

# The association of mandatory tax disclosures with the readability and tone of voluntary tax reports

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## ***Abstract***

This article examines companies with low comparative tax payable (*public exposure – scrutinised*), compared to companies with higher comparative tax payable (*public exposure – low scrutiny*) according to mandatory tax reports (MTRs), for differences in readability and tone in their respective voluntary tax reports (VTRs). In doing so, the authors posit three key opportunities for companies to control the tax narrative through tone and readability: (1) lack of available tax information; (2) lack of alignment between the accounting and taxation systems; and (3) latitude available in voluntary disclosures. The analysis reveals overall that a high (low) effective tax rate is associated with a more (less) readable VTR and a VTR with a more positive (negative) tone. When the companies are segregated, it is noted that *public exposure – scrutinised* companies are found to resort to the tone in tax reporting, whereas those with lower scrutiny rely on the readability of reports.

**Key words:** Voluntary reporting; mandatory tax reporting, public scrutiny, political exposure, corporate taxation; tone; readability; tax transparency, Australia, tax compliance.

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## 1. INTRODUCTION

Tax information in Australia, as with most forms of personal information, is traditionally protected through secrecy provisions in Division 355 of Schedule 1 to the *Taxation Administration Act 1953* (Cth) – the punishment for disclosing protected information being a term of imprisonment. Jurisdictions such as Norway,<sup>1</sup> Finland,<sup>2</sup> Sweden<sup>3</sup> and Denmark,<sup>4</sup> by comparison, view tax information as a social right, and make available (through a web portal administered by the relevant tax authority) to the public certain tax information disclosed in a tax entity's tax returns.<sup>5</sup> Although no longer in place, Italy, France and Japan<sup>6</sup> formerly had similar public disclosure regimes.<sup>7</sup> This article fills a gap in the literature by conducting an empirical study of the association of mandatory tax disclosures on the readability and tone of voluntary tax reports in Australia.

Although a firm's financial statements are, pursuant to accounting standards (including both the International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP)), an important source of information to stakeholders, concern about the ability of tax disclosures to meet users' material fiscal inquiries exists.<sup>8</sup> Australia, in recent times, has begun to see a notable regulatory shift – which has focused on larger businesses – towards more publicly transparent and scrutinised tax affairs. Enacted in 2013 and implemented in December 2015, national laws require the disclosure of certain information about specified companies, including their total income, taxation income and tax paid, collectively referred to as mandatory tax reports (MTR).<sup>9</sup> These are generated by the government on an annual basis and available online.<sup>10</sup> Further and contemporaneously, there exists an optional layer of voluntary tax disclosure. In order to facilitate '...greater disclosure to help build confidence in the majority of Australian businesses that do the right thing',<sup>11</sup> the Board of Taxation developed, at the Australian Government's request, the Tax Transparency Code (TCC) for the purposes of voluntary tax reporting (VTR).<sup>12</sup> Notwithstanding the infancy and

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<sup>1</sup> See the Tax Assessment Act (2016) (*Melding om trekk mv*), § 8-8. See also Regulations on the Processing of Personal Data (2013).

<sup>2</sup> See Constitution of the Republic of Finland (1999, amended 2011), s 12.

<sup>3</sup> See Instrument of Government (1994, amended 2015), Ch 2, Art 1.

<sup>4</sup> See the Act on Processing of Personal Data (2000, as amended 2007), Ch 8, Title III.

<sup>5</sup> Ken Devos and Marcus Zackrisson, 'Tax Compliance and the Public Disclosure of Tax Information: An Australia/Norway Comparison' (2015) 13(1) *eJournal of Tax Research* 108; Therese Catanzariti, 'Transparency of a Tax System – Beware of Glass Houses!' (2004) 47 *Weekly Tax Bulletin* [1962].

<sup>6</sup> Japan's tax disclosure regime had been in place since the 1950s; however, it was abolished in 2005 after assertions were made that disclosures were being linked as a factor in causing crime and harassment, something largely inconsistent with the original aim. See, eg, Makoto Hasegawa, Jeffrey L Hoopes, Ryo Ishida and Joel Slemrod, 'The Effect of Public Disclosure on Reported Taxable Income: Evidence from Individuals and Corporations in Japan' (2013) 66(3) *National Tax Journal* 571.

<sup>7</sup> Erland E Bø, Joel Slemrod and Thor O Thoresen, 'Taxes on the Internet: Deterrent Effects of Public Disclosure' (Discussion Paper No 770, Statistics Norway Research Department, January 2014).

<sup>8</sup> See, eg, European Financial Reporting Advisory Group and the Financial Reporting Council, 'Improving the Financial Reporting of Income Tax Feedback Statement' (Feedback Statement, February 2013).

<sup>9</sup> *Taxation Administration Act 1953* (Cth), ss 3C-3E and related provisions, introduced by *Tax Laws Amendment (2013 Measures No 2) Act 2013* (Cth) and amended by *Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Act 2015*.

<sup>10</sup> See generally Australian Government, 'Corporate Tax Transparency', <https://data.gov.au/data/dataset/corporate-transparency>.

<sup>11</sup> Board of Taxation, *A Tax Transparency Code: A Report to the Treasurer* (2016) 5, [https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/BoT\\_TransparencyCode\\_Final-report.pdf](https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/BoT_TransparencyCode_Final-report.pdf), 5.

<sup>12</sup> *Ibid*.

present voluntary nature of VTR in Australia, however, there are a growing number of entities that are opting to become signatories for the code.<sup>13</sup>

It is the *voluntary* nature of the VTRs spurred by the TTC that is the focus of this article. In particular, the authors examine signatories to the TTC to identify whether the level of public exposure (scrutinised/low scrutiny) arising from MTRs impacts the readability and tone of VTRs. The term *readability* refers to the level of opaqueness, or obfuscation, in the information environment: in which an author prepares more complex, *less readable*, information.<sup>14</sup> As Beuselinck and co-authors state, complexity within the information environment reduces transparency as ‘more time and effort from outsiders to become properly informed’ is required, thereby obscuring the ability to understand.<sup>15</sup> *Tone* refers to the sentiment of the disclosures, being the extent to which reports contain terms with optimistic or pessimistic sentiment that capture ‘the affect or feeling of a communication’.<sup>16</sup>

The motivation for this study is based on three primary factors as follows. First, corporate taxation has gained substantial spotlight in recent times. In a recent outline, the Board of Taxation noted concern about taxation anti-avoidance in stating that ‘[t]he actions of a few businesses, particularly large multinationals engaging in aggressive tax avoidance, have tarnished the reputations of many businesses that are doing the right thing’.<sup>17</sup> In addition to section 3C of the *Taxation Administration Act 1953* (Cth) requiring the annual preparation of a Report of Entity Tax Information for certain corporate tax entities, fairness and transparency have been cornerstone in Australia. The wave of condemnation arising from the ‘Panama papers’ in 2016 and the ‘Paradise papers’ in 2017,<sup>18</sup> or multinational companies such as Apple, are just some examples of the growing public concern over fairness and transparency in the Australian taxation system.<sup>19</sup>

Although a firm’s financial statements are seen as an important source of information, the usefulness of tax disclosures has been of concern for some time.<sup>20</sup> It has already

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<sup>13</sup> See Australian Government, ‘Voluntary Tax Transparency Code: VTTC Reports’ (31 May 2021), <https://data.gov.au/dataset/ds-dga-f71709a8-2eeb-4592-ad1f-443f7f520186/distribution/dist-dga-e44e9729-30f5-4764-848e-f060f5099277/details?q>.

<sup>14</sup> Christof Beuselinck, Belen Blanco, Sandip Dhole and Gerald J Lobo, ‘Financial Statement Readability and Tax Aggressiveness’ (2018) *SSRN Capital Markets: Market Efficiency eJournal*, 4.

<sup>15</sup> Ibid. As such, the terms ‘obfuscation’, ‘readability’ and ‘complexity’ of reports are used interchangeably in this article. See also Feng Li, ‘Annual Report Readability, Current Earnings, and Earnings Persistence’ (2008) 45(2-3) *Journal of Accounting and Economics* 221; Leopold Bayerlein and Paul Davidson, ‘The Influence of Connotation on Readability and Obfuscation in Australian Chairman Addresses’ (2011) 27(2) *Managerial Auditing Journal* 175.

<sup>16</sup> Elaine Henry, ‘Are Investors Influenced by How Earnings Press Releases Are Written?’ (2008) 45(4) *Journal of Business Communication* 363, 399-401.

<sup>17</sup> Board of Taxation, above n 11, 5.

<sup>18</sup> These revealed that offshore entities were being used for illegal activities, such as tax evasion. See for example Will Fitzgibbon and Dean Starkman, ‘The “Paradise Papers” and the Long Twilight Struggle Against Offshore Secrecy’, *International Consortium of Investigative Journalists* (Web Page, 27 December 2017), <https://www.icij.org/investigations/paradise-papers/paradise-papers-long-twilight-struggle-offshore-secrecy/>; ‘Giant Leak of Offshore Financial Records Exposes Global Array of Crime and Corruption’, *International Consortium of Investigative Journalists* (Web Page, 3 April 2016), <https://www.icij.org/investigations/panama-papers/20160403-panama-papers-global-overview/>.

<sup>19</sup> Eg, Harry Grubert and John Mutti, ‘Taxes, Tariffs and Transfer Pricing in Multinational Corporate Decision Making’ (1991) 73(2) *The Review of Economics and Statistics* 285; Prem Sikka and Hugh Willmott, ‘The Dark Side of Transfer Pricing: Its Role in Tax Avoidance and Wealth Retentiveness’ (2010) 21(4) *Critical Perspectives on Accounting* 342; Nor Shaipah Abdul Wahab and Kevin Holland, ‘The Persistence of Book-Tax Differences’ (2015) 47(4) *The British Accounting Review* 339.

<sup>20</sup> European Financial Reporting Advisory Group and the Financial Reporting Council, above n 8, 2.

been noted that a thorough analysis of user needs is required before moving ahead with any changes to or the development of a new standard.<sup>21</sup> The misalignment between the accounting and taxation systems has, more recently, been highlighted as problematic – with disclosures within general purpose financial statements being ‘blurred’ through the application of tax effect accounting, as well as complicated by differences in methodologies between the two systems, such as differing consolidation regimes.<sup>22</sup> These differences largely stem from differing historical developments, a discussion of which is beyond the scope of the present article.<sup>23</sup> The Board of Taxation study released in 2016 is arguably a step towards filling that void to reduce incoherence with tax information in annual tax transparency reports.<sup>24</sup>

The Macquarie Dictionary<sup>25</sup> refers to *transparency* for organisations as being related to the policy or practice of making operations readily open, clearly evident, to public scrutiny and being accountable for those operations. Generally, to be *transparent* means having a property that allows any bodies situated beyond or behind to be distinctly seen, to be easily understood.<sup>26</sup> The authors argue that for disclosures to be fit for purpose, there needs to be a bridge between enterprise activity and their respective contributions to the Australian tax system that can be readily understood by stakeholders, and encourage accountability of such contributions. This is particularly challenging to achieve from the outset due to the lack of available tax information due to privacy regulations and the lack of alignment between the accounting and taxation systems leading to a disconnectedness in available tax information.<sup>27</sup>

Second, corporate entities have a high degree of discretion in managing their internal tax affairs, the result being a shift away from a traditional position to disclosure. Extant research has often had to rely on proxy measures for corporate income tax.<sup>28</sup> With the release of the TTC, and a steady stream of companies becoming signatories to that code and which produce VTRs, a novel level of disclosure is apparent. VTRs, therefore, provide a new insight into corporate tax affairs not previously available in Australia to this extent.

Third, the voluntary nature of VTRs gives rise to a wider latitude towards the qualitative presentations within disclosures made by corporate entities and which presents specific opportunities for entities to strategically obfuscate what is purported to be an approach to increase transparency of the tax affairs of corporate entities. This is, insofar as the content is mandated and uniform across time, similar to annual reports.<sup>29</sup> Due to the recent introduction of VTRs in Australia, there is no existing research examining the correlation between readability and tone of a firm’s financial disclosure. Critically, extant research suggests that scrutiny and public exposure is linked to *tone* and

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<sup>21</sup> Ibid.

<sup>22</sup> Elizabeth Morton, ‘Corporate Tax Transparency Reporting and Benford’s Law’ (2019) 34(1) *Australian Tax Forum* 1.

<sup>23</sup> See Elizabeth Morton, ‘A Historical Review of the Rise of Tax Effect Accounting as a Financial Reporting Norm’ (2019) 24(4) *Accounting History* 562.

<sup>24</sup> Board of Taxation, above n 11, 4.

<sup>25</sup> See ‘Transparency’, *Macquarie Australian Encyclopedic Dictionary* (2006).

<sup>26</sup> Ibid.

<sup>27</sup> Morton, ‘Corporate Tax Transparency Reporting and Benford’s Law’, above n 22, 19-21.

<sup>28</sup> See generally B Brian Lee, Alfreda Dobiyanski and Susan Minton, ‘Theories and Empirical Proxies for Corporate Tax Avoidance’ (2015) 17(3) *Journal of Applied Business and Economics* 21.

<sup>29</sup> Lorenzo Patelli and Matteo Pedrini, ‘Is Tone at the Top Associated with Financial Reporting Aggressiveness?’ (2015) 126(1) *Journal of Business Ethics* 3.

readability,<sup>30</sup> and therefore companies may use disclosures as instruments for social control of and over the narrative.<sup>31</sup>

With the aforementioned in mind, this article examines signatories to the TTC to assess whether categorising companies as *public exposure – scrutinised* (comprising companies having low comparative tax payable as per mandated tax transparency report), compared to *public exposure – low scrutiny* (higher comparative tax payable as per the mandated tax transparency report), will lead to differences in readability and tone in VTRs. By doing so, the authors ask, *does the level of public exposure (scrutinised/low scrutiny) arising from mandatory tax reporting impact readability and tone of voluntary tax reporting?*<sup>32</sup>

The authors posit three key opportunities that entities have in controlling their tax narrative via VTRs:

1. The general lack of available tax information due to privacy regulations;
2. The lack of alignment between the accounting and taxation systems leading to a disconnectedness in available tax information; and
3. The general latitude available in voluntary disclosures.

Two hypotheses are made. First, that companies with *public exposure – low scrutiny* prepare VTRs which are easier to read; and, second, that companies with *public exposure – scrutinised* prepare more optimistic voluntary tax reports. Despite the attempts for companies to control the narrative through obfuscation,<sup>33</sup> government attention may – and noting research by Beuselinck and co-authors<sup>34</sup> and Hope, Ma and Thomas<sup>35</sup> – lead to improvements in readability.

This article is structured as follows: section 2 outlines the background, briefly considering the need to balance privacy and tax transparency and the developments in Australia with respect to mandatory and voluntary tax disclosures. Section 3 sets out the literature and identified gaps in extant research and in doing so, clarifies the present study's focus. Section 4 follows by articulating the research question and hypotheses. Section 5 presents the research design, followed by the key findings, discussion and analysis in section 6. Section 7 summarises and concludes the article, with the main findings, tax policy implications, also limitations and future research.

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<sup>30</sup> See n 15, above.

<sup>31</sup> Daphne A Jameson, 'Telling the Investment Story: A Narrative Analysis of Shareholder Reports' (2000) 37(1) *Journal of Business Communication* 7, 9. See also Li, above n 15; Henry, above n 16; Apostoles A Ballas, 'The Creation of the Auditing Profession in Greece' (1998) 23(8) *Accounting, Organizations and Society* 715.

<sup>32</sup> While there are other, broader notions of the concept of 'scrutiny' (eg, BHP Billiton having an ETR close to the statutory rate but facing high scrutiny in the public's eye), the present article operationalises scrutiny as relating directly to public exposure via the publicised ETR: see further Baljit K Sidhu and Greg Whittred, 'The Role of Political Costs in the Deferred Tax Policy Choice' (2003) 28(1) *Australian Journal of Management* 63, discussing 'politically acceptable threshold'. The concept of scrutiny is expanded upon in section 4 and the 'publicly acceptable threshold', where companies are anticipated to face increased scrutiny, is further discussed in section 5.2 of this article.

<sup>33</sup> See, eg, Jameson, above n 31, 9. See also generally Li, above n 15.

<sup>34</sup> See Beuselinck et al, above n 14, 4.

<sup>35</sup> Ole-Kristian Hope, Mark (Shuai) Ma and Wayne B Thomas, 'Tax Avoidance and Geographic Earnings Disclosure' (2013) 56(2-3) *Journal of Accounting and Economics* 170.

## 2. BACKGROUND

### 2.1 Australian developments in balancing privacy and transparency

Emergent steps in the removal of a veil of secrecy<sup>36</sup> in Australia were present before high-profile cases. This arguably began with the tax transparency reporting regime that was introduced in 2013 in the *Tax Laws Amendment (2013 Measures No 2) Act 2013* (Cth), later amended by the *Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Act 2015*. Certain disclosures (eg, an enterprise's name, Australian Business Number (ABN), total income, taxable income and tax payable) from tax return information was thereafter reported in an annual tax transparency report (MTR). This was implemented in December 2015, with the 2013-14 tax year report being the first published.<sup>37</sup>

Marriott<sup>38</sup> has noted a broader global context in which this issue can be set. Marriott argues that while 'sunlight is the best disinfectant' – in that increasing transparency will reduce corruption – the protection of a country's international reputation is likely to be the greater catalyst for change.<sup>39</sup> Specific government justifications were noted, including the concern of the Group of Twenty (G20) major economies and Organisation for Economic Co-operation and Development (OECD) over base erosion and profit shifting (BEPS) by multinational entities; the aim being to discourage aggressive tax practices and inform public debate over corporate tax policy.<sup>40</sup>

These developments are set within a broader context, which has seen the introduction of tax transparency reporting in Australia, as well as the G20 and OECD recommendations and other initiatives that focus on reporting measures for corporate entities. The Tax Avoidance Taskforce, for example, focused its attention on the top 1,000 multinational and public companies, and top 320 private groups as well as controlling wealthy individuals.<sup>41</sup> In one Australian Taxation Office media release, it was confirmed that AUD 5.6 billion in extra tax had been collected by the taskforce over the two-year period.<sup>42</sup> The media announcement also noted that the Diverted Profits Tax, transfer pricing laws and anti-avoidance powers, and country-by-country<sup>43</sup> reporting are all having a significant effect.<sup>44</sup>

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<sup>36</sup> *Taxation Administration Act 1953*, Sch. 1, Div. 355.

<sup>37</sup> The 2013-14 report captures large public companies, being those with an annual income in excess of AUD 100 million. The following years the report was broadened to include private companies with over AUD 200 million annual earnings.

<sup>38</sup> Lisa Marriott, 'Tax and Corruption: Is Sunlight the Best Disinfectant? A New Zealand Case Study' (2017) 15(2) *eJournal of Tax Research* 262.

<sup>39</sup> *Ibid.*

<sup>40</sup> See Explanatory Memorandum to the Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Bill 2015, [1.13]. Note also concern over the consequences of these disclosures, including the consequence of closely held company disclosures effectively revealing owners financial affairs, commercial sensitivity and personal privacy and security for private companies (which is a genuine concern if Japan's example is considered: see also Hasegawa et al, above n 6. Other concerns also include impact on competition and advantage to larger companies; restructuring to avoid disclosures; disproportionate cost to private companies to disclosure additional information to protect their reputation: see Explanatory Memorandum to the Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Bill 2015, [1.14]-[1.18].

<sup>41</sup> Australian Taxation Office (ATO), 'Tax Avoidance Taskforce Helps Net \$5.6 billion in First Two Years' (Media Release QC 56966, 11 October 2018) 1.

<sup>42</sup> *Ibid.*

<sup>43</sup> Board of Taxation, above n 11, 21, noting that country-by-country reporting 'is designed as a risk management tool for revenue authorities rather than a public disclosure regime'.

<sup>44</sup> *Ibid.*

The Multinational Anti-Avoidance Law (MAAL) has also resulted in restructuring of some global entities and is expected to result in billions of dollars in sales being 'returned to the Australian tax base' as well as additional goods and services tax (GST) payments.<sup>45</sup>

With these developments in mind, there is a substantial regulatory shift in Australia that is focused on more publicly transparent and scrutinised tax affairs with respect to larger businesses. The present study specifically considers the contemporaneous development of voluntary tax disclosures arising as a reasonably new approach to respond to the increasing concern over taxpayers' paying their 'fair share' of tax contributions, and the mandated release of the annual tax transparency reports.<sup>46</sup> The authors consider, in particular, the release of VTRs pursuant to the TTC.<sup>47</sup>

## 2.2 Voluntary tax reporting in Australia

As noted, voluntary tax reporting in Australia is still in its infancy. While some corporations have, over the past decade, been undertaking a level of voluntary tax reporting, a key move towards encouraging corporations to do so arose with the introduction of a framework for voluntary tax reporting initiated by the Australian government. This began with the 2015 Budget. Joe Hockey, the then Treasurer, wrote to the Board of Taxation requesting the development of a code as part of the 2015 Budget:<sup>48</sup>

A voluntary code will provide a framework for large businesses to take the lead, to become more transparent and help educate the public about their compliance with Australia's tax laws.<sup>49</sup>

Following initial consultation with a Working Group<sup>50</sup> in September 2015, the receipt of 19 submissions,<sup>51</sup> and the release of a consultation paper in December 2015, the code was subsequently finalised in February 2016. The 2016-17 Commonwealth Budget announced the new voluntary TTC, highlighting that:

The Government is committed to encouraging greater tax transparency within the corporate sector, especially by multinational corporations. The *Tax Transparency Code* will encourage businesses with an annual turnover of \$100 million or more to publish information to support greater and better informed public scrutiny. The Government encourages all companies to adopt the Code from the 2016 financial year onwards.<sup>52</sup>

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<sup>45</sup> ATO, above n 41, per Deputy Commissioner Mark Konza, ATO.

<sup>46</sup> For example, responding to the potential reputational harm over what has been described as a naming and shaming policy.

<sup>47</sup> Board of Taxation, above n 11.

<sup>48</sup> Hon Joe Hockey (Treasurer), 'Consultation on Tax Integrity Proposals' (Letter to Michael Andrew, 12 May 2015), [https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2015/10/Letter\\_from\\_tsr\\_anti-hybrid.pdf](https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2015/10/Letter_from_tsr_anti-hybrid.pdf); Hon Joe Hockey (Treasurer), 'Voluntary Corporate Disclosure Code' (Media Release, 12 May 2015).

<sup>49</sup> Board of Taxation, above n 11, 5.

<sup>50</sup> The working group included members of the Board of Taxation Michael Andrew (Chair), John Emerson AM, Ann-Maree Wolff and Neville Mitchell, an expert panel including Fiona Martin from the University of New South Wales, Victor Timos from Incitec Pivot and David Watkins from Deloitte and representatives from the ATO and Treasury. See further Board of Taxation, above n 11.

<sup>51</sup> See *ibid.*

<sup>52</sup> Australian Treasury, 'Making Our Tax System More Sustainable', Additional Budget 2016-17 Document (May 2016) 11.

The Board noted that the TTC had been developed in consideration of balancing public interest with business concerns (such as compliance costs, regulatory impact, commercial confidentiality, risk of misunderstanding information, and reciprocity and consistency issues between countries).<sup>53</sup> The Board of Taxation acknowledged that the reputations of many businesses doing the right thing had unfortunately been tarnished by the conduct of a few business (noting that these were primarily large multinationals) who were engaging in aggressive tax avoidance.<sup>54</sup>

The TTC sets out the principles and ‘minimum standard’ in the disclosure of tax information by businesses, dependent on business size,<sup>55</sup> whilst focusing on the company structures. The TTC is voluntary with the expectation that the disclosures will evolve over time as the company board and senior management become more actively involved and foster a culture towards addressing the public appetite for transparency. The alternative of a mandated code raises the concern that the disclosures would become a delegated ‘box-checking exercise’.<sup>56</sup> This view is in contrast to the Commonwealth Senate Economics References Committee inquiry into corporate tax avoidance, which recommended a mandatory scheme rather than a voluntary scheme.<sup>57</sup> The Committee’s aim in such a recommendation was to ‘ensure that relevant information is available in order to maintain public pressure on aggressive tax practices’ and the Committee did not believe that a voluntary scheme would ‘suitably incentivise companies that push the letter and spirit of the law to publish tax information’.<sup>58</sup>

The TTC is targeting larger businesses, with a particular focus on the public interest. Table 1 provides a summary of the TTC.

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<sup>53</sup> Board of Taxation, above n 11.

<sup>54</sup> Ibid 5.

<sup>55</sup> Ibid, referring to ‘medium’ and ‘large’ businesses based on ‘aggregate TTC Australian turnover’, medium businesses being those with a turnover of at least AUD 100 million but less than AUD 500 million, and large businesses those with a turnover AUD 500 million or more.

<sup>56</sup> Ibid.

<sup>57</sup> The Senate Economics References Committee, *Corporate Tax Avoidance, Part 1: You Cannot Tax What You Cannot See* (18 August 2015). See also Senate Economics References Committee, *Corporate Tax Avoidance, Part 2: Gaming the System* (22 April 2016).

<sup>58</sup> Senate Economics References Committee, *Corporate Tax Avoidance, Part 2*, above n 57, [3.12]-[3.13].



**Table 1: Summary of Tax Transparency Code Minimum Standards**

Part	Entity	Minimum Standard of Information	Explanatory Note
Part A <sup>59</sup>	Large and medium	A reconciliation of accounting profit to income tax expense, and income tax paid or income tax payable	A-IFRS General Purpose Financial Statement (GPFS) reconciliation is to income tax expense only.
		Identification of material temporary and non-temporary differences	The reconciliation should identify these material differences.
		Accounting effective company tax rates for Australian and global operations (pursuant to AASB guidance)	Given the variation in which ETR can be calculated, the business should clearly define the basis of this calculation and any underlying assumptions therein. <sup>60</sup>
Part B	Large	Approach to tax strategy and governance	Information should be provided as to: Approach to risk management and governance arrangements; Attitude towards tax planning; Accepted level of risk in relation to taxation; and Approach to engagement with the ATO Additionally, the following optional information is noted by the board as of interest to the community: Overview of business operations; Approach to engagement with other tax authorities; and Description of the assurance regimes. <sup>61</sup>
		Tax contribution summary for corporate taxes paid	Core element: Australian corporate income tax Optional elements: - Other taxes/imposts: eg, Petroleum Resource Rent Tax (PRRT), royalties, excises, payroll tax, stamp duties, fringe benefits tax (FBT), state taxes. - Government imposts collected on behalf of others: eg, GST, PAYG withholding taxes. <sup>62</sup>
		Information about international related party dealings	A qualitative explanation of the nature of international related dealings and measures of associated tax risks for management. Include key categories of dealings that have a material impact on Australian taxable income, the nature of the material categories and country of location. The Board acknowledges the potential for reputational damage from misunderstanding these disclosures; however, sees it as necessary given the community concern and media coverage. <sup>63</sup>

Source: Adapted from Board of Taxation, above n 11, 2.

<sup>59</sup> The Australian Accounting Standards Board (AASB) issued draft guidance on TTC recommendations for the suggested tax reconciliation and calculation of the ETR: see AASB, 'Invitation to Comment: Draft Appendix to the Tax Transparency Code' (May 2017) 11-12, [https://www.aasb.gov.au/admin/file/content105/c9/ITC\\_Draft\\_Tax\\_Transparency\\_Code\\_Disclosures\\_05-17.pdf](https://www.aasb.gov.au/admin/file/content105/c9/ITC_Draft_Tax_Transparency_Code_Disclosures_05-17.pdf) (discussing Regulatory Guide 230, 'Disclosing non-IFRS financial information regarding the risk of misleading users and promoting clear and full disclosures'). See also Australian Securities and Investments Commission (ASIC), 'Regulatory Guide 230: Disclosing Non-IFRS Financial Information' (9 December 2011), <https://download.asic.gov.au/media/1241462/rg230-published-9-december-2011.pdf>. According to the AASB website, two comment letters were received after the comment period closed in February 2018. One raised concern that the recommendations went beyond what was requested by the Board of Taxation: Ernst & Young, 'AASB Draft Appendix to the Tax Transparency Code' (28 February 2018), [https://www.aasb.gov.au/admin/file/content106/c2/TaxTransparency\\_sub\\_1\\_EY.pdf](https://www.aasb.gov.au/admin/file/content106/c2/TaxTransparency_sub_1_EY.pdf). The other noted the need to promote the use of Plain English due to the intended audience: KPMG, 'Submission Invitation to comment - Draft Appendix to the Tax Transparency Code' (27 February 2018), [https://www.aasb.gov.au/admin/file/content106/c2/TaxTransparency\\_sub\\_2\\_KPMG.pdf](https://www.aasb.gov.au/admin/file/content106/c2/TaxTransparency_sub_2_KPMG.pdf).

<sup>60</sup> Prior to the AASB guidance, the Board detailed that the ETR should be calculated as 'company income tax expense divided by accounting profit' and 'global ETR should be calculated "for the worldwide accounting consolidated group" of which the Australian operations form a part': Board of Taxation, above n 11, 18-19. KPMG, above, identified eight different ETRs that are explicitly recommended within the TTC and associated AASB guidance.

<sup>61</sup> Board of Taxation, above n 11, 19-20.

<sup>62</sup> Ibid 20.

<sup>63</sup> Ibid 21.

Disclosures by signatories to the TTC can occur within several contexts, including in the general purpose financial statements (GPFs), in taxes paid reports, and corporate social responsibility (CSR) reports, for example, and are not required to be externally audited.<sup>64</sup> Unlike the alignment issues that arise with the mandated tax transparency reports released annually,<sup>65</sup> the Board of Taxation<sup>66</sup> indicated that disclosures should be capable of being reconciled to the income tax return and financial statements. The Board of Taxation is, nonetheless, aware of the discrepancy between its list of signatories and the ATO published data arising from the flexibility under the TTC, which ultimately ‘makes comparisons less meaningful’.<sup>67</sup> The Board of Taxation has indicated that a separate report is likely to be more accessible to general users, be more user-friendly, avoid the need to incorporate the report into the audit process, and allow for more extensive qualitative information.<sup>68</sup> The Board does not prescribe the format or timing of release.

The TTC is directed towards a target audience of ‘interested users’, including social justice groups, the media, analysts, politicians, investors and shareholders, and ‘general users’, described by the Board of Taxation as ‘the person in the street’ and the community.<sup>69</sup> The Board of Taxation has stated that the target audience are these interested general users, rather than the ATO as the ATO already has access to more detailed tax information.<sup>70</sup> Although not a key user group, revenue and regulatory authorities, which includes the ATO, are listed as a third potential user group.

As at February 2020, 160 signatories of the TTC were identified,<sup>71</sup> with 139 of those having published at least one report and this number is slowly increasing. However, the Board of Taxation has noted that a number of the published reports are not meeting the minimum standard of the TTC. The Board of Taxation commenced a post-implementation review of the TTC in 2018, consulting with a range of stakeholders. A recent consultation paper outlined the following proposed amendments, including minimum standards being supplemented with ‘best practices’, which expand on optional elements; an addition of a new minimum standard for a ‘basis of presentation’ statement; a new minimum standard for a reconciliation to ATO public data disclosures;<sup>72</sup> and other improvements to minimum standards and best practice recommendations.<sup>73</sup>

Given that stakeholders may rely on the narratives in VTRs – comparable to 10-K reports filed with the United States’ Securities and Exchange Commission – to interpret fundamental accounting information and that the readability of the narrative disclosures

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<sup>64</sup> See generally Board of Taxation, above n 11. If, however, Part A is disclosed in the GPFs, then the data will be subject to audit procedure. Furthermore, the disclosures produced generally will be derived from audited materials: Board of Taxation, above.

<sup>65</sup> See generally Morton, ‘Corporate Tax Transparency Reporting and Benford’s Law’, above n 22.

<sup>66</sup> See generally Board of Taxation, above n 11, 23.

<sup>67</sup> Board of Taxation, ‘Corporate Tax Transparency Code and Register’, <https://taxboard.gov.au/current-activities/corporate-tax-transparency-code-and-register> (accessed 2 February 2022).

<sup>68</sup> Board of Taxation, ‘CEO Update – February/March 2019’ (Stakeholder Information Sheet, March 2019), [https://cdn.tspace.gov.au/uploads/sites/74/2019/03/CEO\\_Update\\_March\\_2019.pdf](https://cdn.tspace.gov.au/uploads/sites/74/2019/03/CEO_Update_March_2019.pdf).

<sup>69</sup> *Ibid* 4.

<sup>70</sup> Board of Taxation, above n 11, 23.

<sup>71</sup> See Australian Government, ‘Voluntary Tax Transparency Code: VTTC Reports’ (31 May 2021), [https://data.gov.au/dataset/ds-dga-f71709a8-2eeb-4592-ad1f-443f7f520186/distribution/dist-dga-e44e9729-30f5-4764-848e-f060f5099277/details?q\\_](https://data.gov.au/dataset/ds-dga-f71709a8-2eeb-4592-ad1f-443f7f520186/distribution/dist-dga-e44e9729-30f5-4764-848e-f060f5099277/details?q_)

<sup>72</sup> This relates specifically to the issue of a lack of connection to the mandatory Tax Transparency Reports and considers an approach to bridge the gap between the TTC and mandatory reports.

<sup>73</sup> Board of Taxation, *Post-Implementation Review of the Tax Transparency Code: Consultation Paper* (February 2019), <https://cdn.tspace.gov.au/uploads/sites/74/2019/02/TTC-Consultation-Paper-final.pdf>.

has important implications for communicating value-relevant information effectively to the market participants,<sup>74</sup> firms filing VTR reports should be particularly cautious in their selection of language and text when preparing them. With the aforementioned backdrop in mind, the article now turns to consider the broader context and literature surrounding transparency of tax affairs, financial statement complexity, voluntary reporting and tone.

### 3. LITERATURE REVIEW

#### 3.1 Balancing privacy with transparency

Devos and Zackrisson<sup>75</sup> have discussed, in detail, the rationale that underlies disclosure of taxation information – which they note as comprising: transparency, tax fairness and accountability, and also the principle against disclosure referred to as ‘privacy’.<sup>76</sup> Of relevance is the general distinction between the *perceptions* and *actuality* of these principles. They note that the reasons for whether or not compliance may improve ‘...as a result of increased public disclosure generally relate to good governance and tax administration’.<sup>77</sup> They go on to highlight that the ATO seeks to achieve fairness in the tax system, through addressing issues of horizontal, vertical and exchange inequality; however, the fairness that is recognised as a benefit of disclosure relates to the *perception* of tax fairness. With regards to whether a disclosure of tax burden is considered ‘fair’, such an inquiry is moot since what comprises ‘fair’ is subjective, and dependent on the individual tax system.<sup>78</sup> Nerré,<sup>79</sup> for example, notes that tax policy advice should not disregard the tax-cultural setting and its inherent constraints.

Public disclosure of tax information is seen as an additional strategy for improving tax compliance, on top of more traditional strategies of audit, simplification and guidance.<sup>80</sup> From a tax compliance perspective, there continues to be a pervasive concern over corporations contributing their ‘fair share’ of tax to society, particularly surrounding purported tax avoidance or minimisation activities.<sup>81</sup> Tax avoidance behaviour is generally not observable, with a range of proxies utilised based on a variety of logic constructs, thereby limiting what is known about tax avoidance, including the relationship between financial disclosures and tax avoidance.<sup>82</sup> Hanlon and Slemrod’s observations – regarding investor consequences being short-lived – may imply that firms seek not to be perceived as overstepping the line of tax avoidance if there is a risk that voluntary tax disclosures may allude to this conclusion.<sup>83</sup>

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<sup>74</sup> Tim Loughran and Bill McDonald, ‘Measuring Readability in Financial Disclosures’ (2014) 69(4) *The Journal of Finance* 1643.

<sup>75</sup> See generally Devos and Zackrisson, above n 5.

<sup>76</sup> Ibid; their analysis has been documented in the Appendix to this article.

<sup>77</sup> Ibid 109.

<sup>78</sup> Ibid 112.

<sup>79</sup> Birger Nerré, ‘Tax Culture: A Basic Concept for Tax Politics’ (2008) 38(1) *Economic Analysis and Policy* 153.

<sup>80</sup> Devos and Zackrisson, above n 5.

<sup>81</sup> See, eg, Grubert and Mutti, above n 19, 285-293. See also Sikka and Willmott, above n 19, 348; Wahab and Holland, above n 19, 346-347.

<sup>82</sup> Michelle Hanlon and Shane Heitzman, ‘A Review of Tax Research’ (2010) 50(2-3) *Journal of Accounting and Economics* 127, 129; Hope et al, above n 35, 171-172.

<sup>83</sup> Michelle Hanlon and Joel Slemrod, ‘What Does Tax Aggressiveness Signal? Evidence from Stock Price Reactions to News about Tax Shelter Involvement’ (2009) 93(1-2) *Journal of Public Economics* 126.

Adopting a broader jurisdictional and cultural analysis with respect to tax transparency and tax avoidance, Kerr<sup>84</sup> has concluded that transparency is an important tool for ‘battling’ tax avoidance, after finding those countries and firms with a greater level of transparency exhibit lower levels of tax avoidance. Given recent Australian cases involving tax avoidance, including *Commissioner of Taxation v Rowntree (No 3)*,<sup>85</sup> *Burton v Commissioner of Taxation*,<sup>86</sup> *Commissioner of Taxation v Resource Capital Fund IV LP*,<sup>87</sup> and *Tech Mahindra Limited v Commissioner of Taxation*,<sup>88</sup> and the ATO’s Fraud and Corruption Control Plan 2020-21, this is particularly timely.

Devos and Zackrisson<sup>89</sup> also noted the importance of the tax-culture setting and the public’s response to increased disclosures on legislative reform, suggesting that highly compliant nations have a greater likelihood of accepting increased disclosure, whilst those resistant may lead to further avoidance behaviour, or otherwise manipulate disclosure thresholds or engage in other avoidance schemes.<sup>90</sup>

Extant literature has explored the nexus between earnings management, taxation disclosure and financial reporting. Kim, Pierce and Yeung have investigated the impact of earnings management measures based on tax expense manipulation and management motivation for doing so.<sup>91</sup> In the US, for example, tax reporting rules differ from financial reporting rules, allowing firms to report disparate levels of income to tax authorities and to investors. Since many economic transactions are reported similarly for book and tax reporting,<sup>92</sup> firms often face a trade-off between cash tax savings and lower reported earnings.<sup>93</sup>

### 3.2 An overview of tone and readability

Tone is defined ... as the affect or feeling of a communication. Distinct from promotion, which implies an intent of the speaker to influence a reader’s views, a positive tone as defined here need not imply intent, although many

<sup>84</sup> See generally Jon N Kerr, ‘Transparency, Information Shocks, and Tax Avoidance’ (2019) 36(2) *Contemporary Accounting Research* 1146.

<sup>85</sup> [2021] FCA 306 (concerning promoter of a tax exploitation scheme in contravention of s 290-50(1) of Sch 1 of the *Taxation Administration Act 1953* (Cth)).

<sup>86</sup> [2018] FCA 1857 (concerning gains from investments in the United States and consideration of Australia’s foreign income tax offset provisions in Div 770 of the *Income Tax Assessment Act 1997* (Cth)).

<sup>87</sup> [2019] FCAFC 51 (addressing the entitlement to relief under Article 7 of the *Convention between Australia and the United States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, signed 6 August 1982 (entered into force 31 October 1983)).

<sup>88</sup> [2016] FCAFC 130 (on the issue of allocation of taxing rights and the operation of Art. 7 (business profits rule) of the *Agreement between the Government of Australia and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, signed 25 July 1991, [1991] ATS 49 (entered into force 30 December 1991)).

<sup>89</sup> See generally Devos and Zackrisson, above n 5.

<sup>90</sup> *Ibid.*

<sup>91</sup> See Mark Kim, Spencer Pierce and Ira Yeung, ‘Why Firms Announce Good News Late: Earnings Management and Financial Reporting Timeliness’ (2021) 38(4) *Contemporary Accounting Research* 2691.

<sup>92</sup> See, eg, Frank Brunetti, *Federal Tax Accounting* (CCH Publications, 2021). The present article does not, however, discuss the rules governing US federal tax accounting which include when tax events must be taken into account for federal income tax purposes under the *Internal Revenue Code* (Title 26 of the USC).

<sup>93</sup> See, eg, Myron S Scholes, G Peter Wilson and Mark A Wolfson, ‘Firms’ Responses to Anticipated Reductions in Tax Rates: The Tax Reform Act of 1986’ (1992) 30(Supp) *Journal of Accounting Research* 161, 162; David A Guenther, Edward L Maydew and Sarah E Nutter, ‘Financial Reporting, Tax Costs, and Book-Tax Conformity’ 23(3) *Journal of Accounting and Economics* 225; Edward L Maydew, ‘Tax-Induced Earnings Management by Firms with Net Operating Losses’ (1997) 35(1) *Journal of Accounting Research* 83; Steve Matsunaga, Terry Shevlin and D. Shores, ‘Disqualifying Dispositions of Incentive Stock Options: Tax Benefits versus Financial Reporting Costs’ (1992) 30(Supp) *Journal of Accounting Research* 37.

of the techniques for subtle promotion would create a positive tone. This study does not directly address the intent of the author but rather whether a more positive tone affects investors.<sup>94</sup>

Extant research examines linguistic attributes of various reports and disclosures. *Tone*, or the sentiment of the disclosures – the affect or feeling of a communication<sup>95</sup> – has been found to have information value;<sup>96</sup> influence investors' and analyst views and be associated with economic outcomes;<sup>97</sup> be positively associated with stock issuance<sup>98</sup> and firm performance;<sup>99</sup> and, may reflect managerial behaviour such as tax aggressiveness.<sup>100</sup>

Relevant to this study is the consideration of tone in voluntary reporting. Patelli and Pedrini<sup>101</sup> describe that in the context of press releases, information tone management occurs when the tone of press releases is either too optimistic or pessimistic in comparison to the concurrent quantitative disclosures. VTRs are similar to press releases due to their voluntary nature. Extant research shows that tone in corporate announcements impacts stock market reactions.<sup>102</sup> Huang, Teoh and Zhang<sup>103</sup> note that given managers are not required to follow explicit rules and regulations, there is wide latitude for the qualitative presentation of quantitative information. Importantly, negative tone tends to have a stronger impact than positive tone.<sup>104</sup>

Huang and co-authors<sup>105</sup> observed, within the context of press releases, that tone varies with the quantitative content and as firm performance increases optimism in tone will increase. Their research identified the abnormal component of tone (abnormal positive tone) and found evidence of strategic tone management associated with negative

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<sup>94</sup> Henry, above n 16, 376.

<sup>95</sup> Ibid.

<sup>96</sup> See, eg, Paul C Tetlock, 'Giving Content to Investor Sentiment: The Role of Media in the Stock Market' (2007) 62(3) *The Journal of Finance* 1139. See also Mark H Lang and Russell J Lundholm, 'Voluntary Disclosure and Equity Offerings: Reducing Information Asymmetry or Hying the Stock?' (2000) 17(4) *Contemporary Accounting Research* 623.

<sup>97</sup> See, eg, Liafisu S Yekini, Tomasz P Wisniewski and Yuval Millo. 'Market Reaction to the Positiveness of Annual Report Narratives' (2016) 48(4) *The British Accounting Review* 415, 421; Xuan Huang, Siew H Teoh and Yinglei Zhang, 'Tone Management' (2014) 89(3) *The Accounting Review* 1083, 1098-1099; S P Kothari, Susan Shu and Peter D Wysocki, 'Do Managers Withhold Bad News?' 47(1) *Journal of Accounting Research* 241. See also Henry, above n 16, 378.

<sup>98</sup> Lang and Lundholm, above n 96, 632.

<sup>99</sup> See generally Angela K Davis, Weili Ge, Dawn Matsumoto and Jenny Li Zhang, 'The Effect of Manager-Specific Optimism on the Tone of Earnings Conference Calls' (2015) 20(2) *Review of Accounting Studies* 639.

<sup>100</sup> Kelvin K Law and Lilian F Mills, 'Taxes and Financial Constraints: Evidence from Linguistic Cues' (2015) 53(4) *Journal of Accounting Research* 777. See also Clive S Lennox and Chul W Park, 'The Informativeness of Earnings and Management's Issuance of Earnings Forecasts' (2006) 42(3) *Journal of Accounting and Economics* 439.

<sup>101</sup> See Patelli and Pedrini, above n 29.

<sup>102</sup> Tim Loughran and Bill McDonald, 'When is a Liability Not a Liability? Textual Analysis, Dictionaries, and 10-Ks' (2011) 66(1) *The Journal of Finance* 35, 43-44; Ronen Feldman, Suresh Govindaraj, Joshua Livnat and Benjamin Segal, 'Management's Tone Change, Post Earnings Announcement Drift and Accruals' (2010) 15(4) *Review of Accounting Studies* 915, 924-926. See also Henry, above n 16, 400.

<sup>103</sup> Huang, Teoh and Zhang, above n 97, 1099.

<sup>104</sup> Elaine Henry and Andrew J Leone, 'Measuring Qualitative Information in Capital Markets Research: Comparison of Alternative Methodologies to Measure Disclosure Tone' (2016) 91(1) *The Accounting Review* 153; Loughran and McDonald, 'When is a Liability Not a Liability?', above n 102, 43-44; Paul Tetlock, Maytal Saar-Tsechansky and Sofus Macskassy, 'More Than Words: Quantifying Language to Measure Firms' Fundamentals' (2008) 63(3) *The Journal of Finance* 1437. See also Tetlock, above n 96.

<sup>105</sup> Above n 97.

earnings and cash flow performance. Similarly, Henry<sup>106</sup> found that tone of earnings press releases influences investors' reactions and longer releases reduced market impact. Loughran and McDonald<sup>107</sup> observed that diction is inappropriate for gauging the tone of financial disclosures. That study focused on Form 10-K reports revealing that frequently occurring terms that are optimistic in diction such as 'respect', 'security', 'power', and 'authority' will not be considered nor perceived positively by readers of business documents. The authors refined the general-purpose Harvard's General Inquirer word lists which Tetlock utilised,<sup>108</sup> and classified words in lists so that the words indeed are, from a finance perspective, positive or negative. The authors dealt with the filings' effects on stocks during the 4-days window prior and subsequent to the filing date of a 10-K.

Similar to tone, a growing body of finance and accounting research uses textual analysis to examine the *readability* of corporate reports (primarily 10-K reports), its determinants, and its consequences. Readability refers to the level of opaqueness, or obfuscation, in the information environment.<sup>109</sup> Complexity within the information environment reduces transparency, as 'more time and effort from outsiders to become properly informed' is required, thereby making it more difficult to understand.<sup>110</sup> There is little known literature on the readability of VTRs in Australia. Some studies<sup>111</sup> indicate that in reality average US firms provide less readable information in their 10-K reports. Others indicate that firms provide less readable corporate reports strategically to hide adverse information and to mask poor performance.<sup>112</sup> Lo, Ramos and Rogo<sup>113</sup> found that firms with more incentives to engage in earnings manipulation provide less readable narrative disclosures. Lundholm, Rogo and Zhang<sup>114</sup> show that foreign firms listed on the US exchanges provide more readable corporate reports, arguing that these reduce US investors' information disadvantage and reluctance to own foreign-domiciled companies' stocks. Dyer, Lang and Stice-Lawrence<sup>115</sup> use a global sample and document that textual attributes are associated with regulation and incentives for more transparent disclosure.

Extant research examining the consequences of corporate reports' readability identifies that readability is positively associated with the earnings persistence,<sup>116</sup> analyst coverage, accuracy of forecasts,<sup>117</sup> credit rating,<sup>118</sup> stock liquidity and trading

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<sup>106</sup> See Henry, above n 16, 396.

<sup>107</sup> Loughran and McDonald, 'When is a Liability Not a Liability?', above n 102, 42-43.

<sup>108</sup> Tetlock, above n 96.

<sup>109</sup> Li, above n 15. See also Clarisa Sukotjo and Yanuar Nanok Soenarno, 'Tax Aggressiveness, Accounting Fraud, and Annual Report Readability' (2018) 6(2) *Journal of Finance and Economics* 38, 39.

<sup>110</sup> See Beuselinck et al, above n 14, 4.

<sup>111</sup> See, eg, Samuel B Bonsall IV, Andrew J Leone Brian P Miller and Kristina Rennekamp, 'A Plain English Measure of Financial Reporting Readability' (2017) 63(2-3) *Journal of Accounting and Economics* 329. See also Li, above n 15, 232-233.

<sup>112</sup> See Li, above n 15, 233.

<sup>113</sup> Kin Lo, Felipe Ramos Rafael Rogo, 'Earnings Management and Annual Report Readability' (2017) 63(1) *Journal of Accounting and Economics* 1.

<sup>114</sup> Russell J Lundholm, Rafael Rogo and Jenny Li Zhang, 'Restoring the Tower of Babel: How Foreign Firms Communicate with US Investors' (2014) 89(4) *Accounting Review* 1453.

<sup>115</sup> Travis Dyer, Mark Lang and Lorien Stice-Lawrence, 'Do Managers Really Guide Through the Fog? On the Challenges in Assessing the Causes of Voluntary Disclosure' (2016) 62(2-3) *Journal of Accounting and Economics* 270.

<sup>116</sup> See Li, above n 15, 232-234.

<sup>117</sup> Reuven Lehavy, Feng Li and Kenneth Merkley, 'The Effect of Annual Report Readability on Analyst Following and the Properties of Their Earnings Forecasts' (2011) 86(3) *The Accounting Review* 1087.

<sup>118</sup> See Bonsall et al, above n 111.

volume,<sup>119</sup> and investment efficiency,<sup>120</sup> while it is negatively associated with the cost of debt and the stock price crash risk.<sup>121</sup> Loughran and McDonald<sup>122</sup> demonstrate that lower readability is a reflection of a poor corporate information environment and is related to earnings volatility and more dispersed analyst forecasts. These studies provide useful insights into the implications of corporate reports' readability for capital market participants.

### 3.3 Attention and tax planning

Due to the reliance on financial statements to obtain tax-related information, there are numerous studies which consider readability and tax aggressiveness. Beuselinck and co-authors<sup>123</sup> most recently found within the US context between 1994 and 2014 that firms adopting aggressive tax planning strategies<sup>124</sup> have less readable<sup>125</sup> financial statements, strongly suggesting that they are attempting to confuse the audience regarding their underlying tax risk. The introduction of Schedule M-3,<sup>126</sup> however, led to a weakening of this association. From these results they concluded that when the benefits to obfuscation decline, reliance on obfuscation declines:

... This evidence suggests that managers apply complex financial reporting strategies when the benefits of hiding tax aggressive policies exceed the costs, but rely less on obfuscation through such complexity when the benefits of obfuscation attempts are small.<sup>127</sup>

Similarly, Inger and co-authors<sup>128</sup> considered the trade-off of decision-useful information disclosure for stakeholders and concealment from the tax authority. They found that those firms engaging in higher levels of tax avoidance disclosed less readable tax footnotes (consistent with managers concealing), whilst those engaging in low levels disclosed more readable tax notes. The caveat of such studies is that complexity can arise through the natural consequence of business complexity and temporality. Both Beuselinck and co-authors<sup>129</sup> and Balakrishnan, Blouin and Guay<sup>130</sup> have highlighted the complexity in such studies, looking beyond tax footnotes as well as providing justification for negating firm complexity as having a confounding effect. They note that tax planning can increase the financial complexity of an organisation and annual report complexity can be a natural consequence of business complexity. Balakrishnan

<sup>119</sup> Gus De Franco, S P Kothari and Rodrigo S Verdi, 'The Benefits of Financial Statement Comparability' (2011) 49(4) *Journal of Accounting Research* 895; Dyer et al, above n 115.

<sup>120</sup> Gary C Biddle, Gilles Hilary and Rodrigo S Verdi, 'How Does Financial Reporting Quality Relate to Investment Efficiency?' (2009) 48(2-3) *Journal of Accounting and Economics* 112.

<sup>121</sup> Mine Ertugrul, Jin Lei, Jiaping Qiu and Chi Wan, 'Annual Report Readability, Tone Ambiguity, and the Cost of Borrowing' (2017) 52(2) *Journal of Financial and Quantitative Analysis* 811.

<sup>122</sup> Loughran and McDonald, 'When is a Liability Not a Liability?', above n 102, 43-44.

<sup>123</sup> Beuselinck et al, above n 14.

<sup>124</sup> Ibid (the authors used three measures of tax aggressiveness: incremental tax savings, number of tax haven countries and tax litigation).

<sup>125</sup> Ibid (the authors used the Bog Index, Gunning-Fog Index, 10-K file size and length of the SEC 10-K report to assess readability).

<sup>126</sup> Ibid (outlining the detailed reconciliation of book income to tax income required by the Internal Revenue Service (IRS)).

<sup>127</sup> Ibid.

<sup>128</sup> Kerry K Inger, Michele D Meckfessel, Mi (Jamie) Zhou and Weiguo (Patrick) Fan, 'An Examination of the Impact of Tax Avoidance on the Readability of Tax Footnotes' (2018) 40(1) *Journal of the American Taxation Association* 1.

<sup>129</sup> Beuselinck et al, above n 14.

<sup>130</sup> Karthik Balakrishnan, Jennifer L Blouin and Wayne R Guay, 'Tax Aggressiveness and Corporate Transparency' (2019) 94(1) *The Accounting Review* 45.

and co-authors<sup>131</sup> found that aggressive tax planning is associated with lower corporate transparency. As such, it can be challenging to be sure that complexity is intentionally applied to confuse.

Importantly, an additional analysis undertaken by Beuselinck and co-authors<sup>132</sup> was to consider the increase in IRS attention<sup>133</sup> and whether this affected the tax aggressiveness<sup>134</sup> of firms. In order to assess this, they considered the change in readability and the change in IRS attention, segregated into tax aggressive and non-tax aggressive firms. The analysis found that IRS attention resulted in more readable financial statements for tax aggressive firms. Beuselinck and co-authors identified as a potential explanation that ‘obfuscation through complexity becomes less helpful’<sup>135</sup> after authorities start initial screening, with firms therefore making their financial reports more transparent. Similarly, the findings by Hope and co-authors<sup>136</sup> supported the notion that non-disclosure of geographic earnings helped to mask tax avoidance behaviour, and this was impacted by the implementation of Schedule M-3 which reduced the ability to conceal such behaviour.

As such, public disclosure has an impact on obfuscation activities of entities, evidenced by firms undertaking aggressive tax avoidance behaviours. However, rather than focusing on aggressiveness itself, this study focuses on the interplay between public exposure via government intervention (comparable to the consideration of IRS attention in Beuselinck and co-authors<sup>137</sup>) and the evolution of voluntary tax reporting.

### 3.4 Complexity, scrutiny and voluntary disclosure

...Although economic theory predicts managers use voluntary disclosure to alleviate the information problems associated with complex financial statements, the theory provides little guidance on the context or medium of the voluntary disclosure.<sup>138</sup>

Concern has been raised over the effectiveness of financial statement disclosures, due to the growing complexity of accounting rules and explanatory language leading to investors failing to internalise complex financial statements.<sup>139</sup> Guay, Samuels and Taylor<sup>140</sup> considered the relationship between financial statement complexity and voluntary disclosure.<sup>141</sup> They noted that the relationship depends on how the complexity arises, whether through choice by managers,<sup>142</sup> or by firms’ business

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<sup>131</sup> Ibid 52.

<sup>132</sup> Beuselinck et al, above n 14.

<sup>133</sup> Where the IRS attention is the number of times the IRS download the SEC 10-K in a year: *ibid*.

<sup>134</sup> Tax aggressive firms were identified as firms that: belong to the bottom quintile of industry-year-adjusted cash ETRs, report above industry-year mean values for Tax Haven, and are under consideration of potential tax malfeasance (TaxLitigation = 1). *Ibid*.

<sup>135</sup> *Ibid* 23.

<sup>136</sup> See generally Hope et al, above n 35, 179-180.

<sup>137</sup> Beuselinck et al, above n 14.

<sup>138</sup> Wayne Guay, Delphine Samuels and Daniel Taylor, ‘Guiding Through the Fog: Financial Statement Complexity and Voluntary Disclosure’ (2016) 62(2-3) *Journal of Accounting and Economics* 234, 237.

<sup>139</sup> See Li, above n 15, 232-233.

<sup>140</sup> Guay et al, above n 138, 234-235.

<sup>141</sup> *Ibid*, Table 2, Panels A and B.

<sup>142</sup> In this instance, the complexity of financial statements reflects an information-based agency problem, namely that managers seek to obfuscate poor performance. If intentional, they are unlikely to use alternative disclosure channels to increase information environment quality. See also Guay et al, above n 138, 235, noting that there will be a negative-no relationship between financial statement complexity and voluntary disclosure.

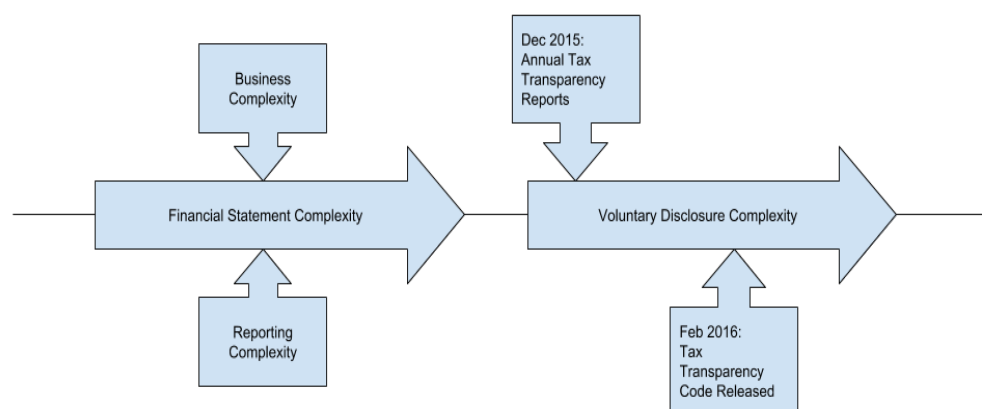


transactions and reporting standards.<sup>143</sup> For example, Hope and co-authors<sup>144</sup> suggested that to the extent managers would believe that non-disclosure of geographic earnings reduces probability of audit, prevents additional foreign sanctions or penalties or deflects public criticism, voluntary disclosures would be avoided. This was, nonetheless, mitigated when a certain level of disclosure became mandated. Dyer, Lang and Stice-Lawrence (2016),<sup>145</sup> however, have raised concern over the ability to *convincingly separate* the disclosure choices from the underlying economics.

With this in mind, Guay and co-authors highlight the other disclosure mediums beyond the financial statements that can ‘achieve an optimal information environment’.<sup>146</sup> In particular, a number of studies consider the interplay between mandatory and voluntary disclosures, finding that the complexity (reflecting lower information accessibility) is associated with increased voluntary disclosure, which is consistent with mandatory and voluntary disclosure serving as substitutes.<sup>147</sup>

Rather than focusing on the complexity of financial statements leading to voluntary disclosures, in this study the focus is on the voluntary disclosures themselves and their tone and readability. The driver of voluntary disclosure is arguably linked to something other than financial statement complexity and disclosure choices: government intervention followed by the rise of voluntary tax disclosures, as set out in Figure 1.<sup>148</sup>

**Fig. 1: Voluntary Disclosure Complexity**



Source: authors, extending Guay et al, above n 138, 237.

<sup>143</sup> In this instance, complexity of financial statements reflects complexity of a firm’s business transactions, GAAP/IFRS reporting and disclosure rules: complexity necessitates complexity. Guay et al suggest that in applying economic theory, managers will voluntarily disclose supplemental information to mitigate negative effects of complex financial statements. Thus, a positive relationship between financial statement complexity and voluntary disclosure will be found. See further Guay et al, above n 138, 235.

<sup>144</sup> Hope et al, above n 35, 178-179.

<sup>145</sup> Dyer et al, above n 115, 273.

<sup>146</sup> Guay et al, above n 138, 253. They found a positive relationship between financial statement complexity and voluntary disclosure, with the strongest (weakest) relationship being found when managers have greater (lesser) incentives to mitigate the informational problems caused by complex financial statements.

<sup>147</sup> Jennifer Francis, Dhananjay Nanda and Per Olsson, ‘Voluntary Disclosure, Earnings Quality, and Cost of Capital’ (2008) 46(1) *Journal of Accounting Research* 53, 62-63; Guojin Gong, Laura Yue Li and Hong Xie, ‘The Association between Management Earnings Forecast Errors and Accruals’ (2009) 84(2) *The Accounting Review* 497.

<sup>148</sup> Lennox and Park, above n 100 (who find a positive relationship between earnings quality and the incidence, frequency and accuracy of voluntary disclosure).

We posit that the greater the absence of tax information generally available, the greater the degree of complexity for the voluntary disclosures. Beyond the limited tax disclosures, there is opportunity to obfuscate due to the lack of alignment between tax and accounting, and the latitude in voluntary reporting.

For the relevant Australian context, prior to the introduction of the TTC and VTRs, the introduction of the *Tax Laws Amendment (2013 Measures No 2) Act 2013* led to annual tax transparency reports (MTRs) being published. Before its enactment, mixed support was provided for this approach towards improving the transparency of the business tax system.<sup>149</sup> In particular, public submissions raised concern over the possibility of disclosures leading to confusion, misunderstanding and misinterpretation and costs to reputation, requiring further costs and disclosures.<sup>150</sup> Hoopes, Robinson and Slemrod<sup>151</sup> have found that following the release of the tax transparency reports, publicly available articles and social media sources have similarly led to negative media attention through which investors reacted negatively to anticipated and actual tax disclosures. The above research indicates that the creation of tax transparency reports can lead to negative investor reactions. Numerous other studies have also explored tax scrutiny and the information environment.<sup>152</sup>

Extant literature suggests that from the firm perspective, public scrutiny results in few consequences,<sup>153</sup> and that investor consequences are short-lived.<sup>154</sup> This seems to suggest, on the one hand, that stakeholder value is perceived by firms to be a lower priority due to being short-lived and therefore not a primary incentive to disclose tax information other than what is mandated. In the alternative, those firms seeking to raise capital through the issuance of shares or bonds may have an incentive to make additional tax disclosures other than what is mandated under statute in order to incentivise investor stakeholders. Irrespective of this, political tax exposure has previously been linked with shifting income tax reporting approaches in Australia during the 1970s when the government was advocating the removal of significant tax concessions.<sup>155</sup> In particular, companies considered to be *politically exposed* – categorised as large with low ETRs – utilised the adoption of inter-period tax allocation that resulted in an increase to their ETRs and as such reduced that political exposure.<sup>156</sup>

Similar evidence has been found more recently in the UK, where Dyreng, Hoopes and Wilde<sup>157</sup> have found public scrutiny led to a change in disclosure and tax avoidance behaviour, resulting in the reported income tax expense increasing. Importantly, Dyreng and co-authors note that there is a trade-off between such tax avoiding behaviour and the ultimate political, reputational and proprietary costs.<sup>158</sup> This can be

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<sup>149</sup> Morton, 'Corporate Tax Transparency Reporting and Benford's Law', above n 22.

<sup>150</sup> Ibid.

<sup>151</sup> Jeffrey L Hoopes, Leslie Robinson and Joel Slemrod, 'Public Tax-Return Disclosure' (2018) 66(1) *Journal of Accounting and Economics* 142, 143.

<sup>152</sup> Shannon Chen, 'Do Investors Value Corporate Tax Return Information? Evidence from Australia' (PhD Dissertation, The University of Texas at Austin, 2017); Scott D Dyreng, Jeffrey L Hoopes and Jaron H Wilde, 'Public Pressure and Corporate Tax Behavior' (2016) 54(1) *Journal of Accounting Research* 147, 151. See also Hoopes et al, above n 151; Sidhu and Whittred, above n 32, 78-79.

<sup>153</sup> John Gallemore, Edward L Maydew and Jacob R Thornock, 'The Reputational Costs of Tax Avoidance' (2014) 31(4) *Contemporary Accounting Research* 1103.

<sup>154</sup> Hanlon and Slemrod, above n 83.

<sup>155</sup> Sidhu and Whittred, above n 32, 79.

<sup>156</sup> Ibid.

<sup>157</sup> Dyreng et al, above n 152, 152.

<sup>158</sup> Ibid 153.

linked to the work by Graham and co-authors,<sup>159</sup> which found reputation to be the second most important factor in the decision not to adopt a potential tax planning strategy. This, it is observed, impacts the degree to which VTR is used as a tool for reputation control. This suggests that firms may be less likely to disclose tax information other than what is mandated for fear of reputational damage to the firm. Moreover, top management was considered to care at least as much about the GAAP ETR as cash taxes paid for the substantial majority of executives (84 per cent).

Returning to Hoopes and co-authors,<sup>160</sup> who also examined the mandatory tax transparency reports in Australia, their study found evidence of firms adjusting their income to avoid disclosure,<sup>161</sup> thus anticipating the cost of disclosure. Similarly, the study by Chen<sup>162</sup> indicates that although investors anticipated an overall net benefit from the disclosure arising from the mandated tax transparency reports (including the benefit from reduced information asymmetry and monitoring of activities), firms likely to face increased scrutiny were found to have small negative market reactions. Comparable findings have also been established in Japan, where a non-trivial number of taxpayers who were otherwise close to the threshold under-reported to avoid disclosure.<sup>163</sup>

As such, the literature suggests that scrutiny and public exposure are linked to impacts in terms of disclosure approaches and mixed concern over increased scrutiny. The focus of the present study is to consider the latitude available in the preparation of VTRs and the opportunity to strategically obfuscate what is a new disclosure regime or set the tone to do so. Although Chen<sup>164</sup> suggests an overall positive impact for investors, companies which are publicly exposed – due to the increased avenues for scrutiny but also being particularly exposed due to their respective level of tax payable – have particular impetus to utilise tone and readability to protect their reputation. Unlike Chen<sup>165</sup> as well as Devos and Zackrisson,<sup>166</sup> however, who explore aggressiveness, the current study explores the level of attention combined with the public exposure in line with Sidhu and Whittred.<sup>167</sup>

#### 4. RESEARCH QUESTION AND HYPOTHESIS

This study examines whether those who face the prospect of public notoriety, comprising having low comparative tax payable as per the mandated tax transparency report (*public exposure – scrutinised*), as compared to those that are not (higher comparative tax payable as per the mandated tax transparency report, *public-exposure – low scrutiny*) will make decisions leading to differences in readability and tone. Therefore, the following research question is proposed: *does the level of public exposure (scrutinised/low scrutiny) arising from mandatory tax reporting impact readability and tone of voluntary tax reporting?*

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<sup>159</sup> John R Graham, Michelle Hanlon, Terry J Shevlin and Nemit Shroff, 'Incentives for Tax Planning and Avoidance: Evidence from the Field' (2014) 89(3) *The Accounting Review* 991, 999-1000.

<sup>160</sup> See Hoopes et al, above n 151, 150.

<sup>161</sup> Relating to the distribution of reported income around the threshold, revealing an increased frequency of income just below the threshold. See *ibid* 143.

<sup>162</sup> See generally Chen, above n 152.

<sup>163</sup> See generally Hasegawa et al, above n 6.

<sup>164</sup> Chen, above n 152.

<sup>165</sup> *Ibid* 143.

<sup>166</sup> Devos and Zackrisson, above n 5.

<sup>167</sup> See generally Sidhu and Whittred, above n 32.

Scrutiny becomes more directly linked to the level of tax disclosed in the mandated tax transparency report. Similarly, Devos and Zackrisson<sup>168</sup> describe the situation where the mandatory tax disclosure regime can lead to public perception issues:

The implications of the new disclosure legislation will vary for Australian listed entities, privately held large businesses and Australian subsidiaries of foreign owned multi-national groups. It will also depend on the cash tax profiles of the large businesses. From a deterrent perspective, public perception issues may arise from the disclosures. For example, if businesses have low cash tax payable due to factors such as carry-forward losses or R&D deductions, increased queries may arise in the absence of full information, from analysts, the public or social welfare groups. Another danger for business is that mandatory disclosure of tax information may adversely affect consumers' buying behaviour (similar to the recent protests directed at Starbucks in Britain). In addition, governments themselves are large consumers of goods and services and may take information on tax contribution into account when making purchasing decisions. There have also been reports about 'ethical investors' who ignore purchasing shares in companies that are not viewed as tax compliant.

The first issue raised is of most relevance here: where the mandatory tax reports reveal certain entities to have low cash tax payable, there is a potential for increasing queries.<sup>169</sup> These variations do not have to represent tax aggressive sources; there can be genuine reasons for a low tax payable rate. As such, we argue that this study does not need to extend the analysis to consider tax aggressiveness of the firms, as unlike in Beuselinck and co-authors<sup>170</sup> this study is considering *the public perception* response.

Alternatively, due to the disclosure of certain tax information via the tax transparency reports, there is a contrasting argument that to the extent there are benefits to obfuscate engagement in (aggressive) tax planning activities, whilst increasing pressure to explain tax transparency disclosures arising through the mandated tax transparency reports, firms may decrease readability of the VTRs. This is comparable to Sidhu and Whittred,<sup>171</sup> who considered the impact of perceptions at a time where the government was proposing to remove tax concessions. This could be linked to what Ballas has described as an instrument of social control or management: ie, control over the narrative.<sup>172</sup> Yet Beuselinck and co-authors<sup>173</sup> and Hope and co-authors<sup>174</sup> reveal government attention to be linked to improvements in readability.

We posit three key opportunities that entities have to obfuscate through readability. First, within the larger context, there is a general lack of available tax information. The MTRs provide limited amounts of information to the general public. Second, this opportunity gives rise to further latitude, due to the lack of alignment between the accounting and taxation systems. This leads to a disconnectedness in the potential content of the MTRs, which offer little information and context to close the lacunae of

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<sup>168</sup> Devos and Zackrisson, above n 5, 118-199 (citations omitted).

<sup>169</sup> Ibid.

<sup>170</sup> See generally Beuselinck et al, above n 14.

<sup>171</sup> Sidhu and Whittred, above n 32.

<sup>172</sup> Ballas, above n 31, 733. See also Jameson, above n 31, 9; Li, above n 15.

<sup>173</sup> Beuselinck et al, above n 14.

<sup>174</sup> Hope et al, above n 35, 181-182.

tax information. This is comparable to the argument posed by Beuselinck and co-authors:<sup>175</sup>

To the extent that non-discovery of aggressive tax planning activities is a considerable benefit, we conjecture that more tax aggressive firms will use more financial reporting obfuscation strategies through overly complex financial reporting.

However, it does not need to be only for the purpose of tax aggressiveness, as seen in the study by Beuselinck and co-authors; it can also be for the purpose of controlling the narrative.<sup>176</sup> The third opportunity allowing for the control of the narrative is the latitude within voluntary disclosures generally.<sup>177</sup>

Following the logic of Guay and co-authors<sup>178</sup> and Morton,<sup>179</sup> complexity in VTRs arises from the lack of alignment between tax and accounting disclosures, the complexity of a firm's business transactions and lack of knowledge with regards to external reporting and disclosure rules. In this sense, *complexity necessitates complexity*, and *publicly-exposed* firms will seek to obfuscate tax activities. In both cases reducing (perceived) information uncertainty mitigates the negative effects of misaligned (revealed) disclosure. Based on the literature discussed, it is anticipated that the VTRs are used as a tool to manage the narrative and therefore the following hypotheses are derived:

- H<sub>1</sub>: Companies with *public exposure – low scrutiny* prepare voluntary tax reports which are easier to read; and
- H<sub>2</sub>: Companies with *public exposure – scrutinised* prepare more optimistic voluntary tax reports.

However, despite the attempts for companies to control the narrative through obfuscation,<sup>180</sup> following Beuselinck and co-authors<sup>181</sup> and Hope and co-authors,<sup>182</sup> government attention may lead to improvements in readability.

The focus, therefore, relates to whether and how tone and readability are being used as a tool for managing audience perceptions to blur the transparent nature of what is purported to be an aid towards transparency of corporate tax affairs, given the voluntary nature of the disclosures and the potential pressure to respond to mandated tax disclosures arising from the annual tax transparency reports. We argue that the extent to which VTRs are used as such a tool is dependent on the level of public inquiry the entity is likely to face, which is directly related to the level of tax payable (*public exposure – scrutinised*; *public exposure – low scrutiny*). Unlike the study by Guay and co-authors,<sup>183</sup> this article does not assess financial statement complexity: see Figure 1. With this in mind, the article investigates the tone and readability of VTRs of signatories to the TTC.

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<sup>175</sup> Beuselinck et al, above n 14, 4.

<sup>176</sup> Ibid.

<sup>177</sup> Huang et al, above n 97.

<sup>178</sup> Guay et al, above n 138, 255.

<sup>179</sup> Morton, 'Corporate Tax Transparency Reporting and Benford's Law', above n 22, 19-21.

<sup>180</sup> See, eg, Jameson, above n 31, 9 and generally Li, above n 15.

<sup>181</sup> Beuselinck et al, above n 14, 4.

<sup>182</sup> See generally Hope et al, above n 35.

<sup>183</sup> Guay et al, above n 138, 256.

## 5. RESEARCH DESIGN

This article examines the association of MTRs with tone and readability of VTRs in Australia. The authors rely on linear regression on secondary data to conduct an empirical study of the association of mandatory tax disclosures on the readability and tone of voluntary tax reports. The following sections outline the process of data collection from the signatories of the TTC; and a description of the sample data, key variables (ETR, tone and readability), before outlining the regression models.

### 5.1 Population and data collection

The ATO is the ‘responsible agent’ that provides a link to issued TTC reports via a central website.<sup>184</sup> VTRs were obtained from this central website on 3 July 2018 (the database being last updated on 29 June 2018). According to the database, of the 137 signatories as at that date, 113 entities had published a VTR (82.5 per cent). On examination and screening however, inconsistencies and inaccuracies were noted in the database. This likely arose due to the onus being on the entity to update the ATO regarding when the reports are published (as well as more generally when the URL links to the VTRs change which is not reported to the ATO).

These discrepancies include: whether or not the URL provided was accurate in sending the user to the report and/or whether it was invalid; inconsistency between specified years; and, whether or not certain year reports were available or produced. Many did not have reports available for the set years, whilst others were available for differing years specified. Each listing on the database was reviewed and the VTR document was obtained, where available. In several instances, the entity website had to be reviewed to obtain the VTR. In three instances, however, no report was able to be located.

As such, the population of entities was reduced from 113 to 110. Furthermore, due to the specified income years not being consistent, these were also reviewed and updated to be consistent across all VTRs. In one instance, it could not be determined what the year-end period was, only the year generally in question.

Across those 110 entities, 150 VTRs were identified spanning the years ending 31 December 2014 through to 31 March 2018. VTR formats from disclosures generally span from being located within the CSR/Sustainability reports (CSR), Corporate Governance reports (CG), Annual Reports (AR), or as standalone tax reports (TR). However, this number warrants further consideration:

- Two signatories were revealed to be related with duplicate VTRs disclosed. The duplicate listing was removed.
- In a number of instances, the VTR disclosures were dispersed across multiple reports. In one instance, that dispersion included a website. The website entry was removed.
- In two instances the single VTR related to two years. The VTR relating to both years was removed.

The sample size thus comprised 107 entities and 147 VTRs. The database also provides basic information in addition to entity name, year and URL. These variables include

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<sup>184</sup> See generally Australian Government, ‘Voluntary Tax Transparency Code: VTTC Reports’ (31 May 2021), <https://data.gov.au/dataset/voluntary-tax-transparency-code>.

the *Size* (large, medium); *Origin – Ultimate Parent Company* (Australia, Australia & Foreign dual listed, Foreign); and, *Disclosure* (Part A & B, Part A & Partially B, Part A). Most entities listed were large, having an Australian ultimate parent company, and were recorded as having disclosed Part A & B in their VTR. However, for one entity, these additional variables were blank. The 147 VTRs are categorised in Appendix Table A2, across three panels.

Acknowledging that: (i) there is a high concentration of ‘TR’ reports and ‘large’ companies disclosing ‘Part A & B’; and (ii) there are integral differences among each company’s average total income and taxable income and tax payable, the analysis focuses on the specific group of 106 observations of ‘TR’ reports issued by ‘large’ companies which disclose ‘Part A & B’.

In addition to the aforementioned VTRs, the tax transparency reports were examined to determine and obtain the mandated tax disclosures spanning the similar time frame (2013-14, 2014-15, 2015-16, 2016-17 report data). In most instances, those companies producing VTRs were also present in the tax transparency reports. From the entities reporting VTRs, four were found not to have any immediate listing in the mandated tax transparency report, with three observations specific to the group of ‘TR’ reports issued by ‘large’ companies which disclose ‘Part A & B’. However, there is some complexity here in matching the entities due to the differing concepts of consolidation under accounting rules compared to taxation rules. Simply put, these entities could be represented by a differing entity not clearly identifiable. In some instances, there is not an exact match of the name listed on the VTR registry to the tax transparency report.<sup>185</sup> This again can stem from the differing consolidation methodology between the two systems. For example, it could be a group listed on the VTR registry, whilst the tax consolidated group head entity is listed on the tax transparency report. Or otherwise, it appears that the full name is not detailed on the VTR registry. The details regarding the companies belonging to the sample are shown in Appendix Table A3, and described further below.

The Effective Tax Rate (ETR) is calculated by dividing variable Tax Payable by variable Taxable Income from the MTR. While this provides consistency, the authors recognise that there is a lack of consensus around the formulation of the ETR calculation.<sup>186</sup> However, the method is premised by virtue of the data source: the article’s focus is on the extent to which VTRs reflect levels of public perception of the disclosures within the MTR, and therefore the ETR is obtained from the MTR,<sup>187</sup> where disclosures are limited to total income, tax payable and taxable income. The ETR has an average of 17.63 per cent and a median of 23 per cent with the distribution outlined in Table 2.

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<sup>185</sup> See section 4 of this article, above. See further Morton, ‘Corporate Tax Transparency Reporting and Benford’s Law’, above n 22 (considering the limitations of MTR disclosures).

<sup>186</sup> See, eg, Thomas Belz, Dominik von Hagen and Christian Steffens, ‘Taxes and Firm Size: Political Cost or Political Power?’ (2019) 42 *Journal of Accounting Literature* 1.

<sup>187</sup> This is in place of VTR or annual reports: *ibid.* Also note that the MTR does not report to any extent the magnitude of tax *refunds*, instead reports these as nil (\$0), discussed in Morton, ‘Corporate Tax Transparency Reporting and Benford’s Law’, above n 22. So, all instances result in positive ETRs.

**Table 2: Effective Tax Rate**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0%	26	24.5	25.2	25.2
	2%	1	.9	1.0	26.2
	4%	1	.9	1.0	27.2
	5%	1	.9	1.0	28.2
	8%	1	.9	1.0	29.1
	9%	1	.9	1.0	30.1
	10%	3	2.8	2.9	33.0
	11%	1	.9	1.0	34.0
	14%	1	.9	1.0	35.0
	16%	2	1.9	1.9	36.9
	17%	1	.9	1.0	37.9
	18%	2	1.9	1.9	39.8
	19%	3	2.8	2.9	42.7
	20%	1	.9	1.0	43.7
	21%	2	1.9	1.9	45.6
	22%	1	.9	1.0	46.6
	23%	5	4.7	4.9	51.5
	24%	6	5.7	5.8	57.3
	25%	3	2.8	2.9	60.2
	26%	6	5.7	5.8	66.0
27%	4	3.8	3.9	69.9	
28%	3	2.8	2.9	72.8	
29%	15	14.2	14.6	87.4	
30%	13	12.3	12.6	100.0	
	Total	103	97.2	100.0	
Missing	System	3	2.8		
Total		106	100.0		

The software JFreq<sup>188</sup> was used to peruse the reports, count the number of words in each annual report, and determine the frequency of each word in the annual report. Word frequency is calculated by dividing the total number of words belonging to a specific word list by the total number of words in the annual report. For the main analysis, word frequency is calculated using the equal weighting method, following prior accounting and finance research.<sup>189</sup> This means that the same weight is applied to each word occurring in the word lists.

The tone refers to the extent to which reports contain words with optimistic or pessimistic sentiment. Bicudo de Castro and co-authors<sup>190</sup> examined 5,034 firm-year

<sup>188</sup> Will Lowe, 'JFreq: Count Words, Quickly', Java Software Version 0.5.4 (2011). See also Will Lowe, Kenneth Benoit, Slava Mikhaylov and Michael Laver, 'Scaling policy preferences from Coded Political Texts' (2011) 36(1) *Legislative Studies Quarterly* 123.

<sup>189</sup> Henry and Leone, above n 104, 172.

<sup>190</sup> Vicente Bicudo de Castro, Ferdinand A Gul, Mohammad Badrul Muttakin and Dessalegn Getie Mihret, 'Optimistic Tone and Audit Fees: Some Australian Evidence' (2019) 23(2) *International Journal of Auditing* 352.



observations drawn from annual reports of non-financial firms listed on the Australian Stock Exchange (ASX) for the period from 2002 to 2014 and provided the top words from the positive and negative word lists in the Australian context in Loughran and McDonald.<sup>191</sup> The words 'Loss', 'Losses', 'Impairment', 'Against' and 'Disclosed' represent the five most frequently used negative words in Australian annual reports and 37.55 per cent of the total frequency of negative words used; the top five most frequently used positive words in Australian annual reports were 'Effective', 'Benefit', 'Strong', 'Outstanding' and 'Gains', representing 22.25 per cent of the total frequency of positive words used. As word frequency is calculated by dividing the total number of words belonging to a specific word list by the total number of words in the document, tone is, therefore, measured as the frequency of positive words minus the frequency of negative words used in a report.<sup>192</sup> Such a measure captures the net use of words characterising the tone between optimistic (ie, a higher net value) and pessimistic (ie, a lower net value). Hence, tone is set as the difference between the number of positive words and negative words recorded in the report, scaled by the total words recorded in the report. The word list in Loughran and McDonald<sup>193</sup> is used for classifying words between positive and negative words. The mean tone of the reports in the selected sample is 0.006, which is slightly more optimistic than the -0.002 recorded on Australian annual reports<sup>194</sup> and the -0.006 recorded on US annual reports.<sup>195</sup>

For this study, the article utilises the readability indexes of Fog and Flesch-Kincaid as proxies for the practice of obfuscation in reports (eg, Bayerlein and Davidson<sup>196</sup>). The Fog or Flesch-Kincaid are readability indexes, and the higher these indexes, the harder a document is to read thus reducing the effectiveness of the information available to stakeholders. The correlations between the variables are shown in Table 3.

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<sup>191</sup> See Table 2 in Loughran and McDonald, 'When is a Liability Not a Liability?', above n 102, 46.

<sup>192</sup> See generally Feng Li, 'Managers' Self-Serving Attribution Bias and Corporate Financial Policies' (Working Paper, Shanghai Advanced Institute of Finance, Shanghai Jiaotong University, July 2010). See also Castro et al, above n 190.

<sup>193</sup> Loughran and McDonald, 'When is a Liability Not a Liability?', above n 102, 43-44.

<sup>194</sup> Castro et al, above n 190, 358.

<sup>195</sup> Loughran and McDonald, 'When is a Liability Not a Liability?', above n 102, 46.

<sup>196</sup> See generally Bayerlein and Davidson, above n 15.

**Table 3: Correlations**

Variable	Ln(JFreq Words)	Fog	Flesch-Kincaid	Tone	Ln(Total Income \$)	Ln(Taxable Income \$)	Ln(Tax Payable \$)	Ln(Market Capitalisation)	Effective Tax Rate
Ln(JFreq Words)	1	-.198*	-.196*	-.193*	.434**	.067	.058	.332**	-.058
Fog	-.198*	1	.982**	-.162	.050	-.044	-.228*	.020	-.246*
Flesch-Kincaid	-.196*	.982**	1	-.211*	.084	-.053	-.230*	.046	-.252*
Tone	-.193*	-.162	-.211*	1	-.072	.349**	.287**	.091	.355**
Ln(Total Income \$)	.434**	.050	.084	-.072	1	.333**	.231*	.609**	.083
Ln(Taxable Income \$)	.067	-.044	-.053	.349**	.333**	1	.710**	.296*	.584**
Ln(Tax Payable \$)	.058	-.228*	-.230*	.287**	.231*	.710**	1	.185	.867**
Ln(Market Capitalisation)	.332**	.020	.046	.091	.609**	.296*	.185	1	.120
Effective Tax Rate	-.058	-.246*	-.252*	.355**	.083	.584**	.867**	.120	1

\*\*Correlation is significant at the 0.01 level (2-tailed).

\*Correlation is significant at the 0.05 level (2-tailed).

## 5.2 Method of analysis

The authors argue that ETR is an independent variable and tone and readability are dependent variables on the basis that the tone and readability of a report will change depending on a high or low ETR. Unlike Sidhu and Whittred,<sup>197</sup> who utilised a probit variable, this study utilises a linear regression model using the continuous variable of ETR; note that tone and readability (Fog and Flesch-Kincaid indexes) are continuous variables as well. The authors propose the following models:

### Model 1:

$$Fog = \beta_0 + \beta_1 ETR + \beta_2 Ln(Market Capitalisation) + \beta_3 Ln(JFreq Words) + \varepsilon$$

### Model 2:

$$Flesch-Kincaid = \beta_0 + \beta_1 ETR + \beta_2 Ln(Market Capitalisation) + \beta_3 Ln(JFreq Words) + \varepsilon$$

### Model 3:

$$Tone = \beta_0 + \beta_1 ETR + \beta_2 Ln(Market Capitalisation) + \beta_3 Ln(JFreq Words) + \varepsilon$$

Given that the article's focus is on the extent to which VTRs reflect levels of public perception of the disclosures within the MTR, the ETR is obtained from the mandatory tax reports rather than the voluntary tax reports or annual reports. The MTRs reflect the particular government intervention of interest that is directed at public education, therefore as already outlined, is our variable of interest. The authors add as control variables to the model variables which represent size of our observations. The Ln(Market Capitalisation) is used as a proxy for size of the corporations and the Ln(JFreq Words) is used for capturing the length of the VTR.

Similar to Sidhu and Whittred,<sup>198</sup> the authors argue that the public exposure via the government's mandatory tax transparency regime (and other measures) as a result of

<sup>197</sup> Sidhu and Whittred, above n 32.

<sup>198</sup> Ibid.

increased scrutiny and public pressure over large corporations in Australia, has led particular companies to respond by producing voluntary tax reports that encompass particular tone and readability characteristics.

In line with Sidhu and Whittred,<sup>199</sup> the authors split the sample using what that study described as a ‘politically acceptable threshold’, perhaps here better described as a *publicly acceptable threshold*. The authors rank the companies based on their ETR, an approach consistent with information sourced from respective mandatory tax transparency reports, and then have defined publicly exposed companies as those with an ETR less than the median. Those below the median are categorised as *public exposure – scrutinised*, whilst those that have a higher ETR are categorised as *public exposure – low scrutiny*. Arguably, this could be seen as an arbitrary threshold as it results in half of the sample being politically exposed and the other half not.

An examination of the correlation between the variables shows no high correlation among the variables used in each of the proposed models, suggesting no issues with variables’ discriminant validity.<sup>200</sup> A note should be made regarding the Fog and Flesch-Kincaid indexes, both being used as proxies for readability and therefore displaying a high correlation. Using two different proxies for measuring readability – with similar findings – improves the reliability of the model when examining the readability. Regarding the validity of the models, the analyses show the coefficients of the independent and control variables adopted in the models are not always statistically significant. Therefore, the regressions present low f-values and low adjusted R<sup>2</sup>. Overall, an analysis of the correlations between the sub-samples’ dependent and independent variables will suffice for reaching the findings of this study.

## 6. DISCUSSION AND ANALYSIS OF THE FINDINGS

### 6.1 Preliminary findings

The preliminary findings examined the relationship between all 106 observations and revealed (see correlation matrix on Table 3) that:

- There is a positive correlation of 0.355 (significant at the 0.01 level) between tone and ETR, meaning that a positive tone is associated with higher ETR, and
- There are negative correlations of -0.246 and -0.252 (both significant at the 0.05 level) between Fog and Flesch-Kincaid indexes and ETR, meaning that reports easier to read are associated with higher ETR.

Regression analysis using tone as an independent variable confirms that a high ETR is associated with reports with a more positive tone. The coefficient for the ETR is 0.414 ( $t=4.005$ ) (see Table A4). In particular, as ETR increases – increasingly contributing to what can be described as perceptions of their ‘fair share’ of tax – the tone of reports becomes more positive. The company is positive towards its tax disclosures, so from the perspective of Treasurer Joe Hockey’s request in 2015, the company may feel it is

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<sup>199</sup> Ibid.

<sup>200</sup> See generally John Hulland, ‘Use of Partial Least Squares (PLS) in Strategic Management Research: A Review of Four Recent Studies’ (1999) 20(2) *Strategic Management Journal* 195.

helping to educate the public about its compliance with the tax laws.<sup>201</sup> The company's tone is positive towards the 'informed public scrutiny'<sup>202</sup> and towards its reputation.<sup>203</sup>

Regression analysis using readability indexes as independent variables and as dependent variables ETR, Ln(Market Capitalisation) and Ln(JFreq Words) (Models 1, 2, and 3) confirms that a high ETR is associated with reports that are easier to read (ie, low readability indexes). The coefficients for the ETR are -0.246 ( $t=2.136$ ), using Fog as an independent variable and -0.251 ( $t=-2.186$ ), using Flesch-Kincaid as an independent variable.

With these findings in mind, the higher the ETR, the more transparent and user friendly the report – being the aim of the TTC and outlined by the Board of Taxation.<sup>204</sup> The clearer the disclosures, the more easily understood the content. These results align broadly to extant research on scrutiny and public exposure being linked to tone and readability.<sup>205</sup> However, this raises questions as to whether the voluntary scheme is having the effect of incentivising companies towards the spirit of the law, as the Senate Economics References Committee enquiry discussed.<sup>206</sup> This is particularly so, given the small number of signatories to the TTC, by that function creating a self-selection bias in the data. This aligns with the argument of Devos and Zackrisson<sup>207</sup> who suggest compliant nations have a greater likelihood of accepting disclosure, although there is some evidence of income being adjusted to avoid disclosure within the Australian setting<sup>208</sup> and Devos and Zackrisson<sup>209</sup> further highlighted those that are resistant will utilise further avoidance behaviour.

Similarly, there is the concern raised by Morton<sup>210</sup> of what is not captured by these disclosure regimes. The MTR offers clarity of what is within the scope of a tax consolidated group, yet it is likely that the more problematic activities are occurring beyond these boundaries. Alternatively, despite the findings by Dyreng and co-authors<sup>211</sup> (on public scrutiny changing disclosure and tax avoidance behaviour) and Graham and co-authors<sup>212</sup> (on reputation being important regarding tax planning strategy adoption), we may see the MTR and TTC as being disregarded, as having short-lived consequences, therefore creating little incentive to disclose anything beyond what is mandated.<sup>213</sup> Irrespective of these issues, variations in ETR do not have to represent tax aggressive sources; there can be genuine reasons for a low tax payable rate. Similarly, the fundamental nature of a voluntary tax report allows choice. As already indicated, this article does not extend the analysis to consider tax aggressiveness of the firms, as unlike in the study by Beuselinck and co-authors<sup>214</sup> it is considering *the public perception* response.

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<sup>201</sup> Board of Taxation, above n 11, 5.

<sup>202</sup> Wording used in the 2016-17 Commonwealth Budget Announcement. See above n 52, 11.

<sup>203</sup> Board of Taxation, above n 11, 5 (raising as a concern the conduct of some entities engaging in tax avoidance).

<sup>204</sup> Board of Taxation, above n 11.

<sup>205</sup> Bayerlein and Davidson, above n 15.

<sup>206</sup> Board of Taxation, above n 11.

<sup>207</sup> Devos and Zackrisson, above n 5.

<sup>208</sup> Hoopes et al, above n 151.

<sup>209</sup> Devos and Zackrisson, above n 5.

<sup>210</sup> Morton, 'Corporate Tax Transparency Reporting and Benford's Law', above n 22.

<sup>211</sup> Dyreng et al, above n 152.

<sup>212</sup> Graham et al, above n 159.

<sup>213</sup> See section 3.4 of this article discussing Gallemore et al, above n 153 and Hanlon and Slemrod, above n 83. Compare, eg, Chen, above n 152, who found only small negative market reactions.

<sup>214</sup> Beuselinck et al, above n 14.

However, driving this analysis is the mandatory disclosures and despite being publicised through the MTRs, not all companies will be under the same particular spotlight: those with higher ETRs will face less scrutiny as they may be perceived as paying their fair share of tax, whilst those with lower ETRs will face more scrutiny in terms of their public exposure<sup>215</sup> and following Beuselinck and co-authors,<sup>216</sup> present perceived benefits to obfuscate through reduce readability.

## 6.2 The level of public exposure

We now turn to consider public exposure, and more specifically to explore whether perceptions of low ETR through the MTR may, as Beuselinck and co-authors find,<sup>217</sup> lead to reduced reliance on readability. The analysis proceeds to divide the sample based on the level of public exposure using the criteria of companies with low ETR and high ETR as a proxy for publicly exposed companies.<sup>218</sup> Splitting the sample using the median ETR provides the two sub-samples which are of similar size. Using the median 23 per cent as cut-off between high and low ETR, there are 50 *public exposure – low scrutiny* companies as against 53 *public exposure – scrutinised* companies. Table A4 sets out the regressions using the total sample, the sample of *public exposure – scrutinised*, and the sample of *public exposure – low scrutiny*, using as dependent variables Fog, Flesch-Kincaid, and tone.

Although not the prime focus of this study, there is evidence throughout the analyses that a larger number of words on the report of *public exposure – scrutinised* companies, as measured through Ln(JFreq Words), is associated with lower readability indexes. This suggests long documents prepared by *public exposure – scrutinised* companies are easier to read, as measured by Flesch-Kincaid and Fog indexes, than short documents. The same evidence does not occur for the *public exposure – low scrutiny* companies.

As few of the variables in the models have coefficients which are statistically significant, the regressions present low *f*-values, as shown on Table A4, suggesting there is room for improvement for the models used for this analysis. Nonetheless, it is worth noting – as shown in Table 3 – the variables ETR, tone, Fog and Flesch-Kincaid, are correlated, regardless of the models.

For the sample of 53 *public exposure – scrutinised* companies, the linear regressions using the *readability* indexes do not provide coefficients which are statistically relevant. However, it is worth noting through the linear regression analysis for *public exposure – scrutinised* companies using tone as an independent variable, the ETR has a positive and statistically significant coefficient of 0.371 ( $t=2.574$ ), suggesting that, for *public exposure – scrutinised* companies, a higher ETR is associated with a more positive *tone*. For the sub-sample data selection of 50 *public exposure – low scrutiny* companies, tone is not associated with ETR, whereas readability indexes remain with negative coefficients. Consistent with the findings by Inger and co-authors, this may indicate that given the higher ETR, they may be engaging in low levels of tax avoidance activities and therefore the trade-off for decision-useful information results in less concealment.<sup>219</sup> The linear regression confirms a high ETR associated with a low Fog

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<sup>215</sup> Referring to creating particular public perception issues and increased inquiries: see Devos and Zackrisson, above n 5.

<sup>216</sup> Beuselinck et al, above n 14.

<sup>217</sup> Ibid.

<sup>218</sup> Ibid.

<sup>219</sup> See generally Inger et al, above n 128.

and Flesch-Kincaid (ie, reports of companies with higher ETR are easier to read) with no association whatsoever regarding tone and ETR.

Summarising, using the criteria of splitting the sample between companies with low ETR and high ETR as a proxy for public exposure and scrutiny,<sup>220</sup> companies which are *public exposure – low scrutiny* having a higher ETR provide reports which are easier to read (ie, high ETR is associated with low readability indexes), whereas the reports from the sub-sample of *public exposure – scrutinised* companies having a higher ETR provide reports with a more positive tone (ie, high ETR is associated with a positive tone). As such the hypotheses are accepted. The authors posit that this is consistent with Beuselinck and co-authors,<sup>221</sup> who find that companies will rely less on obfuscation when there are small benefits to doing so and that *attention* leads to more readable financial statements. The authors therefore concur tentatively that ‘*obfuscation through complexity becomes less helpful*’,<sup>222</sup> rather than ‘*complexity necessitates complexity*’.<sup>223</sup> Importantly, the authors find that companies instead turn to tone.

However, the public perception for this category is likely to be of concern for companies, as lower ETRs suggest lower contributions to what can be described as perceptions of their ‘fair share’ of tax. As initially indicated in section 6.1, the positive tone may be towards the enabling of ‘informed public scrutiny’<sup>224</sup> and towards the company’s reputation.<sup>225</sup> However, in this instance it may be driven by the need to control the narrative<sup>226</sup> over perceptions of their tax compliance (or lack thereof), through creating an affect or feeling<sup>227</sup> and not readability. Table 4 summarises the coefficients for ETR as an independent variable for each model, sample, and sub-sample.

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<sup>220</sup> Sidhu and Whitted, above n 32.

<sup>221</sup> Beuselinck et al, above n 14, 5-6. See also Hope et al, above n 35, 181-182.

<sup>222</sup> Beuselinck et al, above n 14, 23.

<sup>223</sup> Guay et al, above n 138, 258.

<sup>224</sup> See n 52, 11 (using this wording in the 2016-17 Commonwealth Budget Announcement).

<sup>225</sup> Board of Taxation, above n 11, 5 (raising as a concern the conduct of some entities engaging in tax avoidance).

<sup>226</sup> Ballas, above n 31, 733. See also Jameson, above n 31, 9; Li, above n 15.

<sup>227</sup> Henry, above n 16.

**Table 4: Summary of Coefficients for ETR**

Dependent variable	Total Sample (n=106) <sup>a</sup>	Public Exposure – Low Scrutiny companies (n=50)	Public Exposure – Scrutinised companies (n=53)
Tone	.414*** (t=4.005)	.096 (t=.555)	.371** (t=2.574)
Flesch-Kincaid	-.251** (t=-2.186)	-.315* (t=-1.908)	-.218 (t=-1.301)
Fog	-.246** (t=-2.136)	-.282* (t=-1.708)	-.245 (t=-1.472)

a There are 3 missing values regarding ETR, hence the total sample of 106 comprises of 50 public exposure – low scrutiny companies, 53 public exposure – scrutinised companies, and 3 missing values.

\*\*\*. Significant at the 0.01 level. \*\* Significant at the 0.05 level. \* Significant at the 0.10 level.

Overall, the findings indicate that *public exposure – scrutinised* companies resort to the tone of the report, whereas those with lower scrutiny rely on the readability of its reports. On this basis, the hypotheses are supported.

## 7. CONCLUSION

This research examines those companies with particular public attention (those having a low comparative tax payable as per mandated tax transparency report: '*public exposure – scrutinised*') compared to those without (higher comparative tax payable as per the mandated tax transparency report: '*public-exposure – low scrutiny*'). In examining signatories to the TTC, the authors ask, *does the level of public exposure (scrutinised/low scrutiny) arising from mandatory tax reporting impact readability and tone of voluntary tax reporting?* With such an inquiry, the article focuses on the interplay between public exposure via government intervention and voluntary tax reporting. The present study builds on the extant literature<sup>228</sup> by quantitatively measuring how companies are utilising VTRs to control the narrative.

Through examining the literature, the authors posit three key opportunities that entities have in controlling their tax narrative via VTRs:

1. The general lack of available tax information due to privacy regulations;
2. The lack of alignment between the accounting and taxation systems leading to a disconnectedness in available tax information; and
3. The general latitude available in voluntary disclosures.

With this in mind, the authors compare *public exposure – scrutinised* and *public exposure – low scrutiny* categories of companies, established using the *publicly acceptable threshold*.<sup>229</sup>

<sup>228</sup> See generally, Henry above n 16.

<sup>229</sup> The median ETR is consistent with Sidhu and Whittred's '*politically acceptable threshold*': Sidhu and Whittred, above n 32.

## 7.1 Main findings

This article reveals that *public exposure – scrutinised* companies resort to positive tone in tax reporting, whilst those with lower scrutiny rely on the readability of reports. While present literature concerning voluntary reporting notes that tone increases as firm performance increases,<sup>230</sup> the authors find that as the ETR increases, the tone of reports become more positive. This, on segregating the data based on public exposure, is most apparent for *public exposure – scrutinised* companies rather than *low scrutiny* companies. With regards to readability, the authors find that reports are more readable as the ETR increases. On segregating the data based on public exposure, this is seen as evident specifically for low scrutiny companies, inferring readability is associated with higher ETR. This finding is consistent with the study by Beuselinck and co-authors,<sup>231</sup> where it was noted that companies will rely less on obfuscation when there are small benefits to doing so and that *attention* leads to more readable financial statements. The authors therefore concur tentatively that '*obfuscation through complexity becomes less helpful*',<sup>232</sup> rather than '*complexity necessitates complexity*'.<sup>233</sup> Importantly, the authors of the present study find that companies instead turn to tone, therefore focusing on the sentiment of disclosures in their communication.

## 7.2 Tax policy implications

Existing literature suggests that negative media attention and investor reactions to the MTR are evident,<sup>234</sup> suggesting the potential incentive to manage the narrative, particularly those companies categorised as *public exposure – scrutiny* as these will not be *perceived* to meet threshold in terms of 'fair share' of tax in Australia. This is particularly concerning as there is also evidence that companies in Australia<sup>235</sup> (and abroad<sup>236</sup>) are attempting to avoid disclosure due to the anticipated costs of disclosure, and that the MTR scope may be too narrow to reveal planning activities.<sup>237</sup>

In identifying whether these firms are contributing their 'fair share' of tax, the findings in the article suggest that the tone and readability of the narrative that they are presenting will impact stakeholder *perceptions* of transparency, fairness, and accountability.<sup>238</sup> Through maintaining the disclosures as voluntary, therefore, the systemic issue of privacy could be aptly controlled by the firm itself. Firms publishing VTRs should be particularly cautious in their selection of language and text in preparing the reports for stakeholders.

The present study feeds into research seeking to identify key compliance motivators that enhance decision-useful information and tax planning strategies that benefit internal and external firm stakeholders, and also the efforts of policy-makers seeking to provide a better-defined motivation for Australian entities to partake in VTR and greater transparency in the incentives to do so.

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<sup>230</sup> Eg, Huang et al, above n 97.

<sup>231</sup> Beuselinck et al, above n 14, 5-6. See also Hope et al, above n 35, 181-182.

<sup>232</sup> Beuselinck et al, above n 14, 23.

<sup>233</sup> Guay et al, above n 138, 258.

<sup>234</sup> See generally Hoopes et al, above n 151.

<sup>235</sup> Ibid 143.

<sup>236</sup> See generally Chen, above n 152.

<sup>237</sup> Morton, 'Corporate Tax Transparency Reporting and Benford's Law', above n 22, 19-21. Discussed further in sections 6.1 and 7.2 above.

<sup>238</sup> Devos and Zackrisson, above n 5 (discussing the rationale underlying disclosure of taxation information).



The finding that *public exposure – scrutinised* companies resort to the use of positive tone in tax reporting, whilst those with lower scrutiny rely on the readability of reports raises some questions, and is consistent with the Senate Economics References Committee's concerns that firms that 'push the letter and spirit of the law' will not be incentivised 'to publish tax information'.<sup>239</sup> The three opportunities that this article outlines therefore highlight the challenges that policy-makers face in balancing the need for confidentiality and transparency when seeking to build confidence in the corporate tax system.<sup>240</sup>

Despite the tone and readability concerns (and putting aside confidentiality concerns), the question arises as to whether the reports are able to overcome the differences that arise from the lack of alignment between the accounting and taxation systems. Without the connection being readily understood, it is questionable whether MTRs *or* VTRs enable true *transparency* to be achieved. However, the authors do not see this as being ultimately a goal of the policy-makers or businesses, as the basic position in Australia for tax affairs begins with a position of confidentiality.

As Devos and Zackrisson have indicated,<sup>241</sup> the tax-culture setting is highly important to the response to increased disclosure. As such, tax policy needs to reflect this setting, with any additional disclosures at risk of adding to a web of potentially disconnected and incomplete picture. However, the MTRs could be seen as improving the tax disclosures (via VTRs), and albeit with the ability of businesses to control the narrative through tone and readability, add value to the information environment.

### 7.3 Limitations

There are a number of limitations to this study. There is a limited ability to assess the influence (as opposed to association) of the impact of MTR on the tone and readability of the VTRs due to the timing of commencement not allowing a formal pre/post assessment to be carried out. With the introduction of the TTC and VTRs, what is clear is the lack of commitment from businesses reflected in the small number of signatories to the TTC, although it is arguably still in its infancy with the number increasing. A small sample size and in-built selection bias create an unavoidable limitation to this study.

Furthermore, the way in which the MTR data is disclosed creates further limitations of scope, in that the report does not disclose entities with a tax refund or a nil tax position as well as the differences between an economic entity and a tax consolidated group.<sup>242</sup> As outlined in section 4, this article does not extend the analysis to consider tax aggressiveness of the firms, as the focus is on the *public perception* response. Since the MTRs reveal that certain entities have low cash tax payable, which may be genuine or reflective of aggressive strategies, a potential for increasing public scrutiny exists. This study is therefore limited in its ability to reflect on the source of the low cash tax payable that leads to public scrutiny.

### 7.4 Future research

A plethora of lines of future research stemming from the findings of this study exists, including an examination involving how government and legislative intervention

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<sup>239</sup> Senate Economics References Committee, *Corporate Tax Avoidance, Part 2*, above n 57, [3.12]-[3.13].

<sup>240</sup> Board of Taxation, above n 11, 5.

<sup>241</sup> Devos and Zackrisson, above n 5.

<sup>242</sup> See also sections 4, 5 and 6.1 of this article for further discussion.

impacts information disclosure – particularly in the COVID-19 and post COVID-19 environment. The transparency of corporate tax information is becoming increasingly important to satisfy both government and community requirements. The authors note, however, that the approach in which this is achieved needs to be carefully assessed to determine whether disclosures are appropriate and fit for purpose, offering numerous avenues for future research.

Further research should consider the alignment between the accounting and taxation systems, for example by assessing VTR output triangulated with the GPFS and MTR output. This would assist in assessing the extent to which complexity of disclosure regimes impacts the quality of information in a VTR. Moreover, examining company incentives behind signing on to the TTC will also be important, including determining to what extent they seek to control the narrative (for example, in order to manage reputational harm and to what extent the TTC allows for conservative voluntary disclosures to be made<sup>243</sup>), whether they perceive the disclosures as effective in better informing public scrutiny,<sup>244</sup> and whether the process underpinning the TTC is fostering an internal culture that is shifting towards public transparency.<sup>245</sup>

Additionally, expanding the analysis to examine the source of low (high) levels of tax payable is warranted, ie, examining whether proxies for tax aggressiveness impact the associations identified. As already indicated, this article does not extend the analysis to consider tax aggressiveness of the firms, as unlike in the study by Beuselinck and co-authors<sup>246</sup> it is considering *the public perception* response. Further research should consider the impact of tone and readability in relation to the MTR/VTR comparison, bringing in the aggressiveness variable.

In the above context, this research makes three contributions to the literature. First, the article extends existing research exploring complexity and VTR, falling within a contentious and critical area of thought: the corporate tax system. The TTC and its signatories create a novel data set, previously not available dealing with an area of business that faces particularly strong scrutiny: whether companies are *perceived* (or *actually*) contributing their ‘fair share’ of the tax burden. Secondly, the article extends existing research exploring readability and tone within the context of voluntary reporting. The authors find that the level of public exposure impacts the interplay between readability and tone of VTRs. Thirdly, this extends the research through considering how attention, such as government intervention, impacts such information disclosure. The authors posit that the interplay between MTR and VTR creates a positive outcome for limiting opportunities for obfuscation, supporting the hypotheses of the study. While the article sets out three key opportunities for companies to control the narrative, MTRs counter these opportunities, and despite the lack of alignment between MTRs and VTRs create a level of attention otherwise not present.

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<sup>243</sup> Graham et al, above n 159, 1000.

<sup>244</sup> Australian Treasury, above n 52, 11.

<sup>245</sup> Board of Taxation, above n 11.

<sup>246</sup> See generally Beuselinck et al, above n 14.

## APPENDIX

**Table A1: Critical Analysis of Disclosure Principles According to Devos and Zackrisson**

<b>Principle</b>	<b>Transparency</b>	<b>Tax Fairness</b>	<b>Accountability</b>	<b>Privacy</b>
<b>Disclosure/ Advantages</b>	<p>Regulators to supported in policing corporate governance.</p> <p>Improved functionality of financial markets.</p> <p>Promotion of tax compliance.</p> <p>Application of political pressure for good tax policy.</p>	<p>Provides the opportunity for tax authorities to reveal who are not paying their fair share.</p> <p>Perception of fairness created if community believes that public disclosure will improve compliance.</p>	<p>Increases accountability of governments.</p> <p>In a system that is built on self-assessment, disclosure increases the visibility of the tax authorities work as for example the ATO aggregate statistics does not reveal the reasoning underpinning (fairness) focus on certain taxpayers.</p>	<p>Query the reason for not asking nor searching for tax discrepancies due to privacy concerns.</p> <p>Privacy no longer plays a critical role in facilitating tax compliance.</p> <p>Disclosure serves as an 'automatic enforcement device'.</p> <p>Tax compliance tool for intentional and unintentional non-compliance.</p> <p>Enhance good governance and tax administration and productivity due to better ability to target taxpayers and use of limited resources.</p>
<b>Against Disclosure/ Dis-advantages</b>	<p>Inhibit confidentiality.</p> <p>Potential to create confusion amongst stakeholders.</p> <p>The provision of unbalanced power in favour of the Federal government.</p> <p>Unintended behavioural response from end-user.</p> <p>Disclosure level problems including that different taxpayers could become more transparent than others; variation in taxpayer disclosure; and uncertainty with regards required scope of taxpayer disclosure.</p>			<p>Enables the inflation of taxpayers' perceptions of probability of detection and expected costs of non-disclosure</p> <p>Alternatively, create tax-enforcement weaknesses and lower perceptions of the magnitude of penalties</p>

<b>Sources</b>	Lenter, Shackelford, and Slemrod (2003) <sup>247</sup>	Hite and Roberts (1992), <sup>248</sup> Chan, Troutman, and O'Bryan (2000), <sup>249</sup> Tan (1998) <sup>250</sup>	Kornhauser (2005) <sup>251</sup>	Blank (2011; 2013); <sup>252</sup> Kornhauser (2005), <sup>253</sup> Linder (1990), <sup>254</sup> Mazza (2003); <sup>255</sup> Schwartz (2008); <sup>256</sup> Thorndike (2009); <sup>257</sup> Bernasek (2010) <sup>258</sup>
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Source: adapted with reference to Devos and Zackrisson<sup>259</sup>

<sup>247</sup> David Lenter, Douglas Shackelford and Joel Slemrod, 'Public Disclosure of Corporate Tax Return Information: Accounting, Economics, and Legal Perspectives' (2003) 56(4) *National Tax Journal* 803.

<sup>248</sup> Peggy A Hite and Michael L Roberts, 'An Analysis of Tax Reforms Based on Taxpayers' Perceptions of Fairness and Self-Interest' (1992) 4 *Advances in Taxation* 115.

<sup>249</sup> Chris W Chan, Coleen S Troutman and David O'Bryan, 'An Expanded Model of Taxpayer Compliance: Empirical Evidence from the United States and Hong Kong' (2000) 9(2) *Journal of International Accounting, Auditing and Taxation* 83.

<sup>250</sup> Lin Mei Tan, 'Taxpayers' Perceptions of the Fairness of the Tax System – A Preliminary Study' (1998) 4 *New Zealand Journal of Taxation Law and Policy* 59.

<sup>251</sup> Marjorie E Kornhauser, 'Doing the Full Monty: Will Publicizing Tax Information Increase Compliance?' (2005) 18(1) *Canadian Journal of Law and Jurisprudence* 95.

<sup>252</sup> Joshua D Blank, 'In Defence of Individual Tax Privacy' (2011) 61 *Emory Law Journal* 265; Joshua D Blank, 'United States National Report on Tax Privacy' (New York University Law and Economics Working Paper No 332, 2013).

<sup>253</sup> Kornhauser, above n 251.

<sup>254</sup> Marc Linder, 'Tax Glasnost for Millionaires: Peeking Behind the Veil of Ignorance along the Publicity-Privacy Continuum' (1990) 18 *New York University Review of Law and Social Change* 951.

<sup>255</sup> Stephen W Mazza, 'Taxpayer Privacy and Tax Compliance' (2003) 51 *Kansas Law Review* 1065.

<sup>256</sup> Paul Schwartz, 'The Future of Tax Privacy' (2008) 61(4) *National Tax Journal* 883.

<sup>257</sup> Joseph J Thorndike, 'Show Us the Money' (2009) 123 *Tax Notes* 148.

<sup>258</sup> Anna Bernasek, 'Should Tax Bills Be Public Information?', *New York Times* (Online, 13 February 2010) 11.

<sup>259</sup> Devos and Zackrisson, above n 5, 110-111 (citations omitted).

**Table A2: VTRs and Summary of Outcomes**

		2014			2015			2016			2017			2018			Total	
Size	Disclosure	TR	TR	AR	CG	CSR	TR	Sub-total	AR	CG	CSR	TR	Sub-total	TR				
Large	Part A & B	1	4	3	0	5	49	57	6	0	2	51	59	1	122	83.0%		
	Part B	0	1	0	0	0	0	0	0	0	0	0	0	0	1	0.7%		
	Sub-total: Large	1	5	3	0	5	49	57	6	0	2	51	59	1	123	83.7%		
Medium	Part A & B	0	1	0	1	0	3	4	0	1	0	1	2	0	7	4.8%		
	Part A & Partially B	0	1	1	0	0	1	2	0	0	0	0	0	0	3	2.0%		
	Part A	0	0	2	0	0	3	5	2	0	0	0	2	0	7	4.8%		
	Sub-total: Medium	0	2	3	1	0	7	11	2	1	0	1	4	0	17	11.6%		
Neither	Part A & B	0	0	0	0	0	3	3	0	0	0	3	3	0	6	4.1%		
Nil*	Nil*	0	0	0	0	0	0	0	1	0	0	0	1	0	1	0.7%		
Total		1	7	6	1	5	59	71	9	1	2	55	67	1	147	100.0%		
		0.7%	4.8%	4.1%	0.7%	3.4%	40.1%	48.3%	6.1%	0.7%	1.4%	37.4%	45.6%	0.7%	100.0%			

PANEL A:  
SIZE BY DISCLOSURE

PANEL B: DISCLOSURE TYPE	Part A & B	1	5	3	1	5	55	64	6	1	2	55	64	1	135	91.8%
	Part A & Partially B	0	1	1	0	0	1	2	0	0	0	0	0	0	3	2.0%
	Part A	0	0	2	0	0	3	5	2	0	0	0	2	0	7	4.8%
	Part B	0	1	0	0	0	0	0	0	0	0	0	0	0	1	0.7%
	Nil*	0	0	0	0	0	0	0	1	0	0	0	1	0	1	0.7%
	Total	1	7	6	1	5	59	71	9	1	2	55	67	1	147	100.0%
PANEL C: REPORT TYPE	Stand Alone Tax Report (TR)	1	7	-	-	-	59	59	-	-	-	55	55	1	123	83.6%
	Within Annual Report (AR)	-	-	6	-	-	-	6	9	-	-	-	9	-	15	10.2%
	Within Corporate Governance Report (CG)	-	-	-	1	-	-	1	-	1	-	-	1	-	2	1.4%
	Within CSR/Sustainability Report (CSR)	-	-	-	-	5	-	5	-	-	2	-	2	-	7	4.8%
	Total	1	7	6	1	5	59	71	9	1	2	55	67	1	147	100.0%

\*Information missing from database.

**Table A3: Descriptive Statistics**

Variable	N	Range	Minimum	Maximum	Mean	Median	Std. Deviation
<b>JFreq Words</b>	106	10,615	147	10,762	2,239.78	1,826.00	1,809.99
<b>Ln(JFreq Words)</b>	106	4.29	4.99	9.28	7.499	7.509881712	0.64488
<b>Fog</b>	105	16.1	12.7	28.8	18.666	18.441	2.9439
<b>Flesch-Kincaid</b>	105	16.1	9.4	25.5	14.666	14.392	2.8081
<b>Tone</b>	106	0.047	-0.0177	0.0293	0.005985	0.005828	0.0067194
<b>Total Income \$000</b>	103	\$63,804,586	\$107,050	\$63,911,636	\$8,647,590	\$2,546,472	\$13,554,529
<b>Taxable Income \$000</b>	103	\$13,511,203	\$0	\$13,511,203	\$1,092,425	\$155,516	\$2,623,579
<b>Tax Payable \$000</b>	103	\$3,937,948	\$0	\$3,937,948	\$256,527	\$30,674	\$675,075
<b>Market Cap (1/6/2019) \$000</b>	73	\$138,320,099	\$661,901	\$138,982,000	\$19,883,172	\$9,056,500	\$28,288,462
<b>Ln(Total Income)</b>	103	6.39	18.49	24.88	21.9118	21.6580	1.37559
<b>Ln(Taxable Income)</b>	103	23.33	0	23.33	17.2287	18.8623	6.215
<b>Ln(Tax Payable)</b>	103	22.09	0	22.09	13.6419	17.2389	7.94421
<b>Ln(Market Capitalisation)</b>	73	5.35	20.31	25.66	23.0502	22.9267	1.12139
<b>Effective Tax Rate</b>	103	30%	0%	30%	17.63%	23.00%	12.01%
<b>Valid N (listwise)</b>	72						

**Table A4: Regressions****Panel A: Total Sample**

Variable	FOG			Flesch-Kincaid			Tone		
	Coef.	<i>t</i>	Sig.	Coef.	<i>t</i>	Sig.	Coef.	<i>t</i>	Sig.
<b>Constant</b>		3.110	0.003		2.396	0.019		0.401	0.689
<b>Ln(Market Capitalisation)</b>	0.106	0.863	0.391	0.143	1.169	0.246	0.147	1.332	0.187
<b>Effective Tax Rate</b>	- 0.246	- 2.136	0.036	- 0.251	- 2.186	0.032	0.414	4.005	0.000
<b>Ln(JFreq Words)</b>	- 0.265	- 2.172	0.033	- 0.279	- 2.294	0.025	- 0.328	- 2.998	0.004
<b>Adjusted R-Squared</b>	0.074			0.083			0.257		
<b>F-value</b>	2.890			3.129			9.188		
<b>Prob. F</b>	0.042			0.031			0.000		
<b>N</b>	106			106			106		

**Panel B: Public Exposure - Scrutinised**

Variable	FOG			Flesch-Kincaid			Tone		
	Coef.	<i>t</i>	Sig.	Coef.	<i>t</i>	Sig.	Coef.	<i>t</i>	Sig.
<b>Constant</b>		0.456	0.651		0.239	0.813		- 0.456	0.651
<b>Ln(Market Capitalisation)</b>	0.323	1.852	0.073	0.320	1.828	0.077	0.260	1.728	0.093
<b>Effective Tax Rate</b>	- 0.245	- 1.472	0.151	- 0.218	- 1.301	0.202	0.371	2.574	0.015
<b>Ln(JFreq Words)</b>	- 0.336	- 1.991	0.055	- 0.341	- 2.011	0.053	- 0.406	- 2.781	0.009
<b>Adjusted R-Squared</b>	0.086			0.079			0.318		
<b>F-value</b>	2.123			2.030			6.604		
<b>Prob. F</b>	0.116			0.129			0.001		
<b>N</b>	53			53			53		



**Panel C: Public Exposure - Low Scrutiny**

Variable	FOG			Flesch-Kincaid			Tone		
	Coef.	<i>t</i>	Sig.	Coef.	<i>t</i>	Sig.	Coef.	<i>t</i>	Sig.
<b>Constant</b>		4.442	-		3.786	0.001		0.519	0.607
<b>Ln(Market Capitalisation)</b>	- 0.166	- 0.924	0.363	- 0.079	- 0.438	0.664	0.059	0.311	0.758
<b>Effective Tax Rate</b>	- 0.282	- 1.708	0.098	- 0.315	- 1.908	0.066	0.096	0.555	0.583
<b>Ln(JFreq Words)</b>	- 0.159	- 0.881	0.385	- 0.182	- 1.008	0.321	- 0.274	- 1.452	0.157
<b>Adjusted R-Squared</b>	0.076			0.074			0.017		
<b>F-value</b>	1.935			1.908			0.806		
<b>Prob. F</b>	0.144			0.149			0.500		
<b>N</b>	50			50			50		