

[Home](#) > [Tax and Corporate Governance](#) > Conference paper

Financial and Tax Accounting: Transparency and “Truth”


| Conference paper

| pp 71–92 | [Cite this conference paper](#)



Tax and Corporate Governance

Judith Freedman

 Part of the book series: [MPI Studies on Intellectual Property, Competition and Tax Law](#) ((MSIP, volume 3))

 3766 Accesses  12 Citations

Abstract

In the USA there have been calls for greater conformity between the rules producing tax accounts and those used for financial reporting purposes. A number of benefits are claimed for this so-called “book-tax conformity”, including reduced compliance costs and better opportunities for monitoring. In Europe, the debate around use of the financial accounts for tax purposes has arisen from a different conceptual starting point as well as differences in surrounding circumstances. Linkage between tax and financial accounts is common in Europe, although it takes varying forms. This does not result in complete book-tax conformity,

however, and recent developments in accounting may be increasing divergence rather than reducing it. Despite the strong arguments in favor of conformity, there are also good reasons for some divergences, meaning that the most likely outcome in any system, whatever the starting point, is partial convergence. The problem with a hybrid outcome of this kind is that, at the point of divergence, there can be conceptual confusion and difficulties in integrating and managing two conceptually very different rule systems. Clarity of the relationship between the rules and improved accounting disclosure requirements might be more important than convergence, and might be achieved with less distortion to either tax or financial accounting. The current U.K. position is used to illustrate these points.

The author thanks the organizers and participants of the Symposium on Tax and Corporate Governance at the Max Planck Institute for Intellectual Property, Competition and Tax Law in Munich for the helpful discussion. She has also benefited from the Kari Tikka Memorial Lecture delivered by Professor Claes Norberg at the University of Helsinki in June 2007 and the debate which followed.

 This is a preview of subscription content, [log in via an institution](#)  to check access.

Access this chapter

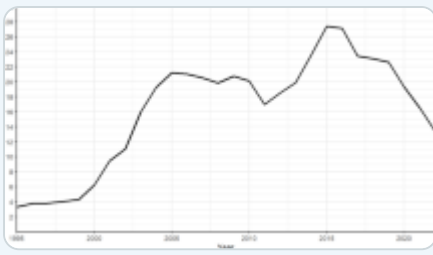
Log in via an institution →

[Institutional subscriptions](#) →

Preview

Unable to display preview. [Download preview PDF.](#)

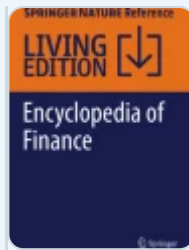
Similar content being viewed by others



Accounting regulation in the European Union

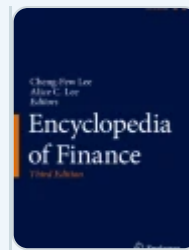
Article | Open access

12 August 2025



Applications of Book-Tax Difference in Accounting and Finance Research

Chapter | © 2021



Applications of Book-Tax Difference in Accounting and Finance Research

Chapter | © 2022

Explore related subjects

Discover the latest articles, books and news in related subjects, suggested using machine learning.

[Accounting](#)

[Business Taxation and Tax Law](#)

[Financial Law](#)

[Fiscal Law](#)

[Public Accounting](#)

[Financial Accounting](#)

References

1 KING/ THORNHILL, Niklas Luhmann's Theory of Politics and Law (2003).

[Google Scholar](#)

3 MILLER, Accounting as Social and Institutional Practice: an Introduction, in: HOPWOOD/MILLER (eds.), Accounting as Social and Institutional Practice, 13 (1994).

[Google Scholar](#)

5 For some of the literature on this debate see KNOTT/ROSENFELD, Book and Tax: A Selective Exploration of Two Parallel Universes, pts 1 & 2, 99 Tax Notes 865 and 1043 (2003); DESAI, The Degradation of Reported Corporate Profits, SSRN working paper (2005) (available at <http://ssrn.com/abstract=758144>) and DESAI/DHARMAPALA, Tax and Corporate Governance: An Economic Approach,

in this volume, at 13; HANLON/SHEVLIN, Book-Tax Conformity for Corporate Income: An Introduction to the Issues, NBER Working Paper No 11067 (2005); PLESKO/MILLS, Bridging the Reporting Gap: A Proposal for more Informative Reconciling of Book and Tax Income, 56 National Tax Journal 4 (2003); JOINT COMMITTEE ON TAXATION, Staff Report, Present Law and Background Relating to Corporate Tax Reform: Issues of Conforming Book and Tax Income (2006) (available at www.house.gov/jct/x-16-06.pdf#search=%22staff%20of%20joint%20committee%20on%20taxation%20book%20tax%20conformity%22); WALKER, Financial Accounting and Corporate Behavior, Boston Univ. School of Law Working Paper No. 06-05 (2006) (available at SSRN: <http://ssrn.com/abstract=894002>).

[Google Scholar](#)

6 *See* SCHÖN, International Accounting Standards — A “Starting Point” for a Common European Tax Base?, 44 European Taxation 426 (2004); SCHÖN, The Odd Couple: A Common Future for Financial and Tax Accounting?, 58 Tax Law Review 111 (2005); FREEDMAN, Aligning Taxable Profits and Accounting Profits: Accounting Standards, Legislators and Judges, 2 eJournal Tax Research 71 (2004). *See also* the debate on a Common Consolidated Corporate Tax Base, discussed below.

[Google Scholar](#)

8 For further discussion of this problem *see* FREEDMAN, The Tax Avoidance Culture: Who is Responsible?, in: HOLDER/O’CINNEIDE (eds.), Current Legal Problems 2006 (2007).

[Google Scholar](#)

9 TAX JUSTICE NETWORK, Mind the Tax Gap (2006).

[Google Scholar](#)

10 NATIONAL AUDIT OFFICE, HM Revenue & Customs Management of large

business Corporation Tax, HC 614 Session 2006–2007, (The Stationery Office) July 2007; HOULDER, “One-third of biggest U.K. businesses pay no tax”, Financial Times, August 28, 2007.

[Google Scholar](#)

- 11 For a much more sophisticated use of the book-tax gap to construct a proxy for tax avoidance in the USA, which attempts to isolate only that part of the book-tax gap not attributable to accounting accruals see DESAI/DHARMAPALA, Corporate Tax Avoidance and High Powered Incentives, 79 Journal of Financial Economics 145 (2006); DESAI/DHARMAPALA, *supra* note 5. The difficulties involved in producing these figures are discussed in depth in HANLON/SHEVLIN, *supra* note 5.

[Article](#) [Google Scholar](#)

- 13 See MILLER, *supra* note 3; HICKS, Maintaining capital intact: a further suggestion, *Economica* IX 174-79 (1942), cited in: MACDONALD, *HMRC v William Grant & Sons Distillers Ltd and Small (Inspector of Taxes) v Mars U.K. Ltd*: accountancy practice and the computation of profit, 2007 British Tax Review 366.

[Google Scholar](#)

- 14 Adam Smith’s Canons of Taxation, SMITH, The Nature & Causes of the Wealth of Nations, Book V, Chap. 11, Part II “Of Taxes”, paras. 1–7.

[Google Scholar](#)

- 15 Deborah Schenk argues that the justifications for the realization rule are not as persuasive as has been thought, but even she agrees that there are valuation and political difficulties in taxing paper gains, making it difficult to abandon realization as a basis for taxation; SCHENK, A Positive Account of the Realization Rule, 57 Tax Law Review 355 (2004).

[Google Scholar](#)

17 See WILSON, Financial Reporting and taxation: marriage is out of the question, 2001 British Tax Review 86; PATERSON, A taxing problem, 130 Accountancy Magazine 94 (11/2002).

[Google Scholar](#)

19 WILSON, *supra* note 17; NOBES, A Conceptual Framework for the Taxable Income of Businesses, and How to Apply it under the IFRS, 38 (2003).

[Google Scholar](#)

20 HANLON/ SHEVLIN, *supra* note 5.

[Google Scholar](#)

21 For details of the U.S. standard setting structure *see* KNOTT/ROSENFELD, *supra* note 5.

[Google Scholar](#)

23 Cited in PLESKO/MILLS, *supra* note 5.

[Google Scholar](#)

24 HUGHES, "What do users really want from 'fair value' accounting?", Financial Times, September 13, 2007.

[Google Scholar](#)

27 There was strong resistance to IAS 39 in Europe for this reason, spearheaded by French banks: MURRAY/CLARK, IAS 39, cash flow hedges and tax, 8 Financial Instruments Tax and Accounting Review 1 (2003); PARKER, "Compliance costs soar for new IAS rules", Financial Times, November 24,

2003. This forced an amendment of IAS 39 by the IASB to enable the European Commission to adopt the standard.

[Google Scholar](#)

28 HUGHES, *supra* note 24.

[Google Scholar](#)

29 HUGHES, "Former KPMG head calls for fix in system", Financial Times, October 11, 2007.

[Google Scholar](#)

30 See Global Capital Markets and the Global Economy: A Vision From the CEOs of the International Audit Networks (2006) (available at [www.deloitte.com/dtt/cda/doc/content/dtt_CEOVision110806\(2\).pdf](http://www.deloitte.com/dtt/cda/doc/content/dtt_CEOVision110806(2).pdf)).

[Google Scholar](#)

31 This seems to be the assumption of the U.K. Government in their consultation papers on Corporation Tax Reform, supporting alignment: Inland Revenue and H.M. Treasury (2002) Reform of Corporation Tax (London); Inland Revenue and H.M. Treasury (2003) Reform of Corporation Tax, London.

[Google Scholar](#)

32 See HANLON/SHEVLIN, *supra* note 5.

[Google Scholar](#)

33 HOOGENDOORN, Accounting and Taxation in Europe-A Comparative Overview, 5 The European Accounting Review, Supplement 783 (1996).

[Google Scholar](#)

34 HOOGENDOORN, *id.*

[Google Scholar](#)

35 See SCHÖN, The Odd Couple, *supra* note 6.

[Google Scholar](#)

37 *Thor Power Tool Co. v Commissioner*, 439 US 522 (1979) and see SCHÖN, The Odd Couple, *supra* note 6.

[Google Scholar](#)

39 For some cases where the courts have not followed accounting practice in assessing taxable income see *Minister of National Revenue v Anaconda*, [1956] AC 85; *Sharkey v Wernher*, [1956] AC 58; *BSC Footwear Ltd v Ridgway*, 1971 2All ER 534 (HL); *Willingale v International Commercial Bank Ltd.*, [1978] 1 All ER 754; however there is debate about the rationale for some of these decisions.

[Google Scholar](#)

41 HERZIG, Tax versus Commercial Accounting in Germany, in: THORELL (ed.), The Influence of Corporate Law and Accounting principles in determining Taxable Income, IFA Congress 1996, Vol. 21b (1996).

[Google Scholar](#)

42 SCHÖN, International Accounting Standards, *supra* note 6; and SCHÖN, The Odd Couple, *supra* note 6.

[Google Scholar](#)

43 NORBERG, Kari Tikka Memorial Lecture, EATLP Helsinki, June 2007.

[Google Scholar](#)

44 H. R May 8, 1957, BNB 1957/208; information taken from a questionnaire prepared by Dr. R. Russo of Tilburg University.

[Google Scholar](#)

[Google Scholar](#)

46 EUROPEAN COMMISSION: Table on use of IAS in the EU (2006) (*see* http://ec.europa.eu/internal_market/accounting/docs/ias/ias-use-of-options_en.pdf).

[Google Scholar](#)

47 ASB, Convergence of U.K. standards with IFRS (2006) (*see* www.frc.org.uk/asb/technical/projects/project0072.html).

[Google Scholar](#)

49 NORBERG, *supra* note 43.

[Google Scholar](#)

52 KNOTT/ ROSENFELD, *supra* note 5, at 1060.

[Google Scholar](#)

54 *See supra* note 4, and SCHÖN, International Accounting Standards, *supra* note 6.

[Google Scholar](#)

55 EU COMMISSION STAFF, working paper, Company Taxation in the Internal Market, SEC(2001) 1681, 322-324 (2001) (available at http://ec.europa.eu/taxation_customs/resources/documents/company_tax_study_en.pdf).

56 For example the European Commission in its proposals for a consolidated tax base: *see* European Commission Consultation Document, The application of International Accounting Standards in 2005 and the implications for the introduction of a consolidated tax base for companies' EU-wide activities (2003) and EUROPEAN COMMISSION, Summary report on results of consultation (2003) (both to be found on www.europa.eu.int/comm/taxation_customs/taxation/consultations/ias.htm); Communication from EU Commission (2003) (COM 2003 726 final) An Internal Market without company tax obstacles: achievements, ongoing initiatives and remaining challenges (*see* http://europa.eu.int/eur-lex/en/com/cnc/2003/com2003_0726en01.pdf).

[Google Scholar](#)

57 Commission Non-Paper to informal Ecofin Council, September 10 and 11, 2004, A Common Consolidated EU Corporate Tax Base (*see* http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/CCTBWPNon_Paper.pdf).

[Google Scholar](#)

58 European Commission CCCTB Working Group, Possible Elements of a Technical Outline, CCCTB/WP057\doc\en, July 26, 2007 (available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/CCCTBWP057_en.pdf).

[Google Scholar](#)

59 Testimony of Mihir A. Desai before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate, June 5, 2007 (*see* www.people.hbs.edu/mdesai/DesaiTestimony060507.pdf).

[Google Scholar](#)

62 Corporate debt and currency accounting (Finance Act 1996 as amended by Finance Act 2002); derivatives (Schedule 26 Finance Act 2002); intangibles (Schedule 29 Finance Act 2002). *See* MACDONALD/MARTIN, Taxing Corporate Gains: Proposals for Reform, 2005 British Tax Review 628, for proposals to further align capital gains taxation with corporation tax. These proposals have not been adopted to date.

[Google Scholar](#)

63 For an example *see* the Finance Act 2006 definition of funding leases which goes beyond the accounting definition of finance lease: CARSON, Traditional Equipment Leasing, The Tax Journal, October 23, 2006, 11.

[Google Scholar](#)

65 For a more detailed history of the introduction of this provision *see* FREEDMAN, *supra* note 6.

[Google Scholar](#)

68 *See Gallagher v Jones* [1993] STC 537; other cases discussed in FREEDMAN, *supra* note 6. For a contrary view *see* FREEDMAN, Ordinary Principles of Commercial Accounting—Clear Guidance or a Mystery Tour?, 1993 British Tax Review 468.

[Google Scholar](#)

69 [2007] UKHL 15.

[Google Scholar](#)

70 MACDONALD, *supra* note 13.

[Google Scholar](#)

71 [2004] STC (SCD) 253.

[Google Scholar](#)

72 [2005] STC 958.

[Google Scholar](#)

73 [2006] STC 69.

[Google Scholar](#)

74 For some examples of such cases *see* FREEDMAN, *supra* note 6. On the question of the capital/revenue divide being a question of law *see* the unequivocal statement of Lord Denning in *Heather v P E Consulting Group Ltd*, [1972] 48TC293: “The courts have always been assisted greatly by the evidence of accountants. Their practice should be given due weight; but the courts have never regarded themselves as being bound by it. It would be wrong to do so. The question of what is capital and what is revenue is a question of law for the courts. They are not to be deflected from their true course by the evidence of accountants, however eminent”.

[Google Scholar](#)

75 For a detailed account of the older cases *see* FREEDMAN, Profit and Prophets — Law and Accountancy on the Timing of Receipts, two parts, 1987 British Tax Review 61 and 104.

[Google Scholar](#)

76 (1972) 47 TC 495 (Lord Reid, dissenting, but not on principles).

[Google Scholar](#)

77 [1973] Ch 288, 48 TC 257 (Pennycuik VC at first instance).

[Google Scholar](#)

79 As J. Collins and D. Dixon commented in COLLINS/DIXON, Open and Shut case?, The Tax Journal, April 9, 2007, 6, their Lordships made the case seem so simple that they left us with a real problem to understand why it ever got as far as it did; this suggests some over-simplification of the issues.

[Google Scholar](#)

80 [1956] AC 85.

[Google Scholar](#)

81 Following this decision, LIFO was rarely considered to be good accounting practice either: contrast the U.S. where LIFO appears to have been used for tax reasons and attempts to limit this by a statutory conformity requirement failed because everyone accepted that this figure would be tax driven and accounts provided additional information in other ways; *see* SHAVIRO, The Optimal Relationship between Taxable Income and Financial Accounting Income: Analysis and a Proposal, NYU Law & Economics Working Paper No. 07-38 (2007) (available at <http://ssrn.com/abstract=1017073>).

[Google Scholar](#)

82 The attempts of the lower courts to introduce their own analysis were subject to a considerable amount of criticism from accountants in the professional press but it was mainly accountants who commented and, arguably, they did not understand the legal perspective. *See* TRUMAN, Mars barred, Taxation, June 30, 2005; Accounts don't contain whisky, Taxation, October 27, 2005; WINGFIELD in The Tax Journal, April 12 and 19, 2004 and April 25, 2005.

[Google Scholar](#)

83 KING/ THORNHILL, *supra* note 1, and see the discussion of systems theory in FREEDMAN, *supra* note 6, at 96 and below.

[Google Scholar](#)

85 As explained by Lightman J [2005] STC 958 at para. 39.

[Google Scholar](#)

86 [2005] STC 958 at para. 36.

[Google Scholar](#)

87 *See supra* note 74.

[Google Scholar](#)

88 *See* TRUMAN, *supra* note 82.

[Google Scholar](#)

89 [2004] STC (SCD) 253 at para. 267.

[Google Scholar](#)

90 Similarly in the case of *Gallagher v Jones*, accounting standards were in fact followed only in part — *see* FREEDMAN, *supra* note 68.

[Google Scholar](#)

91 *See supra* note 68.

[Google Scholar](#)

92 *Id.*, at 544, line h. In another case dealing with the conversion of rental payments into a capital lump sum by way of assignment, the entire question

was treated as one of law, to the surprise of the dissenting judge in the Court of Appeal, Arden LJ, who thought that the accountancy treatment was a relevant consideration: *IRC v John Lewis Properties*, [2003] STC 117. Legislation has not introduced a solution to the issue addressed in that case which comes close to the accounting treatment. 93 Finance Act 2006, Schedule 8 amending Capital Allowances Act 2001.

[Google Scholar](#)

94 For examples of such a response under the present system, *see*, in addition to *Gallagher v Jones*, the cases on “judicial gap filling” discussed in FREEDMAN, *supra* note 6, at 87 *et seq.*

[Google Scholar](#)

95 KING/ THORNHILL, *supra* note 1, at 26-27; NOBLES/SCHIFF, *A Sociology of Jurisprudence* (2006).

[Google Scholar](#)

96 KING/ THORNHILL, *id.*

[Google Scholar](#)

98 DESAI/ DHARMAPALA, *supra* note 5; DESAI, *supra* note 59.

[Google Scholar](#)

99 *See* SHAVIRO, *supra* note 81, who considers the difficulties created by conformity make it inferior to partial conformity. By this he means, however, a form of partial conformity, this would not be based on altering the detailed rules for profit computation but would take the form of an adjustment of the final figures. This is a practical proposal to address the tax avoidance problem although the rationale is not entirely clear. If it is reasonable to have a tax base which differs from the financial accounting base, why should it be

justifiable to have an adjustment? *See* also MCCLELLAND/MILLS, Weighing Benefits and Risks of Taxing Book Income, 2007 TNT 35-61, Special Reports.

[Google Scholar](#)

100 HUBBARD (panel member), Presentation on Tax Accounting versus Commercial Accounting, IFA Congress 2006.

[Google Scholar](#)

101 KNOTT/ ROSENFELD, *supra* note 5, Part II, discuss the issues of publication of tax returns and the Schedule M-1 reconciliation of book and tax accounts. *See* also MANZON/PLESKO, The Relation Between Financial and Tax Reporting Measures of Income, 55 Tax Law Review 175 (2002); LENTER/SLEMROD/SHACKLEFORD, Public Disclosure of Corporate Tax Return Information: Accounting, Economics and Legal Perspectives, 56 National Tax Journal 803 (2003).

[Google Scholar](#)

103 NATIONAL AUDIT OFFICE, *supra* note 10.

[Google Scholar](#)

Author information

Authors and Affiliations

Taxation Law in the Law Faculty, Oxford University, Oxford

Judith Freedman (KPMG Professor)

Editor information

Editors and Affiliations

Rights and permissions

[Reprints and permissions](#)

Copyright information

© 2008 Springer-Verlag Berlin Heidelberg

About this paper

Cite this paper

Freedman, J. (2008). Financial and Tax Accounting: Transparency and “Truth”. In: Schön, W. (eds) Tax and Corporate Governance. MPI Studies on Intellectual Property, Competition and Tax Law, vol 3. Springer, Berlin, Heidelberg. https://doi.org/10.1007/978-3-540-77276-7_6

[.RIS↓](#) [.ENW↓](#) [.BIB↓](#)

DOI	Publisher Name	Print ISBN
https://doi.org/10.1007/978-3-540-77276-7_6	Springer, Berlin, Heidelberg	978-3-540-77275-0

Online ISBN	eBook Packages
978-3-540-77276-7	Business and Economics
	Business and Management (R0)

Keywords

[Supra Note](#)

[Accounting Standard](#)

[Financial Account](#)

[Accounting Practice](#)

[Financial Account Standard Board](#)

These keywords were added by machine and not by the authors. This process is experimental and the keywords may be updated as the learning algorithm improves.

Publish with us

[Policies and ethics](#) 

Search

Search by keyword or author



Navigation

Find a journal

Publish with us

Track your research