.”*

*INT. Right. So, it wasn’t a case of being penalised for being too complex, was it a case of just not being aware of how effective it was?*

*RES. My personal view is that the analyst community in particular found it extraordinarily difficult to plug all this stuff into a model, and therefore weren’t very interested. It lacked predictability, even though there was a track record over time of sizeable releases of return on investment, from real cash that had been generated from the underlying investments, in a tax effective way, but lumpy, that was never rewarded because it wasn’t predictable, (I18-Big 4-P-A).*

One CFO held a view that it creates an impression of better management, if senior executives demonstrated effective management of the ETR in disclosures rather than focusing on managing actual tax cash flows even though this makes little sense, “*That’s a theory, and I would be fascinated if research indicates that that’s not the case,*’ (I1-CFO). The important point here is that companies may need to decide whether effective but complex tax planning activities might

be ignored or even misinterpreted by investor groups, which a recent quantitative study by Francis et al. (2019) suggests may be the case.

The lack of willingness among institutional investors in cell 2 to probe tax information was justified by privileging industry over tax expertise as a lens for evaluating performance. Analysts believed they did not need to ask too many questions on tax issues, if senior executives would helpfully draw attention to anything that they needed to know, within a culture of trust. Other technical issues could be glossed over (I-8-EA).

We gathered rich data about the hidden or façade area (cell 3) of the Johari window. This represents information known within the company about tax planning or policy issues but not known in public. We were given a picture of highly fragmented understandings of what might constitute material tax planning issues, with real cash flow implications. Attitudes to seeking tax efficiencies can be strongly shaped by the personality of the CEO, ranging from complete indifference to extreme caution or high-risk takers (II-CFO). It was also intriguing to hear from tax and audit partners that executives frequently disregarded professional tax advice, including the advice of internal experts, if they viewed tax planning through a commercial rather than a tax planning prism.

Also, unforeseen, sometimes complex events in the tax field can result in an item, previously considered immaterial becoming an obligatory disclosure for information users. This is what happened in our opening story. Initially, the tax charge arising on the sale of One2One was deemed to be a contingent tax liability as a type of indemnity to Deutsche Telekom to cover any potential tax liability. However, a post year end change in the liquidity position at C&W triggered a term in a loan agreement that *legally* required senior executives to quantify and disclose all material contingent liabilities. This was the “tax surprise” that we refer to in our opening story about C&W.<sup>28</sup> The point here is that the tendency to oversimplify disclosures can result in potential tax shocks being absorbed, especially where investor groups are not proactive in evaluating the tax implications of events.

We also discussed with institutional investors if they critically reflected on the implications of tax planning arrangements and thus potential exposure for shareholders to a form of tax risk that arises from controversial practices. We were told that tax law is so complicated, both in the UK and Australia that, “*even for someone like me with that skillset, it would be hard to know*” (III-EA). An institutional investor, representing participants in financial markets further commented:

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<sup>28</sup> See our opening story in the introduction re Cable & Wireless.

*Analysts who look at companies, I don't think they are really going to be really attuned to those issues. I can't see a company analyst coming to a view that a listed company's share price is too high because they've taken too high a tax risk, or the Australian Tax Office has taken a different view on something, (I9-II).*

We were told that if the overall direction of the share price was satisfactory, institutional investors were less concerned about the detail of back-stage tax practices (I2-Big 4-P-T).

If, however, analysts trust executives to tell them what they need to know, and executives themselves face substantial tax uncertainty, in the form of unknown knowns (their own blind spots or uncertainties about future changes in tax law for example) or known unknowns (e.g. the unknown outcome of known disputes) then the potential exists for material tax surprises to arise. Investor groups were aware of this:

*Now I would argue that we are trusting the companies to give us everything we need to know on those big risks...Actually maybe what we're getting is perfectly fine, but it comes back that Donald Rumsfeld, known unknowns, unknown unknowns ..., (I8-EA).*

We summarise these points in Figure 3.

Insert Figure 3 around here – Assembling the Johari Window

### **5.5 Macro-perspectives – blind spots in public tax knowledge**

We queried how the conduct of meetings and preference for simple explanations about tax performance influenced how tax information is channelled into the public domain, “*There is a danger that the simplistic view is one that gets perpetuated by analysts*”, (I7-CFO) and, “*They (analysts) are very good at effectively playing back what they've been told, which is, I think, what we see an awful lot of*, (I18-Big 4-P-A).

Regarding the implications, a Big 4 UK tax partner suggested, “*I'm not sure that Capital Markets are particularly fussed about it*, (I2-Big 4-P-T). We observed similar beliefs among Australian interviewees, “*To be honest, they (analysts) don't spend a lot of time on tax*,” (I15-CFO) and:



*There is a good dose of ignorance amongst both executives within businesses and the whole investment community around tax. And there's so much data out there, people want it simple, because people don't like complicated explanations, (I7-CFO).*

Simplistic assumptions may be made about tax rates, which raise queries about traditional approaches to financial modelling:

*Now, some fascinating work...was done by (a large global bank) ...that the multiple applied to after-tax earnings on which companies are valued has absolutely no relationship to the effective tax rate of the company concerned...people expect the tax rate to remain where it is. Now that is surprising because he then looked at the range of tax rates by industry, across all industry sectors, and they quite commonly vary from about 10%-15% up to 45%-50% in extreme cases. So, there's a huge variation in the rate, in almost every sector, and yet we still seem to be saying that how high or low the rate, investors expect it to stay where it is, (I5-EA).*

We asked if oversimplification is significantly affecting public tax knowledge:

*Perhaps it could be ...because it's just too difficult and because of the lack of disclosed information and lack of understanding, it's just impossible for investors and analysts to penetrate this area. It may be it's because other factors are considered to be more important, although I certainly question that... (I1-CFO).*

An institutional investor, while suggesting that the market is not inefficient in relation to tax because tax matters are largely immaterial, then contradicted himself:

*It just hasn't come up that much to say it does create any inefficiencies. I am sure there are cases where it does. I mean it's too small. Well not small, that's the wrong word, but just one factor out of 100. But if you increase or decrease the average tax rate a few percent, it has a very material impact on the earnings per share, ratio, I guess.*

***So, as we are talking, I am thinking we should pay more attention to it (our emphasis added), (I17-II).***

Another paradox in our data was that analysts considered tax not to be a particularly important subject area and yet also acknowledged it could be very important, “*For individual companies, at individual points in their life, it will become super-important,*” (I8-EA). We suggest that this contradiction is partly because tax risk exposure for institutional investors is lower. Tax risk for an individual investment tends to be that of a possible material additional tax assessment. This risk can be diversified away within a large portfolio of investments (I11-EA).

A lower exposure to tax risk appeared to influence institutional investor understandings as to what might constitute material tax information. Their interest was largely in matters that might impact on the sustainability of the ETR. We saw little evidence of any interest in seeking information about socially responsible tax policies. This lack of demand for wider enhanced tax disclosures has real social consequences and closes possibilities for knowledge exchanges.

## **6. Discussion and concluding thoughts**

### *6.1 The effects of disciplinary power*

Prior research suggests that the tutelage of institutional investors has played a powerful role in guiding senior executive behaviours. The latter have been observed to willingly (rather than coercively) discharge accountability for corporate conduct in the name of maximising short-term shareholder value (Roberts et al. 2006). Our study extended this work. Drawing on a Foucauldian lens, we explored how disciplinary power flows through communication channels between these two groups of actors at an important regulatory interface between financial reporting and tax governance. We examined how beliefs about tax complexity influenced processes of social control.

Our study has limitations. We do not suggest that general conclusions can be drawn from one specific group of interviews and questions. Moreover, governments are continuing to take steps to modernise tax systems globally. However, our interviewees spoke with such candour that our findings constitute a reference point to open critical discussion of an aspect of tax governance that we know little about. Indeed, the subject of the selective attitude of professional investors to corporate governance remains as topical as ever (Wong, 2015).

Foucault observed that where the referent of disciplinary power is a difficult object of knowledge, power works in ways that render social processes of control more manageable (Foucault, 1984, p. 208), “*discipline fixes...it clears up confusion...and also in the least expensive way possible,*” (Foucault, 1984, pp. 208-209). In our study, a key finding was how disciplinary power managed complexity in discussions around tax performance by normalising routines that simplified tax information. Senior executives willingly internalised institutional

investor preferences for simple disclosures (with a focus on the sustainability of the ETR and reassurance about the stability of future tax cash flows). This way of thinking (or mentality of governance, Dean, 1999) framed discussions and knowledge production about tax performance. Moreover, institutional investors appeared willing to rely on senior executives to tell them what they needed to know about tax matters. This could be interpreted as disciplinary power flowing through a mechanism of social control in two directions. Senior executives willingly provided simplified stories about tax performance that institutional investors sought. However, the former also appeared to guide how the latter internalised what they needed to know about tax matters. While this can be understood as disciplinary power working effectively to manage tax complexity with as little expense as possible (given the reluctance, apparent in our data, among professional investors to spend time and resources on developing their own tax skill sets), such routines could limit the scope for deeper knowledge exchanges.

At the same time, senior executives were sensitive to how the content of tax disclosures would be subject to the gaze of the tax regulator. As Westermann et al. (2019) have observed, regulatory fear (in the case of audit firms preparing for a PCAOB inspection) can work to dumb down the selection of information that is subject to evaluation to the point of functional stupidity. While not withholding information, excessive documentation and box-ticking can replace critical thinking. In our study, senior executives had a high exposure to regulatory, compliance and reputational aspects of tax risk and might perceive aspects of tax risk to be beyond their own control, especially with unexpected changes in tax law. Routines thus operated to respond to tax risk by delegating the production side of tax disclosures to committee members. A willingness to delegate responsibility for tax matters within companies has already been observed (Erle, 2008). Building on these findings, we observed how responsibility was delegated in a way that both balanced the cleansing of disclosures, to avoid attracting regulatory attention, with routines that simplified data for institutional shareholders. This focused attention on the careful construction of sanitised stories about tax performance but limited the value of the information flow for providing deeper insights into backstage tax arrangements.

Another interesting finding in our paper was that institutional investors and senior executives were less comfortable talking about tax matters compared to other aspects of corporate performance. Dramaturgical processes in the public arena allowed all actors to adhere to certain rituals and rules of the game where complex areas of tax performance could be glossed over, and potential loss of face avoided. Corrigan (2018) comments on how theatrical practices play a potent role in the accounting field, where discussion about the visual representation of an accounting instrument, such as a budget, can mask the back stage problems that actors encounter

in the workplace and their lack of ability to control particular issues. In our study, theatrical processes placed disclosures, particularly information about the ETR, as a type of centre stage object, or simulacrum of tax conduct. This rendered the task of evaluating tax performance more manageable on a superficial level, with discussions intended to provide reassurance about the effective management of uncertain tax cash flows. However, this masked how the management of tax cash flows, behind the scenes, can be highly uncertain and sometimes difficult to control.<sup>29</sup>

This mutually consensual, self-disciplining among actors, not volunteering too much information or asking too many probing questions, normalised practices that skimmed over more technical tax issues. For different reasons, this suited both institutional investors and senior executives but constrained possibilities for critical reflexivity about tax conduct. We interpret this as a thin or superficial alignment between their subjectivities as self-disciplining individuals. By exercising restrained examination of tax data, ‘tax surprises’ were potentially being absorbed or buried through mutually acceptable practices that over-simplified disclosures. It was convenient for all actors involved not to lift the lid on Pandora’s Box, as (I8-EA) commented.

As a result, possibilities for material “unknown unknowns” and blind spots may exist within tax disclosures because of constraints on critical reflection. It is only when actors are prepared to probe blind spots or uncover issues buried in the façade area that the potential exists to open up a more socially responsible, frank examination of tax data and performance (as illustrated in figure 2). We saw scant evidence of this in our interview data, apart from recognition that, on occasions, discussions would open up more where a chief executive officer had a particular interest in tax or how it could be useful to bring individuals with tax expertise into meetings to address a skills gap. This did not appear to be the norm. As a result, possibilities remain for a *tax knowledge* gap to exist, at a macro level, in our public knowledge about corporate tax arrangements alongside the known financial tax gap (between expected and actual government tax revenues). This tax knowledge gap may be considered immaterial by institutional investors who have less exposure to tax risk, but it is material from a public interest and social justice perspective.

Plumlee (2003) observed that institutional investors engaged to a lesser extent with more complex tax data and concluded that this was either because they lacked the skill set or did not consider developing tax knowledge to be cost effective. Francis et al. (2019) further suggested that they misunderstand complex tax planning. Our data potentially provide evidence of a bigger story behind these quantitative findings. If institutional investors are mainly interested in

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<sup>29</sup> We are grateful to an anonymous reviewer for suggesting we emphasise this point.

assimilating tax data that fit company financial evaluation models (and neglect information that lacks predictability) and while senior executives are willing to supply plausible, simple stories about tax conduct that meet investor group information preferences, both groups of actors have little incentive to discuss tax in more depth and the scope of knowledge exchanges is constrained. Disciplinary power operating in this subtle way may absorb tax shocks. This does little to improve the quality of what we know in the public domain about corporate tax behaviours.

Institutional investors provided reasons to explain their reluctance to engage in scrutiny of more technical aspects of tax conduct. Eshraghi & Taffler (2015) have previously observed that professional analysts vigorously defend themselves when their performance is queried. In our study, analysts justified their marginalisation of tax expertise compared to industry knowledge on the grounds that tax is boring, or not an institutional priority or a less productive area to spend time on. Ironically, this is at a time when government policy makers are more concerned than ever about the poor quality of tax disclosures. As investor groups have relatively low exposure to tax risk (their concern is more on the overall direction that share prices travel in rather than the tax risk inherent within any one specific investment) they can afford to take a more *laissez-faire* position. We suggest that possibilities for tax surprises could arise because of this selective approach to corporate governance.

Our theoretical contribution lies in utilising the Johari window approach (Luft & Ingham, 1961) to give visibility to Foucault's ideas about the nuanced effects of governmentality on knowledge production but also "*façade*" (Foucault, 2002, pp. 84-85). Actors, in our data, appeared highly selective about information that was sought and what they were prepared to query or disclose in face to face meetings. This produced more complex behaviours in information exchanges (Hase et al. 1999). Dean (1999) has drawn attention to how freedom is an important aspect of governmentality, but that individuals are free to act in ways that governing authorities may not expect. In our study, the Johari window approach provides insights into how freedom may be exercised (*both* by those who govern and the governed) in subtle, mutually acceptable ways that a regulator might not expect.

Senior executives were free not to over-disclose and had little incentive to do so where additional information might be misinterpreted. This concern, about additional tax information being misunderstood, is aligned to recent findings by Francis et al. (2019) and Oats & Tuck, (2019). The Johari window approach to exploring communication helps to reveal that beneath the surface of what may appear to be ordered discourse are more muddled issues and questions that may remain hidden behind the *façade* of a system:

*One is used, in fact, to consider that discourses and their systematic ordering are not only the ultimate state, the final result...Behind the façade of the system, one posts the rich uncertainty of disorder; and beneath the thin surface of discourse, the whole mass of a largely silent development,” (Foucault, 2002, pp. 84-85).*

Our study demonstrates how the conduct of tax conduct can be imagined as areas of interplay. A partial or superficial alignment in subjectivities between institutional investors and senior executives opens certain zones in knowledge exchanges but beneath the façade of the system is a disorder and an aspect of discourse that remains unknown. Choices about comfortable zones of interplay between self-disciplining individuals may permit material issues to remain below the radar.

Consequently, some important tax issues may lack the material conditions necessary for their disclosure. Trust alone is not a substitute for the rigorous evaluation of tax information. This is not a situation where blame attaches individually to any parties but arises out of social routines that become normalised. The “market” (as represented by institutional investors) is not involved (and not even interested) in overseeing the social justice aspect of corporate tax. This demonstrates how claims that the ubiquity of the market deals with every human parcel of activity is just a myth. Effective regulation is a key aspect of ensuring social justice.<sup>30</sup> Gendron (2018) highlights the importance of understanding that corporate governance is a malleable term and it is crucial to ask corporate governance for who and for what? Our study maps onto this critical scholarship by drawing attention to rituals that are enacted but where reflective skills are kept underdeveloped (Gendron, 2018).

The modernisation of tax systems is beginning to change moral outlooks in the tax field (Holland et al. 2016; Radcliffe et al. 2018). Our interviewees, in theory, welcomed the idea of enhanced disclosures and commented particularly on the usefulness of locating voluntary tax disclosures in one place. However, we echo concerns raised by Oats and Tuck (2019) that new transparency initiatives have limitations because of considerable misunderstandings about their benefits. From a Foucauldian perspective, it remains imperative as we believe our study shows, to continue querying mentalities and imagine how disciplinary power operates to normalise routines that can have unintended consequences for governing authorities (Dean, 1999). Our findings also build on observations made by Holland et al. (2016). Governments cannot rely on

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<sup>30</sup> We are grateful for helpful editorial comments that suggested we include and develop this important point.

managerial attitudes or voluntary frameworks if they wish to change the behaviour of managers in relation to tax avoidance or to tax more widely.

## *6.2 Beliefs about the materiality of tax matters*

It also emerged from our study how beliefs about the materiality of tax information were highly fragmented. Ironically, in tax law, there is no place for the materiality concept (Business Income Manual (BIM) 34105, 2013; Edgley, 2010).<sup>31</sup> Tax practices must comply precisely with tax legislation. Yet at the interface between tax and accounting, considerable variations in understandings were apparent in subjectivities between investor groups, senior executives and accounting practitioners about what constitutes ‘a material’ tax item in discretionary disclosures. We already know that judgments about materiality can be more challenging within information disclosed in the supporting notes to financial statements (Deloitte, 2015) and this may be magnified in tax reporting.

Prior literature has identified that materiality judgments are a social, behavioural phenomenon contingent on context (Carpenter et al. 1994; Edgley, 2014; Edgley et al. 2015) and executives, assurers and users may have different beliefs about materiality because of their different motivations and incentives (Messier, 1983; Estes & Reames, 1988, Messier et al. 2005). In our data, divergence was linked to how tax information was understood as an object of knowledge/governance. On the production side of materiality judgments, senior executives had an incentive to hide behind the materiality to avoid over-disclosing data. Scholarship suggests that producing higher levels of disclosure may increase the risk of considerable misunderstandings among users in how additional information might be misunderstood (Oats & Tuck, 2019). We saw parallels here with difficulties that attach to applying the materiality concept to softer, qualitative rather than quantitative issues in corporate social responsibility reporting, where materiality decisions were highly subjective. To protect corporate reputation, senior executives could hide behind the materiality concept, as a shield, to justify partial, or non-disclosure of issues (Solomon & Edgley, 2008; Edgley, 2014; Edgley et al. 2015; Bolt, 2016). According to our institutional investor interviewees, senior executives could easily obscure information.

On the evaluation side of materiality judgments, we were informed that even experienced tax and audit practitioners could hold divergent viewpoints about materiality. They potentially brought different expertises and domains of knowledge (in tax planning, tax law compliance or

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<sup>31</sup> This is perhaps ironic given that materiality is applied in arriving at accounting profits which are the starting point for computing taxable profits. Interested readers are directed to the work of Lamb (2008).

financial audit for example) to decision making about tax matters.<sup>32</sup> Consensus was particularly challenging to reach when assessing the relevance of future, uncertain tax positions. Institutional investors, on the other hand, tended to view tax data that lacked the quality of predictability (and thus did not fit financial valuation models) as less material. With little specific exposure to tax risk, they could tolerate high materiality thresholds in relation to tax matters. Their interest in tax performance as a governable object was not therefore well aligned with regulator or public concern about corporate tax behaviours. Exploring divergent understandings of materiality in the tax field could be a rich area for further qualitative research, mirroring how different types of knowledge workers bring different expertises and knowledge systems to decision making.

### *6.3 Concluding Thoughts*

Our study raises crucial questions about the disciplinary effects of meetings between institutional investors and senior executives within a broad system of tax governance. Both groups of actors recognized that, albeit for different reasons, they had little incentive or reward for engaging too deeply in discussions and knowledge exchanges about tax conduct. Disciplinary power operated in subtle ways to manage perceptions of tax complexity through mutually consensual dramaturgical practices. Moreover, disciplinary power worked in both directions, from institutional investors over senior executives but also vice versa, to normalise the oversimplification of tax data. Such constraints limit the value of information that flows into the public domain. Our study draws attention to how this produces a form of myopia, with little motivation, on the part of actor willing subjectivity, to disrupt a comfortable status quo. This is a meaningful illustration of how, “a mentality is not usually examined by those who inhabit it,” (Dean, 1999, p. 16). Actors may not understand that taken for granted ways of seeing the world can keep self-reflective skills underdeveloped (Gendron, 2018). Encouraging reflexivity and understanding how there are different ways of producing truth are essential aspects of substantive governance:

*“On the one hand, we govern others and ourselves according to what we take to be true about who we are, what aspects of our existence should be worked upon, how, with what means, and to what ends. On the other hand, the ways in which we govern and conduct ourselves give rise to different ways of producing truth (Dean, 1999, p.18).*

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<sup>32</sup> We are grateful to an anonymous reviewer for suggesting we emphasise this point in our findings.



Jung & Dobbin (2012) comment that the narrow focus of institutional investors on financial modelling under the banner of shareholder value, which can be understood as a mentality, produces results that sharply conflict with the interests of regulators, and possibly the values of the average shareholder and stakeholders. We extend this observation to their narrow conceptualisation of tax disclosures as an instrument of accountability. If the role of analysts, as critics, is to learn about socially legitimated valuations (Zuckerman, 1999), their lack of engagement on tax issues has both material and social impacts on knowledge production.<sup>33</sup>

Our study has practical relevance not just for companies, their professional advisors and tax regulators but also for government tax policy makers and for current efforts to improve the quality of tax reporting and tax governance practices. We need to continue broadening the scope of ongoing critical discussions about tax governance to appreciate how social processes of control can include operations that may fail. Divergent, at times myopic, understandings of what constitutes a material tax issue and the resulting tax knowledge gap have real material and social impacts for society. It may be time to lift the lid on this Pandora's Box.

*Acknowledgements:* interview material was obtained while conducting an earlier project which was funded by the ICAEW Charitable Trusts. We are particularly grateful to the interview participants, and especially to Professor Chris Evans (UNSW, Sydney, Australia) for facilitating access to the Australian based interviewees. We are also grateful for helpful comments, encouragement and feedback on the paper from: delegates at the Critical Perspectives on Accounting conference in Quebec, 2017, and the paper discussant, Dr Carlene Wynter; seminar participants at the universities of Cardiff, Essex and Nottingham; Professors Mahmoud Ezzamel, Annie Pye, Lynne Oats and Keith Robson. Finally, we are particularly grateful to the Editor and anonymous referees for their helpful comments, feedback, and suggestions.

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<sup>33</sup> Highlighting the continuing need to push companies to disclose more information, in the most recent HM Treasury Budget 2020, from 2021, large companies will be required to notify HMRC where they adopt tax positions that HMRC may query. Consultation is taking place on the notification process. See [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/871799/Budget\\_2020\\_Web\\_Accessible\\_Complete.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/871799/Budget_2020_Web_Accessible_Complete.pdf) - section 2.26 / Accessed 11 May 2020.

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**Table 1 – Interviewee roles**

<u>Interviewee Number</u>	<u>Interviewee Details - UK</u>	<u>Interviewee Number</u>	<u>Interviewee Details - Australia</u>
1-CFO	Chief Financial Officer (CFO)*	9-II	Senior Executive - Industry Body representing participants in financial markets
2-Big 4-P-T	Big 4 Firm Tax Partner	10-Big 4-P-T	Big 4 Firm Tax Partner
3-STM	Senior Tax Manager*	11-EA	Equity Analyst – Director
4-TL	Tax Lawyer – Industry Representative Body	12-EA	Equity Analyst - Director
5-EA	Senior Equity Analyst Investment Bank	13-II	Institutional Investor – Tax Executive
6-II	Institutional Investor-Senior Tax Analyst	14-Big 4-P-A	Big 4 Firm Assurance Partner
7-CFO	CFO*	15	CFO*
8-EA	Senior Equity Analyst - Investment Bank	16-Big 4-P-A	Big 4 Firm Assurance Partner
		17-II	Institutional Investor Investor Adviser
		18-Big 4-P-A	Big 4 Firm Assurance Partner

\*Large quoted company

Figure 1 – The Johari Window

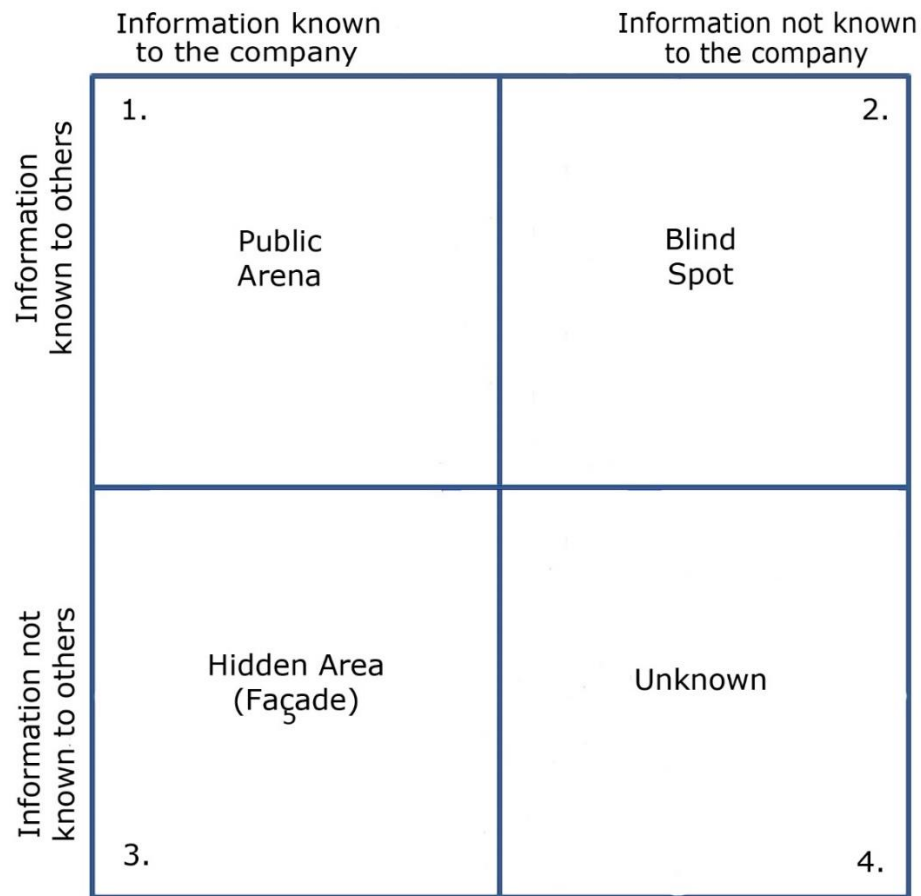
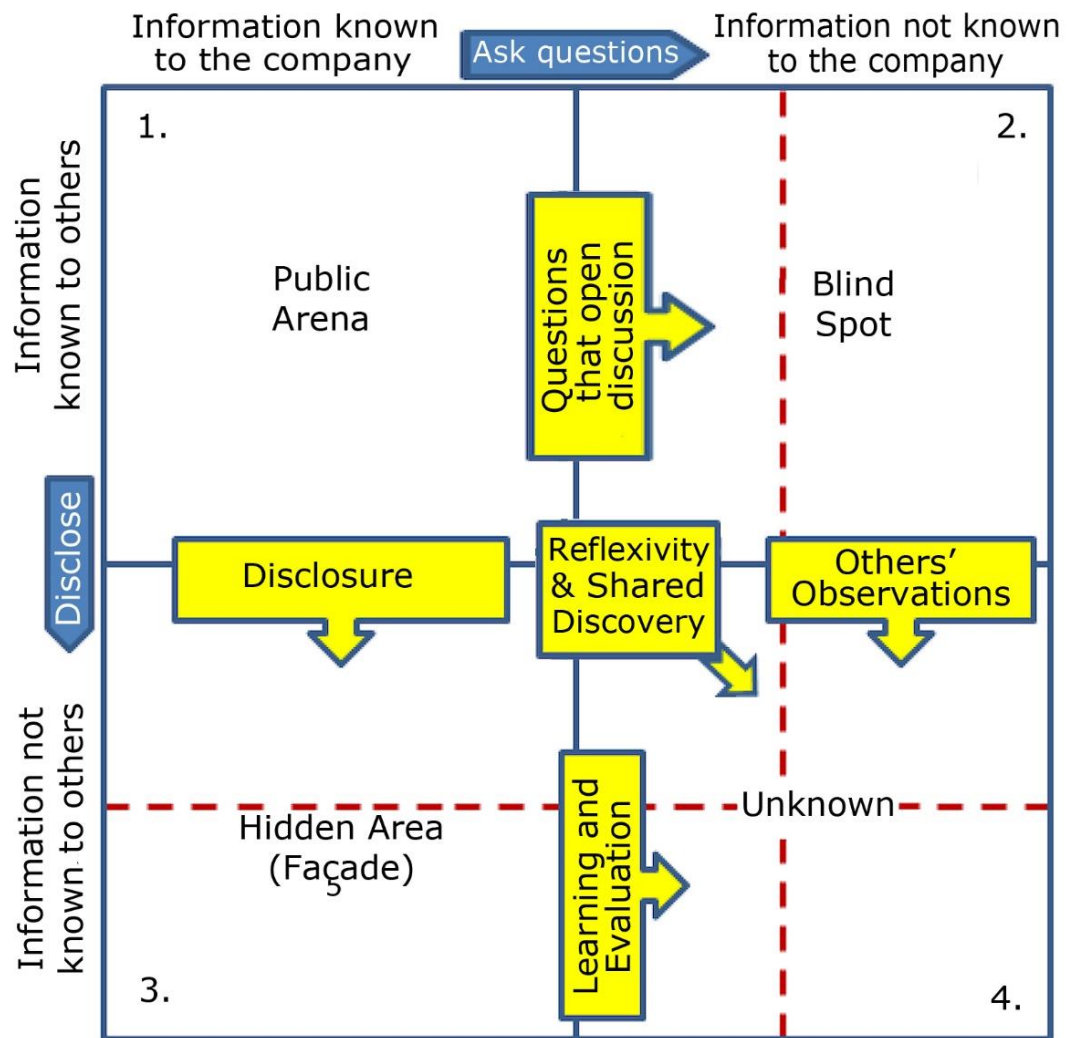


Figure 2 - The Johari Window Applied



#### Notes

The role of the facilitator is to observe and analyse the exchange of information in the public arena (cell 1).

The blue arrows represent how the scope of knowledge exchanges in the public arena will open up if questions are asked that address blind spots and senior executives consequently disclose more information that would otherwise remain hidden in the façade area.

The activities in yellow (where actors listen to feedback, and evaluate information), encourage reflexivity and shared discovery. Possibilities for “unknown unknowns” to exist reduce. This is represented by the red dotted lines in the diagram.

Where there is little incentive for all actors to engage in practices highlighted in yellow, this constrains the scope of knowledge exchanges in cell 1 and the type of knowledge that is produced.

Figure 3 – Assembling the Johari Window

Tax information	Tax information known to the company	Information not known to the company
Known to Others	<p><b>PUBLIC ARENA</b>  <u>KNOWN KNOWNS</u>  Disclosures available and discussed in the public domain.  <b>BUT</b>  If disclosures are not understood they cannot be rigorously queried.  If disclosures are not rigorously queried, their importance may be overlooked....  If analysts do not ask for information – executives are likely to be happy not to disclose.  If disclosures are understood by some analysts but not others, issues are unlikely to be discussed if this provides a short-term institutional advantage.</p>	<p><b>BLIND SPOT</b>  <u>UNKNOWN KNOWNS</u>  What regulators or analysts know– and executives do not.  This could be an intention by a regulator to challenge an interpretation of tax law. This information is potentially price sensitive, confidential and NOT publically known. This creates uncertainty.  Analysts may have a view or understanding about corporate tax performance that they do not share, that is retained for their own institutional advantage. While material issues disclosed by companies must be made public/available to all investors, information discussed in private may become material if interpreted by a sophisticated investor alongside other sources of data. This form of private interpretation is permitted (Solomon &amp; Soltes, 2015).</p>
Not Known to others	<p><b>FAÇADE</b>  <u>KNOWN UNKNOWNNS</u>  This constitutes information that companies know about future, uncertain tax positions or aspects of tax planning arrangements with material implications that are not disclosed or partially disclosed but obscured within sanitised, boiler plate language in disclosures.  There may be a dispute with a regulator, known only to the company and tax regulator but not the public.  Executives may also be aware of a <i>possible</i> tax risk – for example, an ongoing high-profile tax case in the public domain but where the outcome is not yet decided.</p>	<p><b>UNKNOWN</b>  <u>UNKNOWN UNKNOWNNS</u>  What companies and their advisors, HMRC, shareholders and the public do not know about a tax-payer’s position. This is where an issue or item has not been intentionally hidden but has not been disclosed and yet will become material at a future point in time. Such tax surprises might be the result of a future change in tax law or a test case where a future event, or case law judgment have retrospective implications.  Where such oversights are because of myopia on the part of senior executives and without mechanisms that encourage greater self-reflection, tax surprises may arise, for example, the anomaly we refer to at the start of our introduction.</p>

## Appendix 1 - Interview Questions

### Interview Questions – 60-minute duration

- As you perceive them, what are the important, material aspects of companies' corporate tax positions to capital markets, (equity and debt markets)?
- As you perceive them what factors shape understandings within companies of important tax matters?
- How is the selection of tax information for disclosure managed within companies?
- As you perceive this, how do Board members engage with tax – e.g. depth of engagement, perceptions about risk management practices, main players etc?
- What is your assessment of capital markets' ability to understand important/material aspects of a company's tax position?
- Typically, what aspects of taxation do capital markets find difficulty with, if any?
- Are there particular user groups that have more or less difficulty? (E.g. Institutional shareholders, analysts, private shareholders. Are they proactive requesting clarification?)
- What factors influence the ability of capital markets to understand important tax issues – and the relative importance of legislative features and company features? (E.g. industry, international scale of operations, disclosure policy)?
- Does the markets ability to interpret tax matters help or hinder companies in their tax planning? Are companies misunderstood? Effect in responding to Government initiatives on e.g. R&D?
- How well briefed are senior executives about tax matters?
- What factors influence the timing and content of tax related disclosures to capital markets?
- How do companies monitor markets understanding of tax e.g., press coverage, broker publications, and discussions with analysts? Are analysts proactive in tax matters? Is there modelling by companies of likely responses to tax related announcements?
- Are senior executives fully informed – i.e. understand their tax position. Who are the major players in the process? Are there internal barriers to understanding?
- What is your assessment of current practice in tax reporting?
- In what way could current financial reporting requirements be improved if considered necessary?