TLIP: Lip service or in service?
A review of the non-commercial loss and STS measures against the TLIP principles

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Abstract
In order to address criticisms about the extraordinary complexity of the Australian income tax system, the Federal Government embarked on an ambitious mission in the mid-1990s to simplify the income tax legislation. Part of this response was the creation of the Tax Law Improvement Project (‘TLIP’) taskforce to rewrite the Income Tax Assessment Act 1936 (‘the 1936 Act’) into plain English. The rewrite project was to have been accorded priority until its ultimate completion; however, in 1998 there was a major diversion of resources away from the income tax act’s rewrite in order to implement the new Tax Reform measures. This resulted in the rewrite project being set aside and left incomplete; yet, new provisions have continued to be inserted into the Income Tax Assessment Act 1997 (‘the 1997 Act’).

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Whilst the mandate of the TLIP taskforce was only to simplify the legislation through improving readability without effecting any major policy changes, it is nonetheless submitted that the project still made a valuable contribution to the process of income tax simplification by devising a set of drafting techniques that improve the readability of tax legislation. Readability is linked to improved taxpayer compliance by increasing the capacity and willingness of taxpayers to comply with tax laws through reducing the compliance costs necessary to understand and work with the legislation.

This paper examines whether the TLIP drafting principles are still being applied when new legislative tax provisions are drafted. This examination is desirable because considerable resources have already been invested into developing this arguably successful method of drafting simpler tax legislation. If this is the case these drafting principles should continue to be applied to new tax legislation in order to achieve more readable tax legislation, which is linked to reduced compliance costs and increased compliance. The results of this study will indicate that the TLIP drafting principles are being applied to the new legislative provisions studied, and that the resulting readability is of an arguably acceptable standard for professional users. However, the readability of supporting material such as public rulings was found to be more difficult overall than legislation. Given that the supporting material is intended to aid the understanding of the legislative provisions, this finding is of concern; although it may be that the difficulties in synthesising the application of the law to factual scenarios, as well as the need to protect taxpayer privacy are the main causes for this phenomenon.

I. Introduction

‘Report after report for the commonwealth has earnestly rehashed Adam Smith’s taxation golden rules of equity, economy and simplicity, and government after government has piled tax on tax, concession on concession, and ruling on ruling to create a 10,000-page monster that no practitioner can master.’

In response to criticisms levelled at the extraordinary complexity of the Australian income tax system, the Federal Government embarked on an ambitious mission in the mid-1990s to simplify the tax legislation. Part of this response was the Tax Law Improvement Project’s (TLIP) procedure whereby the Income Tax Assessment Act 1936 (‘the 1936 Act’) was to be

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The original timeframe for completion of the project was to have been three years from 1 July 1994: Tax Law Improvement Project, above n 2, p 3.

The new Tax Reform measures were announced by the government on 13 August 1998 in Tax Reform: Not a New Tax – A New Tax System (‘ANTS’). New measures other than the introduction of the GST included the introduction of the Simplified Imputation System; and extended capital gains tax (‘CGT’) rollover relief and retirement exceptions for small business; as well as moves to reducing the company tax rate to 30 per cent. See Treasurer (1998) Tax Reform: Not a New Tax – A New Tax System, Treasury, AGPS, pp 17 – 24.


into the new *Income Tax Assessment Act 1997* (‘the 1997 Act’); even though the actual rewrite of the 1936 Act has ceased.

Various studies have since examined whether the rewrite actually simplified the tax law,\(^9\) with readability of the 1997 Act found to be improved compared to that of the 1936 Act, but still not at a level to be easily comprehensible.\(^{10}\) In response, several observers have asserted that tax legislation cannot be simplified by addressing the readability of the legislation alone.\(^{11}\) What is thought to be required is a simplification of the underlying policies of the legislation made in conjunction with the use of simplified drafting techniques.\(^{12}\) Whilst the mandate of the TLIP taskforce was only to simplify the legislation through improving readability without effecting any major policy changes,\(^{13}\) it is nonetheless submitted that the project still made a valuable contribution to the process of income tax simplification by devising a set of drafting techniques that are designed to increase the readability of tax legislation.

The purpose of this paper is to examine whether the TLIP drafting principles are still being applied when new legislative provisions, rather than a rewrite of provisions in the 1936 Act, are being enacted into the

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\(^{10}\) David Smith and Grant Richardson (1999) ‘Keeping it ‘simple’ – assessing TLIP’ 69 *Australian CPA* 58. The researchers compared the readability of 95 sections from the 1997 Act against the corresponding sections from the 1936 Act. The level of readability of the rewritten sections was found to be marginally better; however, the new sections were still considered to be difficult to read.


1997 Act post-TLIP. This examination is important because having already invested considerable resources into developing a method of drafting simpler tax legislation; the Government should ensure that new tax provisions are modelled on these drafting principles in order to optimise readability of the legislation. This is particularly desirable as simpler tax legislation is linked to reduced compliance costs and increased compliance, and therefore improves the efficiency of the tax system. It is submitted that this outcome is an essential component in improving compliance.

First, this paper will outline the actual drafting principles that were identified by the TLIP taskforce as being more likely to result in tax legislation being presented in a more attractive simplified form. The role of the TLIP in attempting to simplify the original income tax legislation will also be discussed.

Then, an examination of the premises behind tax law simplification will be undertaken, along with an analysis of the rule of law in relation to taxation, since the element of simplicity is inextricably linked to the rule of law.

Next, two of the recent measures that have been legislated into the 1997 Act will be examined in order to ascertain whether the TLIP drafting principles have continued to be applied to new tax legislative provisions enacted post-TLIP. The two measures that have been selected for analysis are the non-commercial loss provisions and the Simplified Tax System (STS) regime, both of which pertain to small business taxpayers. However, the background to the introduction of these provisions will be outlined first, along with a brief overview of the operation and effect of these provisions and their relevance to small businesses. Measures applicable to small businesses were chosen as compliance costs are not only regressive for these taxpayers, but they are ill-equipped to deal with these costs and associated obligations. Consequently, the adoption of TLIP principles in drafting new tax legislation is more pertinent for these taxpayers.

Finally, to analyse whether the TLIP drafting principles were utilised when the non-commercial loss and STS provisions were drafted, this

14 Michael Kobetsky et al, above n 2, p 5.
15 The commercial loss provisions are contained in Division 35 of the 1997 Act, and the STS measures are contained in Division 328 of the same Act.
paper will measure the readability of the legislation utilising the Flesch Readability Index. Additionally, a subjective analysis of whether the TLIP drafting principles were adhered to when the provisions were enacted will be undertaken. Since the TLIP drafting principles were intended to be applied to all subsequent tax legislative provisions, as well as to the whole range of supplementary material available such as tax public rulings and explanatory memoranda, these other publicly available documents will also be assessed for readability.

Through this analysis it will be concluded that the TLIP drafting principles have been utilised for the legislation studied. However, the readability of supporting material, especially public rulings and Interpretive Decisions, appears more difficult than their legislative counterparts.

2. The Tax Law Improvement Project

‘... the extent to which innovative techniques have been used in the rewrite is probably unprecedented in modern legislation.’

The Government set out to simplify the tax legislation in the early 1990s as a response to the many criticisms that had been levelled at the extraordinary complexity of the income tax system. As part of this simplification process, the TLIP taskforce was formed in order to ‘makeover’ the 1936 Act by the means of a plain English rewrite. This rewrite was desired as the clarity of language and form of expression used in tax legislation and other documentation is crucial in facilitating a greater ease of understanding of the associated concepts and requirements. Simplicity in expression is particularly important in the tax arena, since tax complexity increases the associated compliance costs for both taxpayers and tax administrators.

17 The Flesch Readability Index is the tool that is commonly used to quantitatively assess the level of simplicity of tax legislation in terms of its readability, with simplicity being positively correlated to readability.
19 JW Durack, above n 11, p 164.
Commentators have expressed many concerns over the observation that the complexity of tax legislation precludes taxpayers from being able to comply fully with their obligations under the law.\textsuperscript{23} Given that Australia’s self-assessment system relies on voluntary compliance, it is imperative that the intent of the Government in forming tax laws is expressed in clear and certain language.\textsuperscript{24} It is submitted that for a tax system to be effective and efficient, taxpayers must be able to understand the requirements of the law, which in turn requires that the law must be expressed in a readable manner.

2.1 Background to the Project

The Government announced in late 1993 that it would be establishing the TLIP task force to rewrite the 1936 Act in direct response to a recommendation made by the Joint Committee of Public Accounts.\textsuperscript{25} The TLIP task force was established and funded from 1 July 1994 with a budget of $40 million and over 40 full time staff.\textsuperscript{26} Their goal was to redraft the 1936 Act over a three-year period.\textsuperscript{27} Unfortunately due to the need to redirect resources into establishing the tax reforms made pursuant to the new Tax Reform and Ralph Report recommended measures, only three instalments of the TLIP activity were produced before the project ceased.\textsuperscript{28}

The aims of the project were to rewrite the 1936 Act into plain English, and to reduce the length of the income tax legislation through redrafting

\begin{itemize}
\item\textsuperscript{23} For example, see Robert Couzin, above n 21, p 491.
\item\textsuperscript{25} The Joint Committee of Public Accounts in Recommendation 22 of their report (The Parliament of the Commonwealth of Australia and the Joint Committee of Public Accounts (1993) Report No. 326 An Assessment of Tax: A Report on an Inquiry into the Australian Taxation Office, Australian Government Publishing Service) suggested that the government should create a taskforce to complete a full simplification redraft of the ITAA 1936 within five years. See Michael Kobetsky et al, above n 2, p 4 for more information.
\item\textsuperscript{26} Michael Kobetsky et al, above n 2, p 4; and Simon James et al, above n 12, p 32.
\item\textsuperscript{27} See Tax Law Improvement Project, above n 2, p 3.
\item\textsuperscript{28} Michael Kobetsky et al, above n 2, p 4. The three instalments of the income tax legislation that were rewritten before activity on the TLIP ceased were the provisions on substantiation, deductible expenses, and CGT.
\end{itemize}
the provisions into a more coherent structure.\textsuperscript{29} Whilst the audience the rewrite was directed at were primarily tax professionals, upon whom the duty would fall to advise individual taxpayers of their rights and obligations;\textsuperscript{30} it was contended that individual taxpayers would still benefit from the rewrite through decreased compliance costs.\textsuperscript{31} It was acknowledged that it would not be possible to completely simplify the tax law, given that a fair proportion of complexity inevitably results from commercial reality.\textsuperscript{32}

2.2 The TLIP Drafting Principles
Before work was started on rewriting the 1936 Act, the TLIP taskforce invested considerable resources into reviewing communication and writing theory, which they then applied to legislative drafting.\textsuperscript{33} The resulting drafting principles elucidated were described as ‘a truly revolutionary new style for writing legislation.’\textsuperscript{34} However, the drafting principles were not received without some criticisms; particularly in regard to the mandate of the TLIP taskforce being only to simplify the legislation through improving readability without effecting any major policy changes.\textsuperscript{35}

Based on the information contained in the Explanatory Memorandum to the \textit{Income Tax Assessment Bill 1996}, it is submitted that the four drafting features of structure, numbering, language, and layout are the ‘TLIP drafting principles’.\textsuperscript{36} These four drafting principles will be utilised later to determine whether the non-commercial loss and STS measures have been drafted in accordance with these principles.

\textsuperscript{31} Trevor Boucher, above n 18, p 279.
\textsuperscript{32} Brian Nolan and Tom Reid, above 29, p 449.
\textsuperscript{33} Richard Krever, above n 12, p 492.
\textsuperscript{34} Richard Krever, above n 12, p 492.
\textsuperscript{36} See The Parliament of the Commonwealth of Australia, above n 30.
Structure
The TLIP taskforce stated that the best way to achieve a logical and flexible structure to underpin legislation was to arrange the concepts in a pyramid structure as depicted below:\textsuperscript{37}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{pyramid_structure.png}
\caption{Diagram of the TLIP pyramid structure.}
\end{figure}

The pyramid structure operates so that the basic or core concepts of the tax law, such as whom the legislation applies to, and how to use it are situated at the start of the legislation.\textsuperscript{38} That is, the reader will enter the Act at the beginning, through the top of the pyramid.\textsuperscript{39} These core provisions are then followed by the general provisions that provide the rules which are applicable to most taxpayers, such as the specification of what is included in income.\textsuperscript{40} Then the third layer of the pyramid specifies the specialist provisions, which describe situations and obligations that relate to specific groups of taxpayers, such as capital gains tax or trust distributions.\textsuperscript{41} Not depicted on the diagrammatical version of the pyramid above, but included in the TLIP structure, are the following three layers. These are the collection and recovery of tax provisions, which are followed by the administrative provisions, and then finally the main definition section which forms the

\begin{itemize}
\item \textsuperscript{37} Tax Law Improvement Project, above n 2, p 7.
\item \textsuperscript{38} The Parliament of the Commonwealth of Australia, above n 30, Chapter 2.
\item \textsuperscript{39} The Parliament of the Commonwealth of Australia, above n 30, Chapter 2.
\item \textsuperscript{40} The Parliament of the Commonwealth of Australia, above n 30, Chapter 2.
\item \textsuperscript{41} The Parliament of the Commonwealth of Australia, above n 30, Chapter 2.
\end{itemize}
base of the pyramid. All words used that needed defining were to be marked with an asterisk to indicate that they were defined in the dictionary at the rear of the Act.

Furthermore, orientation material, guides and theme statements were to be written in plain English and placed at the beginning of new divisions in order to give the reader an overview of the operation and structure of the legislation.

**Numbering**
The key element of the new section numbering system was the use of two components separated by a dash, which is known as bifurcation. The first component identifies the Division number, whilst the second component indicates the section number within the Division. The bifurcation numbering system would also apply to Subdivisions.

A key element of the new numbering system was to be the use of gaps of at least five numbers to enable new Parts, Divisions, and sections to be inserted into the legislation later, without corrupting the logic or structure of the numbering. In addition, clearer cross references were to be used that would indicate other sections of the Act that were applicable to a particular section. Finally, the use of sub-subparagraphs was banned as they caused structural complexity.

**Language**
The language was to be drafted in plain and clear words that were designed for the widest possible professional audience so that the legislation could be understandable by all who needs to read it. In order that the language could be effectively communicated by tax advisors to their clients, the language used was to directly address the taxpayer. For example the word ‘you’ would be used. In addition, an active tense was to be used for all language as this not only helps advisors explain the material better but it

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44 The Parliament of the Commonwealth of Australia, above n 30, Chapter 2.
45 The Parliament of the Commonwealth of Australia, above n 30, Chapter 3.
46 The Parliament of the Commonwealth of Australia, above n 30, Chapter 3.
47 The Parliament of the Commonwealth of Australia, above n 30, Chapter 3.
48 The Parliament of the Commonwealth of Australia, above n 30, Chapter 3.
49 The Parliament of the Commonwealth of Australia, above n 30, Chapter 3.
50 The Parliament of the Commonwealth of Australia, above n 30, Chapter 1.
51 The Parliament of the Commonwealth of Australia, above n 30, Chapter 1.
simplifies the text. Furthermore, all definitions were to have a consistent meaning throughout the Act.

Layout

In laying out the text and structure of the legislation, the key element was the use of extra white space, both in the margins and before each paragraph, and the addition of running headings to facilitate reader orientation.

2.3 The Results of the TLIP Taskforce’s Efforts

The first instalment contained the structure and framework of the 1997 Act, as well as a rewrite of the substantiation provisions. The substantiation provisions were chosen as they affected 70 per cent of the population, and much criticism about their complexity had been made. It was found that the rewritten substantiation provisions did appear much simpler. This simplification was effected through reducing the total number of words by about 60 per cent, and the average sentence length to 34 words from an amazing 241 words. The second and third instalments released involved the redrafting of the deductible expenses provisions, and the CGT provisions respectively.

The readability of the redrafted provisions of the 1936 Act have been calculated and analysed by other commentators using the Flesch Readability Index. The use of the Flesch Readability Index is widely practised, and it is generally accepted as providing a very good indication of the level of difficulty of readings and thus the level of inherent complexity of these readings. In Australia, this index has been used to evaluate the ease of reading of the GST legislation, as well as the effect that the rewrite of the 1936 Act had on readability. In this latter study, the readability of

52 The Parliament of the Commonwealth of Australia, above n 30, Chapter 1.
54 The Parliament of the Commonwealth of Australia, above n 30, Chapter 1.
55 Simon James et al, above n 12, p 41.
56 Simon James et al, above n 12, p 41.
57 Simon James et al, above n 12, p 42.
58 Simon James et al, above n 12, p 42.
59 See David Smith and Grant Richardson, above n 9.
the rewritten provisions was found to have improved by nearly 21 per cent. However, the ease of reading was still considered to be of a difficult standard. The improvement in the level of reading ease was found to be partially attributable to the use of shorter sentences in the 1997 Act.

3. Simplifying income tax legislation

‘The hardest thing in the world to understand is income tax’

(Albert Einstein)

In order to comprehend the challenges that faced the TLIP taskforce, it is necessary to consider both what is meant by tax simplification, as well how this interacts with the rule of law.

3.1 The Need for Tax Simplification

It is generally agreed upon that the Australian tax system is overly complex, and that it needs to be simplified in order to increase taxpayer compliance, whilst also minimising compliance costs. However, opinions vary as to what legislative complexity is, and as to what factors contribute to the complexities present in the tax system. Given the need that the tax legislation must address a wide variety of circumstances in detail, some level of complexity will be inevitable in a tax system. Hence, several commentators have argued as to what actually needs to be defined is ‘excessive complexity’. That is, what needs to be identified is what degree of complexity will constitute an acceptable level to both the users and administrators of a tax system. As complexity and simplicity are essentially antonyms, these concepts will be addressed interchangeably. However, in order to explain what simplicity is in the context of a tax system, it is first desirable to explain which elements make up a good tax system, and how these elements interact.

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Smith and Grant Richardson, above n 9, respectively.
62 David Smith and Grant Richardson, above n 9, p 330.
63 David Smith and Grant Richardson, above n 9, p 330.
64 Alison Towler, above n 2, p14; Richard Krever, above n 12, p 467; and Trevor Boucher, above n 18, p 277.
65 Robert Couzin, above n 21, p 488.
3.2 The Basic Tenets of a Good Tax System

Adam Smith first set the foundation of what constitutes a good tax system by enunciating his four canons of taxation: ‘equality’, ‘certainty’, ‘convenience of payment’, and ‘economy in collection’. Adam Smith’s ideals have over time evolved into modern taxation theory, which consists of four main criteria that are used to evaluate tax systems. The first of these criteria is the concept of fairness or ‘equity’ in the application of a tax system to its taxpayers. Equity can be either horizontal or vertical in its operation. Horizontal equity requires that taxpayers earning the same amount of taxable income pay the same amount of tax. However, this concept is flawed in that these taxpayers may often be in different economic positions to one another regarding their levels of essential outgoings, and the number of their dependents. Thus, intrinsic differences in taxpayers’ personal financial situations can result in a tax being imposed inequitably. Vertical equity refers to the concept that taxpayers, who are in different positions regarding income, should be taxed differently. That is, those who earn more should bear a heavier tax burden. However, the appropriate degree of unequal treatment that should be prescribed is uncertain.

The second criterion of evaluating a tax system is that of ‘simplicity’. This concept requires that the financial, temporal, and psychological compliance costs associated with the administration and collection of taxes be minimised. Financial compliance costs relate to the expenditure necessary for taxpayers to undertake their tax obligations; which includes the cost of professional advice, as well as that involved in keeping and maintaining records or completing returns. Temporal compliance costs refer to the time taxpayers spend in complying with their tax affairs, such as keeping records or completing returns. Psychological compliance

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68 Robin H Woellner et al, above n 7, p 25.
70 Robin H Woellner et al, above n 7, pp 26 – 27.
71 Robin H Woellner et al, above n 7, pp 26 – 27.
74 Robin H Woellner et al, above n 7, p 27.
75 Robin H Woellner et al, above n 7, p 28.
76 Robin H Woellner et al, above n 4, p 197.
77 Robin H Woellner et al, above n 4, p 197.
costs refer to the anxieties experienced by taxpayers in attempting to keep up with, and understand their tax obligations.\textsuperscript{78} In a major international survey conducted by the Organisation for Economic Cooperation and Development (OECD) in 1998, it was estimated that direct compliance costs relating to tax regulations cost Australian small and medium sized businesses $8 billion a year.\textsuperscript{79} The size of this figure indicates the importance of easing the compliance burden on these business taxpayers, in order to achieve economic efficiencies.

The other two main criteria used to evaluate a tax system are those of ‘certainty’ as to the incidence, liability and collection of taxation; and ‘neutrality’ in that the impact of a tax should not affect individual or business choices.\textsuperscript{80} Additional desired qualities of a tax system include the need for fiscal adequacy in providing enough revenue for the government; political acceptability; evidence as to the requirement that taxpayers should be aware of their tax liabilities; and suitability for achieving macro-level objectives, such as the redistribution of wealth.\textsuperscript{81}

It has been contended that the level of compliance costs of a tax system is linked to the level of readability and comprehensibility of the legislation.\textsuperscript{82} It is for this reason that this paper includes analyses of the readability of the two new legislative provisions that are being examined. Arguably, if readability of legislation is enhanced, the associated compliance costs should be lessened. The concept of simplicity will be expanded upon in the following section of the paper.

Additionally, it should be noted that many of the requirements of a good tax system such as certainty, equity, and simplicity are related to the ideal of the rule of law.

3.3 SIMPLICITY – NOT SO SIMPLE

Like complexity, simplicity in relation to a tax system is not easily definable, but both are comparative concepts in that they are assessed through comparing compliance costs between differently drafted tax provisions.\textsuperscript{83}

\begin{itemize}
  \item \textsuperscript{78} Robin H Woellner et al, above n 4, p 197.
  \item \textsuperscript{79} Survey figures quoted in Gary Banks, above n 16, p 4. Figures were not available for small businesses separately.
  \item \textsuperscript{80} Robin H Woellner et al, above n 7, pp 25–34.
  \item \textsuperscript{81} Robin H Woellner et al, above n 7, pp 34–35.
  \item \textsuperscript{82} Robin H Woellner et al, above n 4, p 199.
\end{itemize}
Tax simplification means different things to different people, and may not even be desirable; with complexities in the tax system due largely to the need to ensure that the legislation is certain in its operation to prevent potential scope for tax avoidance.\textsuperscript{84} The idea being that this protects revenue whilst also ensuring that the legislation operates fairly. Whilst this view legitimates the presence of complexity, it still must be weighed up against the effect of complexity on a tax system as measured through increased compliance costs that in turn decrease the efficiency of a tax system.\textsuperscript{85}

The complexity of a tax system is contended to result from the drafting techniques chosen, the language used, the volume of the legislation, and the need for diversity.\textsuperscript{86} The scope of this paper is confined to an analysis of the language and drafting techniques chosen, both of which determine the resultant readability of legislation. However, it is still worth noting the effect that diversity has on these two elements, as well as on the physical volume of legislation. Diversity in the tax system means different taxes like income tax or capital gains tax are applied differently to different situations and taxpayers.\textsuperscript{87} However, providing for diversity contributes to an increased volume of legislation, as this is necessary to detail the exact operation and scope of the legislation.

Whilst the presence of diversity in a tax system obviously offends the requirement for neutrality and to a lesser extent horizontal equity, the Government considers diversity necessary to maintain vertical equity and to promote other social objectives. An example of diversity would be the different rates of income tax that apply to different taxpayers. Natural resident taxpayers are taxed according to a progressive scale that includes a tax-free threshold, whereas corporate taxpayers and superannuation funds are taxed on their assessable income at a singular flat rate.\textsuperscript{88} This situation

\begin{flushleft}
\textsuperscript{84} Adam Broke (2000) ‘Simplification of Tax or I Wouldn’t Start from Here’ \textit{British Tax Review} 18, p 20.

\textsuperscript{85} Adam Broke, above n 84, p 20.

\textsuperscript{86} Adam Broke, above n 84, p18.

\textsuperscript{87} Adam Broke, above n 84, p18.

\textsuperscript{88} The rate is a flat 30 per cent for corporate taxpayers: section 23(2) \textit{Income Tax Rates Act 1986}. Superannuation funds are taxed at 15 per cent if they are complying superannuation funds, and 47 per cent if they are not: section 26 \textit{Income Tax Rates Act 1986}. The progressive rates are located in Schedule 7 of the \textit{Income Tax Rates Act 1986}. The rate of tax applicable to trusts and beneficiaries depends on the status of each beneficiary, and whether trust income is retained in the trust or distributed to beneficiaries.
\end{flushleft}
offends the requirement of neutrality, as the ability to access a lower tax rate will often influence business and investment choices; and breaches the requirement for horizontal equity, as different taxpayers with the same taxable income will often pay different amounts of tax. Further nuances apply in determining the applicable tax rate, such as whether the taxpayer is a resident of Australia for taxation purposes, or even the taxpayer’s age if they are an individual.\textsuperscript{89}

These are just a few of the many examples of how different tax rates can apply to different taxpayers, so perhaps it is not surprising that the \textit{Income Tax Rates Act 1986}, which only sets income tax rates, is at least 93 pages in length. In addition, there are different rebates and concessions in both the 1936 and 1997 Act that are available to different taxpayers, which affect the rate of tax ultimately applicable to these taxpayers.\textsuperscript{90} When one considers the interaction between the income tax system and other taxation regimes such as that of fringe benefits tax or GST, it can be appreciated as to how a concept such as a tax on income becomes so complex and results in such a large volume of legislation necessary to define it all. Note that as of December 2005, the 1936 Act consisted of nearly 5,500 pages; whilst the 1997 Act consisted of over 3,500 pages. This means that the \textit{Assessment Acts} alone amount to an incredible 9000 pages, and that is without taking into account the existence of related income tax legislation, like the \textit{Income Tax Rates Act 1986} or the \textit{Medicare Levy Act 1986}, which would bring the total to over 13,500 pages.

Another factor that contributes to complexity in a tax system is the interaction of the different tenets that make up a good tax system. It should be noted that it is not possible for all of the tenets to co-exist in harmony at once.\textsuperscript{91} For instance, the detail needed to ensure equity and certainty increases the complexity of a tax system, with the result that these tenets directly conflict with the element of simplicity.\textsuperscript{92} An example of this would be the aforementioned disparity in tax rates.

\textsuperscript{89} The $6,000 tax free threshold does not apply to non-resident taxpayers, and passive income for minors is taxed at a higher rate with a lower tax-free threshold than for other individuals under section 18 of the \textit{Income Tax Rates Act 1986}.

\textsuperscript{90} For example, the capital gains tax discount that is available under Division 115 of the 1997 Act to certain taxpayers is a concession that ultimately operates to decrease the tax payable on the receipt of assessable capital gains.

\textsuperscript{91} Robin H Woellner et al, above n 7, p35.

\textsuperscript{92} Robin H Woellner et al, above n 7, p35.
Given that the income tax legislation is so voluminous and complex, it is submitted that the TLIP taskforce were never likely (nor expected) to completely simplify the tax law; but rather they made a significant contribution in improving the readability of the redrafted legislation.

3.4 HOW THE RULE OF LAW APPLIES TO TAX LEGISLATION

‘Tax complexity itself is a kind of tax’.

(Max Baucus)

The rule of law is a set of ideals that describe how a Government is to govern legitimately. It prescribes certain elements that should be present when laws are made, which are equally applicable to specific tax legislation being part of the greater law of the land.

3.4.1 What is the rule of law?

The ideal of the rule of law ‘means that government in all its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one’s individual affairs on the basis of this knowledge’. The three elements of the traditional model of the rule of law are ‘constitutionality’, ‘formal legality’ and ‘procedural legality’. ‘Constitutionality’ requires that the government of a nation must be made under laws, not through laws. This element is achieved by the installation of some superior rules above government that dictate how the government is to govern. This element is reflected in Australia’s Constitution, which is the statute that dictates the powers of our government in respect of the laws it can make. This element of constitutionality is then maintained through the separation of powers, which requires that the legislature, executive and judiciary all function independently of one another.

The second element ‘formal legality’ describes the necessary characteristics that a law should possess to be considered legitimate

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95 Stephen Bottomley and Stephen Parker, above n 94, p 48.
under the rule of law. Laws must be general and impersonal in their application, and clear and specific as to their operation. Laws should be prospective in their operation, and must actually be practicable to comply with. Furthermore, laws must be stable in their operation to allow a degree of certainty. In addition, laws must be properly promulgated (or publicised), so that the public generally knows the existence of the law and its requirements. This element will be considered further in considering the rule of law in a tax context below.

The third element, ‘procedural legality’ describes the necessary procedures under which a law must operate. These procedures are also known as ‘due process’ or ‘natural justice’ and require that trials be conducted in an unbiased manner by impartial tribunals, and that both parties are fairly represented in a dispute.

In general terms, the rule of law requires that a tax system should be understandable by taxpayers; otherwise they will not be able to comply with it, and thus as a corollary, neither will they be able to take advantage of its provisions. The rule of law’s interaction with taxation can be further exemplified by considering the three elements that comprise the rule of law, with particular emphasis on ‘formal legality’, in a tax context.

3.4.2 The rule of law in a tax context

The importance of the rule of law in relation to the taxation regime cannot be underestimated. Tax legislation needs to be such that taxpayers are easily and clearly able to identify their rights and obligations in respect of their taxation liabilities. Only then, can taxpayers be confident in planning their financial affairs; secure in the knowledge that they will be protected from subsequent penalties or prosecution in respect of their tax liabilities.

To be valid and binding on taxpayers, taxes must be constitutional in that they must be imposed through a proper parliamentary process, within

98 Stephen Bottomley and Stephen Parker, above n 94, p 49.
100 Stephen Bottomley and Stephen Parker, above n 94, p 50.
101 Stephen Bottomley and Stephen Parker, above n 94, p 50.
102 Stephen Bottomley and Stephen Parker, above n 94, p 49.
103 Stephen Bottomley and Stephen Parker, above n 94, p 51.
104 Stephen Bottomley and Stephen Parker, above n 94, p 51.
the given authority of the government under the Constitution.\textsuperscript{106} This notion will be contradicted where the separation of powers is breached through legislative authority being delegated to bureaucrats; or where taxes are imposed through administrative or judicial discretion.\textsuperscript{107} Geoffrey de Q Walker argues that the separation of powers in relation to tax has been eroded in Australia because of the wide grants of discretion that are given to the Australian Tax Office (‘Tax Office’) and the courts.\textsuperscript{108} Walker contends that ‘the executive government exercises legislative and quasi-judicial powers, the judiciary exercises policy-making powers, rights effectively turn on opinions about a citizen’s purposes and in a variety of ways the law is changed at the point of application.’\textsuperscript{109}

Geoffrey de Q Walker’s observation appears to be substantiated. Due to the complexities and vagaries of the tax legislation, the judiciary often has to resort to defining the meaning and scope of legislative definitions, as well as analysing the intent of the taxpayer in undertaking a certain action. An example of this occurrence is in the operation of the general anti-avoidance provisions. The operative provision requires that for the legislation to apply, it must first be shown that a scheme existed in which the relevant taxpayer obtained a benefit, and that the scheme was entered into for the dominant or sole purpose of obtaining that benefit.\textsuperscript{110} Through analysing the policy behind the anti-avoidance provisions, the High Court in Federal Commissioner of Taxation v Spotless Services Ltd, elucidated that the ‘dominant purpose’ can be ascertained by examining what the ‘ruling, prevailing or most influential purpose’ of the taxpayer was in entering the scheme.\textsuperscript{111} Whilst being a somewhat insipid example, it stills serves to show that the separation of powers in regards to tax legislation is not being strictly observed, as the court is effectively imposing tax law by determining the extent of the application of the provision. Although it may be by allowing the judiciary this discretion that it allows for both flexibility and readability of legislation, especially as not every fact scenario can be envisaged to enable an enactment within a set of defined guidelines.

\textsuperscript{106} Graeme S Cooper, above n 105, p 15.
\textsuperscript{107} Graeme S Cooper, above n 105, p 15.
\textsuperscript{109} Geoffrey de Q Walker, above n 108, p ix.
\textsuperscript{110} \textit{Income Taxation Assessment Act 1936} (‘ITAA 1936’), s 177D.
\textsuperscript{111} (1996) 186 CLR 404 at 416.
However, the principle is that this breaches the rule of law and creates uncertainty.

Likewise, the executive government breaches the requirement of a separation of powers by exercising legislative and quasi-judicial powers through the administrative functions of the Tax Office in making public rulings. The rationale behind public rulings and tax determinations is to explain and delineate the scope of legislative provisions that have been brought into question. Public rulings are often of assistance in providing guidance to taxpayers as to how a law will apply in their given situation. Indeed public rulings can actually be favourable to taxpayers, as less tax may be payable under the public ruling than would be under the correct interpretation of the law. However, when rulings are binding, they take on a legislative flavour. Prior to January 2006 public rulings, being those that apply to the public in general for a given factual situation, were binding on the Commissioner where they were published after 1 July 1992. However, for these public rulings to be binding on the Commissioner the taxpayer’s arrangement must have fallen squarely within the terms of that particular ruling. From 1 January 2006 a new ruling regime commenced, which provides that a public ruling is binding on the Commissioner when the ruling is applicable to the taxpayer and the taxpayer relies on the ruling by acting in accordance with it. The aim of the new ruling regime is to improve certainty in the tax system for those who rely upon the Tax Office’s interpretation of the law; especially since a greater variety of written instruments can now be classified as public rulings. Likewise with private rulings, being those that only apply to the particular taxpayer that requested the ruling, the Commissioner also takes on a quasi-judicial

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113 Robin H Woellner et al, above n 7, p 160.
114 Taxation Administration Act 1953, (the previous) Part IVAAA.
115 Bellinz Pty Ltd v FC of T 98 ATC 4634, at 4645-4647.
116 Schedule 2 of the Tax Laws Amendment (Improvements to Self-Assessment) Act (No. 2) 2005 has completely replaced Part IVAA and Part IVAAA of the Taxation Administration Act 1953 with Divisions 357 to 361, which are located in Schedule 1 of this Act. The previous Part IVAA and Part IVAAA of the Taxation Administration Act 1953 related to Private and Public Rulings respectively.
117 Taxation Administration Act 1953, Schedule 1, s 357-60.
118 Taxation Administration Act 1953, Schedule 1, s 358-5. For example, Tax Packs can become public rulings if it is stated that they are one on them.
role in deciding how the law is to be interpreted and applied; although the taxpayer is free to follow the ruling or not.

Note also, that the volume of Tax Office rulings further adds to the complexity of the system; along with related supplementary materials such as policy papers, circulars, bulletins, administrative guidelines, and practice statements.119 Due to the prevalence of such supplementary materials, they together with the legislation will be analysed by the authors in terms of readability using the Flesch Readability Index.

With respect to the requirement of formal legality, taxpayers should be able to predict the tax consequences of their actions in advance, and with a sufficient degree of certainty that the tax laws have been properly applied.120 However, in respect of the taxation system, this requirement proves to be difficult. The income tax legislation is currently over 13,500 pages121 in length and constantly under amendment. Even with the current project on foot to reduce the size of Income Tax Assessment Acts by up to 28 per cent or 2,100 pages through repealing the inoperative provisions,122 it is nonetheless observed by the authors that the substantial size of the remaining legislation will ensure that these Acts remain complex and unwieldy to use.123 The sheer size of the legislation means that predictability and certainty are eroded.124

Finally, the notion of procedural legality requires that where tax laws have been enacted, the government and the administration, being the Tax Office, must comply with the laws as passed.125 Additionally, taxpayers

120 Graeme S Cooper, above n 105, p 16.
121 Whilst the length of the two Assessment Acts is around 9,000 pages, associated tax legislation such as the Taxation Administration Act 1953 or the Income Tax Rates Act 1986 is commonly included when quantifying the size of Australia’s income tax legislation.
122 Peter Costello, Treasurer (200) ‘Income Tax Reduced by Around 30 Per Cent’, No. 102, 24 November. The inoperative provisions were identified by the Board of Taxation in their October 2005 report to the Treasurer, ‘Identification and possible repeal of the inoperative provisions of the 1936 and 1997 Income Tax Assessment Acts.’
123 It also submitted by the authors that whilst repealing the inoperative provisions of the Income Tax Assessment Acts should make the remaining operational parts of the Acts marginally quicker to navigate to, it would do nothing to address the complexity of the income tax system; not least, because the provisions that are inoperative are not being used anyway.
124 Geoffrey de Q Walker, above n 108, p 2. Note that the tax legislation at 13,500 pages long includes the capital gains, fringe benefits and superannuation provisions.
125 Graeme S Cooper, above n 105, p 15.
must be allowed a neutral and accessible venue in which to dispute tax assessments in. The cost of litigation being so prohibitive means that for the majority of taxpayers the use of the court system is not assessable. Walker points out that given the Commissioner’s wide discretionary powers to alter taxpayers’ liability and to issue binding rulings, that in practice the Tax Office is becoming the absolute deciding authority over the courts.126 As the Tax Office could be perceived as having a vested interest in collecting revenue being the administrator of the tax system, it could be argued that it is not an independent neutral tribunal as required by the rule of law. The issuing of binding rulings allows the application of the law to be altered at the point of application resulting in the law not being complied with as passed by Parliament, and that ‘personal opinions and extraneous policy considerations’ are erroneously factored into the decisions.127 In addition, the wide discretionary powers that have been granted to the Tax Office further undermine the rule of law by eroding the principles of certainty, and equality before the law.128

Thus, when introducing new tax laws, the Government must also be mindful that the process is implemented within the bounds of the rule of law, as well as being drafted clearly. The presence of excessive complexity in a tax system goes against the very foundation of the rule of law, in that a law must be capable of being comprehended before it can be complied with.129 The aim of the TLIP to simplify the 1936 Act through the rewrite, would have served to strengthen the operation of the rule of law in the tax system, especially in regard to formal legality, if it was successfully completed.

Given the background and aims of the TLIP, and an awareness of the complexities inherent in tax law simplification, this paper will now consider whether the TLIP drafting principles are still being applied when new provisions have been drafted for incorporation into the 1997 Act. Consideration of this is imperative, because even though the rewrite of the 1936 Act has now ceased, it would be a loss if the Government was not utilising the drafting techniques instigated by TLIP in introducing new legislation. It is submitted that the adoption of the TLIP drafting principles

129 Michael Dirkis and Brett Bondfield, above n 22, p 8.
would help to address the requirement of ‘formal legality’ pursuant to the rule of law, and thereby decrease, but by no means resolve, complexity.

4. The New Measures

The new provisions chosen for review are the non-commercial loss and the STS provisions. These provisions were intentionally chosen by the authors as they deal with small businesses and the complexity of tax law is known to be a substantial issue for these taxpayers. Small business studies have in fact demonstrated that compliance costs are regressive for small business taxpayers and that these taxpayers are less well equipped to deal with these costs.130 A 2001 survey found that of greatest concern to small businesses was the ‘frequency and complexity of changes to tax laws and rules’, closely followed by the ‘level of taxation’.131 In fact, tax related issues comprised at least 15 out of the 50 highest ranked areas of concern to small business operators. A similar survey conducted in 2004 found that for small businesses, the ‘level of business taxes and charges’ was the foremost impediment in constraining business investment in plant and equipment.132 This finding is of significance as an investment in plant and equipment is usually made for the purposes of expanding a business. Hence, the presence of excessive business taxes affects business decisions, which not only breaches the requirement of neutrality, but also discourages economic growth.

Furthermore, out of the 16 hours that small businesses were found to spend on compliance and administrative activities on average each week, three of these hours were spent directly in relation to taxation activities.133 The Small Business Task Deregulation Force specifically found that small business taxpayers faced higher compliance costs because their ‘time and expense outlaid are over and above normal commercial practices’ and that

130 Brian L Johns, above n 16, p 32; and Gary Banks, above n 16, p 5.
131 Australian Chamber of Commerce and Industry (2001) ‘What Small Business Wants: ACCI’s Pre-Election Survey Results’ 81 ACCI Review 1, p 1. This statistic is in relation to small businesses consisting of 20–99 employees, as well as those consisting of greater than 100 employees.
the burden includes ‘lost opportunities and disincentives to expand their business.’ These observed inequities in relation to taxation compliance costs is one of the reasons that the Government enacts special tax provisions that only apply to small business taxpayers.

The complexity of the tax system to small businesses should not be underestimated as whilst small, the small business sector together contributes $160,000 million to the economy, which accounts for 30 per cent of Australia’s Gross Domestic Product.

Additionally, the small business sector provides employment to over 3.6 million people, which accounts for 49 per cent of all private sector employment. Accordingly, it is submitted that it is of particular importance that the TLIP drafting principles are being applied to new legislation introduced into the 1997 Act, especially if they concern small businesses. However, before these provisions and the associated source materials are analysed for compliance with the TLIP drafting principles, an overview of the background of the introduction of the provisions, as well as their operation and effect will be presented. This step is undertaken in order to provide some context as to the operation of the provisions, in order for the reader to gain a sense of the level of complexity of the provisions without having to rely solely on quantitative readability data. Both sets of provisions have been criticised for their complexities and inconsistencies in operation. However, the focus of this article is on the

136 Cynthia Coleman and Chris Evans, above n 135, p 147.
‘drafting complexities’ compared to the operational complexities of the provisions studied.

4.1 Non-Commercial Losses

The non-commercial loss provisions in Division 35 of the 1997 Act operate to prevent certain losses, deemed as being non-commercial in nature, from being used to offset the other income of an individual taxpayer, either alone or in partnership. These provisions effectively act to prevent losses generated by consistently unprofitable business activities from being allowed to be offset against the proprietors’ other income. This prevents those individuals from gaining a valuable personal tax advantage where the business-like activities that they operate appear to have no real commercial purpose, and do not contribute to Government revenue in any significant way. These provisions have been in force since 1 July 2000.

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138 These provisions were introduced as a response to a recommendation in the Ralph Report to address revenue leakage and improve the integrity of the tax system: Review of Business Taxation, above n 8, Recommendation 7.5. Furthermore, it was desirable that a systematic way of determining which business activities were commercial in nature was introduced, since the Tax Office’s method of assessing this on a case-by-case basis had proved to be resource intensive and create unnecessary uncertainty for taxpayers: Review of Business Taxation, above n 8, p 296. In addition, by assessing eligibility on a case-by-case basis, the ATO was operating in breach of the rule of law as they were exercising quasi-judicial powers. Also, taxpayers were not being allowed a neutral venue in which to dispute whether the non-commercial loss rules applied to them.

139 See: Review of Business Taxation, above n 8, p 296. Note that the new rules are only designed to be applied when determining whether losses from business activities that are carried on by individual taxpayers, either alone or in partnership, can be offset against the other income of those taxpayers. The rules do not alter those general law tests that assess whether an individual is carrying on a business activity: The Parliament of the Commonwealth of Australia (2000) ‘Explanatory Memorandum accompanying the New Business Tax System (Integrity Measures) Bill 2000’, p 3.

140 Division 35 – ‘Deferral of losses from non-commercial business activities’ was inserted into the Income Tax Assessment Act 1997 (Cth) by the New Business Tax System (Integrity Measures) Act 2000 (Cth). The New Business Tax System (Integrity Measures) Act 2000 (Cth), Schedule 1, s 4 states that Division 35 will ‘apply to assessments for the 2000–01 income year and later income years.’
4.1.1 An outline of the operation and effect of Division 35

The operative provision requires that losses arising from the business activities of individual taxpayers, either acting alone or in a partnership, not be allowed to be deducted from the taxpayer’s other income and are instead deferred; unless one of the four tests can be satisfied, or the Commissioner exercises his discretion, or an exception applies. Where a partnership exists, and one of the partners is not an individual, the interests of the non-individual partner must be ignored when calculating eligibility to satisfy one of the quantitative tests. Also, note that the non-commercial loss provisions only apply to business activity income, and similar activities can be grouped together.

The four determinative tests, in that if any one of them is satisfied then the default rule in section 35-10 will not apply to the relevant business activity for that particular income year, are outlined below along with the other exceptions.

(1) **Assessable Income Test** – To satisfy this test, the business activity must have generated at least $20,000 in assessable income in that income year. Where the activity has commenced or ceased during an income year the proprietor is able to make a reasonable estimate of the income as if the business had been in operation for the full year.

(2) **Profits Test** – This test will be satisfied in a particular income year if the business activity generated a profit for at least three of the previous five income years.
(3) **Real Property Test** – To satisfy this test, the business activity must have a freehold or leasehold interest in at least $500,000 worth of real property, calculated at market value or reduced cost base, which is used on a continuing basis in carrying on that activity for that particular income year. Dwellings and land that are used mainly for private purposes are excluded from being used to satisfy this test. It is believed that non-proprietary rights in real property, such as licence rights, will not be able to be included in this test.

(4) **Other Assets Test** – If the written down value of at least $100,000 in other assets such as depreciable assets, trading stock, leased assets, and intellectual property rights are used on a continuing basis in carrying on a particular business activity in that particular income year, then this test will be satisfied. Real property, cars, motor cycles and other similar vehicles are excluded from being counted in this test.

**The Commissioner’s Discretion** The Commissioner can exercise a discretion where it would be unreasonable for the operative rule to apply because the business activity was affected by special circumstances ‘outside of the control of the operators of the business activity, including drought, flood, bushfire or some other natural disaster.’ Alternatively, the discretion may be applied where the business activity had commenced but because of the nature of the business, none of the quantitative tests was able to be satisfied, and an independent objective expectation existed that the business

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148 ITAA 1997, s 35-40. Note that either the interest in the real property or the underlying real property can be used to satisfy this test: Commissioner of Taxation (2001) Taxation Ruling TR 2001/14: *Income tax: Division 35 – non-commercial business losses*, Australian Taxation Office, at para 64.

149 ITAA 1997, s 35-40(4).

150 Andy Milidoni and Keith James (2002) ‘Division 35 – non-commercial loss provisions’ 36(10) *Taxation in Australia* 554, p 555. The authors note that Division 35 is silent on the matter; but reading into the Commissioner’s opinion on licence rights concerning the GST, it is expected that the Commissioner would hold a similar view in relation to this test.

151 ITAA 1997, s 35-45.

152 ITAA 1997, s 35-45(4).

would be profitable or be able to satisfy one of the tests within ‘a period commercially viable for the industry concerned.’

The $40,000 Exemption for Primary Producers and Artists  This exception allows individuals running primary production and professional arts businesses to have their losses applied to other income, as long as that other income is less than $40,000.

The other new measure chosen for analysis, in determining whether the TLIP drafting principles are still being applied when new provisions are added to the 1997 Act, is the STS regime.

4.2 The Simplified Tax System
The STS has been in operation since 1 July 2001, and the system is actually part of the wider income tax system with its operative provisions being contained in Division 328 of the 1997 Act. The STS was introduced in response to a recommendation made in the Ralph Report that given the nature of small businesses, and the substantial compliance burdens that these taxpayers inequitably face in relation to their taxation obligations; that these entities should be provided with an ‘alternative tax system’ that would be simpler to comply with. The STS provides eligible small businesses that have straightforward financial affairs with an alternative method of determining taxable income, so that the amount of tax payable is purportedly reduced along with compliance costs.

154 ITAA 1997, s 35-55(1)(b). This discretion allows for a start-up business where the nature of the activity means that there will be a lag between commencing operations and becoming commercially viable. For example an activity involving the planting of hardwood tree for harvest, where many years would pass before the activity would reasonably be expected to produce income. See: Australian Taxation Office (2004) ‘Non Commercial Losses: Commissioner Discretion-questions and answers’, 18 February 2004, available at www.ato.gov.au/print.asp?doc=/content/1849.htm
155 ITAA 1997, s 35-10(4),(5).
156 The STS provisions were inserted into the Income Tax Assessment Act 1997 (Cth) as Division 328 by the New Business Tax System (Simplified Tax System) Act 2001 (Cth).
158 Robin H Woellner et al, above n 7, p 993.
4.2.1 An outline of the operation and effect of Division 328

There were originally three concessions to the STS measures, the first being the use of cash accounting to recognise income and deductions.\(^\text{159}\) However, due to the enactment of a recent election promise by the Howard Government,\(^\text{160}\) STS taxpayers are now able to account on a non-cash or accruals basis.\(^\text{161}\) Another concession is a simplified depreciation regime, which allows depreciating assets costing less than $1,000 to be immediately written-off, and the remaining depreciating assets to be pooled and depreciated at an accelerated rate.\(^\text{162}\) The final concession is a simplified trading stock regime in that changes in the value of trading stock do not have to be accounted for when the difference in value between the start and end of the income year is reasonably estimated to be less than $5,000.\(^\text{163}\) These measures are intended to reduce the amount of tax payable by STS taxpayers as well as reducing the associated compliance costs.\(^\text{164}\)

However, not every business taxpayer can use the STS measures. For a taxpayer to be eligible to be part of the STS measures, they first must have carried on a business in that income year.\(^\text{165}\) Next, the entity and its related entities must have had an average turnover of less than $1 million for that year.\(^\text{166}\) The third and final condition is that the business and its

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160 See: The Howard Government Election 2004 Policy (2004) Small Business, Big Future, Canberra, pp 4 – 5. This move allows more businesses to join the STS as there are many businesses that currently account on an accruals basis that would not find it to be economically viable to incur the expense necessary to alter accounting systems.

161 On 1 April 2005, Division 328 of the ITAA 1997 was amended by Schedule 2 of the Taxation Laws Amendment (2004 Measures No. 7) Act 2005 (Cth) to remove the eligibility requirement of only accounting on a cash basis.

162 The Parliament of the Commonwealth of Australia, above n 157, p 7. See Subdivision 328-D of the ITAA 1997. For depreciating assets with an effective life of less than 25 years the pooled depreciation rate is 30 per cent, and for those assets with an effective life of more than 25 years the rate is 5 per cent: s 328-190(2).


165 ITAA 1997, s 328–365(1)(a). A ‘business’ is defined to include ‘any profession, trade, employment, vocation or calling, but does not include occupation as an employee’: ITAA 1997, s 995–1(1).

166 ITAA 1997, s 328–365(1)(b). This is calculated by reference to the turnovers of the previous three years across that business and its grouped entities. Also, for the purposes of the STS provisions, annual turnover does not include any GST payable:
grouped entities must hold no more than $3 million worth of depreciable assets at the end of that year between them.\footnote{167} If all three conditions are satisfied and the taxpayer wishes to enter the STS, they must then notify the Commissioner of this intent.\footnote{168} It is important to note that eligibility is not just assessed initially, but on a year-to-year basis.\footnote{169}

The consequence for those eligible businesses that choose not to enter the STS is that these taxpayers will not have access to the benefits provided under the STS. Instead, these taxpayers will be treated like any other business taxpayer. That is they will only being able to claim an immediate deduction for depreciable assets that cost less than $100,\footnote{170} with the rates of depreciation for their other capital assets also being lower than those for STS taxpayers.\footnote{171} Due to the present value of money as well as the

\footnote{167} ITAA 1997, s 328-365. The written down value at the end of the income year is used in this test. Also, for the purposes of this test and the second eligibility test, ‘grouped entities’ refers to other entities that either control or are controlled by the STS taxpayer, or that are STS affiliates of the STS taxpayer: ITAA 1997, s 328-380. An STS affiliate is defined in s 995-1(1) of the ITAA 1997 to be an entity that acts, or could reasonably be expected to act, in accordance with the STS taxpayer’s directions or wishes in relation to the business affairs of the STS entity: ITAA 1997, s 328-380.

\footnote{168} ITAA 1997, s 328-435. This notification can be made at any time during the financial year, or even at the end of it: ITAA 1997, s 328-435.

\footnote{169} Therefore, a STS taxpayer can choose to leave the STS at any time: ITAA 1997, s 328-440(1). However, if a STS taxpayer does opt out of the system, they will not be eligible to re-enter the STS for a period of at least five years after that income year in which they opted to leave: ITAA 1997, s 328-440(3). This restriction on re-entry is intended to prevent entities from selectively taking advantage of the STS measures through entering and leaving the STS on a frequent basis: The Parliament of the Commonwealth of Australia, above n 157, p 30. Alternatively, a STS taxpayer will no longer be eligible to remain in the system when they no longer satisfy all three of the entry requirements: ITAA 1997, s 328-440(1)(b). In that case, the STS taxpayer will have to leave the system at the end of that income year. In either case, when a STS taxpayer leaves the STS, they must notify the Commissioner of this intent: ITAA 1997, s 328-440(1), (2).

\footnote{170} ATO Practice Statement Law Administration PS LA 2003/8: Taxation treatment of expenditure on low cost items for taxpayers carrying on a business.

\footnote{171} The Parliament of the Commonwealth of Australia, above n 157, p 6. In addition, non-STS business taxpayers will still be required to undertake annual stock takes, which is an increased compliance burden for these businesses compared to STS taxpayers: The Parliament of the Commonwealth of Australia, above n 157, p 7.
uncertainties of the future, an immediate deduction is more valuable to a taxpayer than a deferred one.

As a further incentive for eligible small businesses to join the STS, the Government recently announced the introduction of a 25% Entrepreneurs’ Tax Discount on the business income tax liability for STS taxpayers with annual turnovers of $50,000 or less.\textsuperscript{172} However, this turnover limit was increased to $75,000 when the initiative came into effect.\textsuperscript{173} At the time of this initiative’s conception, the Government estimated that over 300,000 small businesses will be eligible for this tax discount.\textsuperscript{174} It will be interesting to see if this new STS concession will actually encourage more businesses to join the STS.\textsuperscript{175}

Having described the background to the introduction of the non-commercial loss and STS provisions, as well as their operation and effect; the analysis of whether these provisions and their associated supplementary material conform to the TLIP drafting principles as presented.

5. Are the TLIP Drafting Principles Still Being Applied?

To assess whether the TLIP drafting principles have been adhered to in enacting Divisions 35 and 328,\textsuperscript{176} the readability of the legislation and the associated written explanatory material such as Tax Office fact sheets and the Commissioner’s public rulings will first be computed. Then a subjective analysis of whether the specific TLIP drafting principles have been followed in the drafting of these Divisions will be undertaken.

\textsuperscript{172} The Howard Government Election 2004 Policy, above n 160, p 5. The discount will apply from 1 July 2005, and the Government will also be introducing anti-avoidance measures to prevent ineligible businesses from subdividing in order to access the discount.

\textsuperscript{173} The operative provisions of the new 25per cent Entrepreneurs’ Tax Discount are contained in Subdivision 61-J of the ITAA 1997. They were inserted into that Act by Schedule 1 of the \textit{Taxation Laws Amendment (2004 Measures No. 7) Act 2005} (Cth) on 1 April 2005.

\textsuperscript{174} The Howard Government Election 2004 Policy, above n 160, p 5.

\textsuperscript{175} Whilst over 95 per cent of all businesses, including 99 per cent of all primary production businesses were eligible to join the STS at its inception; only 285,000 eligible small businesses or 16 per cent of those eligible have so far elected to enter the STS: The Parliament of the Commonwealth of Australia, above n 157, para 8.18; and Australian Tax Office (2003) \textit{Who’s in the simplified tax system?} 21 \textit{The TAXAGENT newsletter} 9, respectively.

\textsuperscript{176} The analysis has been on the legislation as enacted as at 1 November 2004.
5.1 The Readability of the Non-commercial Loss and STS legislation, and Supplementary Materials

One way that the simplicity of expression of tax material can be quantified is by the Flesch Readability Index. Reading indices are statistical tools that ‘take into account characteristics of writing style that are measurable and then evaluate the extent to which each identifiable attribute impacts on reading difficulty.’177 That is they measure certain characteristics of written passages, and then use the resultant measurements to calculate a score, which then indicates the ease of readability of a written piece. However, there are limitations to the use of reading indices as they are unable to take into account other important factors that impact on the ultimate ease of reading; for example, ‘reader characteristics such as interest level, motivation, experience and maturity’,178 conceptual difficulty, semantics, and the ‘presentation of material such as size, type of print and general format’.179 Nonetheless, given that a low level of readability is an important factor in contributing to tax complexity, and that reading indices are widely applied to taxation legislation and administrative literature by academics, the use of such indices does provide a very reliable indication as to the readability of text.180

For the purposes of this study, the Flesch Reading Ease Score is calculated by the following formula:181

\[
\text{Flesch Score} = 206.35 - 0.846wl - 1.015sl
\]

Where: 
\(wl\) = the number of syllables per 100 words
\(sl\) = the average sentence length of the reading in words.

This formula generates scores ranging from 0 (most difficult to read) to 100 (easiest to read).182 It has been noted that the main factors that contribute to reading complexity are the use of ‘lengthy complicated sentences coupled with indirect and inactive types of writing’.183 It is contended then that the Flesch Reading Ease Score provides a good measure of readability; as it measures the length of sentences, as well as the complexity of the language by counting the average number of syllables. A summary of the ease of

177 Lin Mei Tan and Greg Tower, above n 24, p 361.
178 Lin Mei Tan and Greg Tower, above n 24, p 361.
179 Lin Mei Tan and Greg Tower, above n 24, p 361.
180 Lin Mei Tan and Greg Tower, above n 24, pp 361-362.
181 Grant Richardson and David Smith, above n 61, p 19.
182 David Smith and Grant Richardson, above n 9, p 327.
183 Lin Mei Tan and Greg Tower, above n 24, p 371.
reading related to the scores is given below in Table 1 – Summary of Flesch Readability Scores.

**Table 1 – Summary of Flesch Readability Scores**

<table>
<thead>
<tr>
<th>Flesch Score</th>
<th>Equivalent Education level needed</th>
<th>General Reading Ease</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 – 30</td>
<td>University graduate</td>
<td>Very difficult</td>
</tr>
<tr>
<td>30 – 50</td>
<td>University undergraduate</td>
<td>Difficult</td>
</tr>
<tr>
<td>51 – 60</td>
<td>Grade 10 – 12: high school</td>
<td>Fairly difficult</td>
</tr>
<tr>
<td>61 – 70</td>
<td>Grade 8 – 9: high school</td>
<td>Standard</td>
</tr>
<tr>
<td>71 – 80</td>
<td>Grade 7: primary school</td>
<td>Fairly easy</td>
</tr>
<tr>
<td>81 – 90</td>
<td>Grade 6: primary school</td>
<td>Easy</td>
</tr>
<tr>
<td>91 – 100</td>
<td>Grade 5: primary school</td>
<td>Very easy</td>
</tr>
</tbody>
</table>

A score ranging from 61 – 70 is generally considered acceptable, as it indicates an ease of reading at a standard level. However, it is submitted that based on recent education attainment statistics from the Australian Bureau of Statistics (‘ABS’), a lower Flesch Score may still be considered acceptable. As at May 2002, nearly 46 per cent of the population aged between 15 – 64 years had at least completed Year 12. This would mean that based on the Flesch Reading Ease Scores, nearly half of this age group should be proficient at reading at least at a ‘fairly difficult’ level. Further, nearly 18 per cent of this same group had attained a bachelor degree or higher. This sub-group would then supposedly be comfortable at reading material of a ‘very difficult’ level. Included in this sub-group would be tax advisors, as these professionals would be university graduates.

This observation of education levels may appear to legitimise the use of reading material that is pitched at a ‘fairly difficult’ to ‘very difficult’ standard, given the ability of a substantial proportion of the public to understand it. Supposedly, those that would not be able to cope with the complexity of the reading would be able to rely on the availability of tax advisors. However, relying on tax advice increases compliance costs, which in turn decreases the efficiency of a tax system. Therefore, for the

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184 This table was derived from information contained in David Smith and Grant Richardson, above n 9, p 331.
185 David Smith and Grant Richardson, above n 9, p 327.
186 Australian Bureau of Statistics (2004) *Year Book Australia: Education and Training Educational Attainment*, 1301.0, ABS, Table 10.34. Note that the inclusion of persons aged 15 – 16 years would negatively distort this figure, as persons in this age group would generally still be undertaking their secondary school studies.
187 Australian Bureau of Statistics, above n 186, Table 10.36.
purposes of this study, it is submitted that a reading ease score ranging 51 – 60 would be quite acceptable; as this range would take into account the minimum education levels of taxpayers balanced against the use and cost of professional tax advice.

5.1.1 Methodology
To ascertain whether the non-commercial loss and STS measures are easily comprehensible, the readability of the legislation and associated explanatory material was analysed using the Flesch Readability Index. The data sample included all operative sections of Divisions 35 and 328 that were greater than 50 words in length as at 1 November 2004. In addition, the readability of 32 Tax Office Interpretative Decisions (‘ATO Interpretative Decisions’), and a selection of eight Tax Office publications explaining the operation of the non-commercial loss provisions were computed. Also, the readability of a selection of fourteen Tax Office publications and eight randomly chosen Tax Office public rulings on the operation of the STS were analysed.

The selection of this data is important because the publications, rulings, and tax determinations are specifically directed at taxpayers, as well as their advisers. The non-commercial loss provisions only apply to those small business operators that carry on their business as sole traders or through a partnership. These operators are acknowledged to be generally unsophisticated taxpayers in their ability to understand and work with tax legislation.

Note that in regards to the non-commercial loss supplementary materials, only Interpretative Decisions were analysed despite there being many Product Rulings on non-commercial losses in existence. It was considered that because Product Rulings only apply to a very select group of taxpayers, these rulings should be excluded from this study as it can be assumed that these taxpayers, being investors, will be relying on their tax advisers to explain the consequences of the Commissioner’s decision in regards to their particular scheme.

188 Text samples consisting of fewer than fifty words are considered to be inappropriate to apply the index to: Grant Richardson and David Smith, above n 61, p 21.
189 These are also known as ATOIDs, which stands for Australian Tax Office Interpretative Decisions.
190 ITAA 1997, s 35–10.
191 Brian L Johns, above n 16, p 32.
192 Being those taxpayers that have invested in a particular scheme.
In addition to the Flesch Score, the number of words per sentence (‘WPS’) was also tabulated, because the use of overly long sentences is linked to text complexity. Finally, the incidence of passive voice sentences was also tabulated, because an over-usage of the passive voice, which is indicated by a proportion of about 35 to 55 per cent, increases the complexity of a text.

Studies have shown that computer grammar tools like those contained in Microsoft Word, are more accurate in calculating these indices and figures than humans are, especially in relation to calculating the number of syllables in a word. Thus, the scores tabulated were generated by the computer grammar tool contained in Microsoft’s Word XP program, rather than manually.

### 5.1.2 Analysis of the Flesch Readability Results

The individual results of the readability analyses of the non-commercial loss and STS measures are given in Appendices A and B respectively. A summary of the Flesch Score results for these measures are set out respectively in Table 2 – The Comparison of the Average Readability of Non-commercial Losses Written Material and Table 3 – The Average Readability of the STS Written Material.

#### Table 2 – The Comparison of the Average Readability of Non-commercial Losses Written Material

<table>
<thead>
<tr>
<th>Type of Reading</th>
<th>Flesch Score</th>
<th>General Reading Ease</th>
<th>WPS (average)</th>
<th>Passive Voice %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-commercial Losses Legislation</td>
<td>32.8</td>
<td>Difficult</td>
<td>44.5</td>
<td>0</td>
</tr>
<tr>
<td>Tax Office Publications</td>
<td>45.3</td>
<td>Difficult</td>
<td>18.0</td>
<td>0</td>
</tr>
<tr>
<td>ATO Interpretative Decisions</td>
<td>25.3</td>
<td>Very difficult</td>
<td>25.8</td>
<td>1.0</td>
</tr>
<tr>
<td>Public Rulings¹</td>
<td>24.1</td>
<td>Very difficult</td>
<td>30.4</td>
<td>15.5</td>
</tr>
</tbody>
</table>

¹ These are public rulings – as it is not possible for the authors to analyse private rulings, which by their nature are not publicly available.

The scores for all four types of written material pertaining to non-commercial losses fell well below the general acceptable range of readability.

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193 Lin Mei Tan and Greg Tower, above n 24, p 364.
194 Lin Mei Tan and Greg Tower, above n 24, p 364.
195 David Smith and Grant Richardson, above n 9, p 328.
of 61 – 70; or as was earlier submitted, the lower proposed acceptable range for tax legislation of 51 – 60 or ‘fairly difficult’.

Out of the four types of written material analysed, the ATO Interpretative Decisions and Tax Office public rulings were found to require the highest level of reading ability to understand, with the average Flesch readability level of 25.3 and 24.1 respectively, falling into the very difficult category. This implies that these explanatory documents are unlikely to be comprehended by anyone who is not a university graduate.

It is submitted that it is unfortunate that both the ATO Interpretative Decisions and public rulings are more complex in terms of readability than the legislation itself. The ATO Interpretative Decisions are the publicly released versions of Private Rulings, which are intended to clarify how an aspect of the tax law applies to a particular taxpayer’s tax affairs. The ATO Interpretative Decisions are used by tax officers as precedential Tax Office views, and tax officers must search for, identify and apply relevant ATO interpretative decisions in resolving technical interpretative issues. The Freedom of Information Act 1982 requires such Tax Office internal guidelines to be made publicly available, thus allowing the public to be aware of the internal guidelines that tax officers will be following in their decision making process. The authors contend that the major factor contributing to the readability of these ATO Interpretative Decisions is the ‘plain’ presentation of ATO Interpretative Decisions – which is necessitated by the need to remove any identifiable details of the original taxpayers to whom the Private Rulings initially applied. This means there is a desire to briefly outline the operation of the law to situations couched in necessarily vague terms to protect the identity of the taxpayers. It appears that because of this focus on protecting the original taxpayer’s privacy, the readability of the ATO Interpretative Decisions are compromised. Whilst it is accepted that the original taxpayer’s privacy is important, it is unfortunate that this means that readability is compromised, and thereby increases the difficulty for both the public and tax officers in reading and understanding these internal guidelines.

196 Robin H Woellner et al, above n 7, p 163.
As previously discussed, public rulings are intended to clarify how the law will apply in a given situation,\textsuperscript{200} and thereby improve certainty in the tax system. It is questionable whether this certainty can be achieved given that according to these results public rulings can be very difficult to read. This can make it hard for taxpayers to comprehend what the Tax Office’s interpretation of the law exactly is. A reason that may explain why public rulings having a low Flesch Score is that they are interpretative, involving the synthesis of legislation, case law and facts. Such an analysis can be difficult. This phenomenon is explored further in the discussion of the results for the STS measures.

The readability of the legislation resulted in an average Flesch Score of 32.8 or ‘difficult’. It is submitted that although the readability narrowly misses being deemed ‘very difficult’, that instead, the level of readability is quite acceptable given that the most common readers of it are likely to be tax professionals and academics, with both groups of these readers being tertiary educated. Given that these groups are the intended readers of the legislation,\textsuperscript{201} the level of readability of the provisions is then arguably quite acceptable. This result is similar to prior studies on the readability of the re-written provisions of the 1936 Act, which found the ease of reading at a ‘difficult’ standard.\textsuperscript{202}

Note that there were two non-commercial loss provisions that were observed to have a Flesch readability level of zero.\textsuperscript{203} These sections describe the ‘profits test’ and ‘apportionment’ rules. However, the readability of the Tax Office fact sheet on the profits test was comparatively readable with a Flesch Score of 48.4 observed. The sections were both quite ‘readable’ to the authors, therefore it is submitted that the high number of words per sentence observed contributed to the formula generating the scores of zero, rather than any complexity in the actual language used.

The readability for the fact sheets released by the Tax Office resulted in an average Flesch Score of 45.3, which indicates that the required readability level has fallen into the top tier of the ‘difficult’ readability range. This can be interpreted as requiring the reader to have at least completed Grade

\textsuperscript{200} Les Nethercott, above n 112, p 526.
\textsuperscript{201} Tax Law Improvement Project, above n 2.
\textsuperscript{202} David Smith and Grant Richardson, above n 9.
\textsuperscript{203} These were sections 35-35 and 35-50 of the ITAA 1997. See Appendix A, Table A1 for these and other individual readability results for the non-commercial loss provisions.
12, and then perhaps at least one year of undergraduate study at a tertiary institution to be able to comfortably understand the material.

Additionally, it is interesting to make a comparison between the different written materials available on the individual topics. For example, the legislative provision describing the Commissioner’s power of discretion has a Flesch Score of 25.4, whilst the corresponding Tax Office-issued fact sheet improves on this with a Flesch Score of 45.4. Yet, the ATO Interpretative Decisions on the operation of the Commissioner’s discretion had some of the lowest Flesch Scores observed in this study with the scores ranging from 18.7 – 22.6. In this case, it would be the most judicious for a layperson to read the fact sheet on the Commissioner’s power of discretion before consulting the legislation.

Note that the average number of words per sentence and incidence level of passive voice sentences were found to be of an excellent standard, indicating that neither element increases the complexity of the given readings, and that the TLIP principles may have been adhered to when the material was drafted or written. In addition, the level of readability of the fact sheets was almost in the arguably acceptable ‘fairly difficult’ category which indicates that the writing style used in them was almost acceptable.

Table 3 – The Average Readability of the STS Written Material

<table>
<thead>
<tr>
<th>Type of Reading</th>
<th>Flesch Score</th>
<th>General Reading Ease</th>
<th>WPS (average)</th>
<th>Passive Voice %</th>
</tr>
</thead>
<tbody>
<tr>
<td>STS Legislation</td>
<td>46.1</td>
<td>Difficult</td>
<td>26.9</td>
<td>0</td>
</tr>
<tr>
<td>Tax Office Publications</td>
<td>42.5</td>
<td>Difficult</td>
<td>19.2</td>
<td>0.64</td>
</tr>
<tr>
<td>ATO Interpretative Decisions</td>
<td>32.25</td>
<td>Difficult</td>
<td>25.38</td>
<td>0</td>
</tr>
<tr>
<td>Public Rulings</td>
<td>33.90</td>
<td>Difficult</td>
<td>26.25</td>
<td>0</td>
</tr>
<tr>
<td>Tax Determinations</td>
<td>26.15</td>
<td>Very difficult</td>
<td>28.40</td>
<td>0</td>
</tr>
</tbody>
</table>

The results indicate that the average Flesch Scores for the various Tax Office interpretations of the STS legislation was around 30. This means that readings are considered to be ‘difficult’ to ‘very difficult’ and more likely to be understandable by university graduates than other types of readers.

The Tax Office fact sheets were found to be more readable with an average Flesch Score of 42.5, which indicated that education to university

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undergraduate level was desirable for readers to be in a better position to understand the material.

The readability of the legislation was found to result in the highest scores, and thus more readable than the ATO Interpretative Decisions or fact sheets. It is submitted that this result is unexpected given that taxpayers are not assumed to read the legislation, but instead are assumed to rely on supposedly easier information sources to digest such as the Tax Office fact sheets. Since binding Tax Office public rulings are considered to provide taxpayers with the most certainty concerning their tax affairs, it is unfortunate that this source of information is one of the most complex for taxpayers to try to understand. It is submitted that this result is unexpected given that taxpayers are not assumed to read the legislation, but instead are assumed to rely on supposedly easier information sources to digest such as the Tax Office fact sheets. Since binding Tax Office public rulings are considered to provide taxpayers with the most certainty concerning their tax affairs, it is unfortunate that this source of information is one of the most complex for taxpayers to try to understand. Similarly to public rulings for non-commercial loses, the reason for the lower score is that the public rulings combine law with the factual scenarios. Such an analysis and synthesis of facts to law, both legislative and judicial, is often difficult. Additionally, public rulings can contain direct judicial quotes from case law. These quoted judgements may negatively impact on the overall readability of the ruling as they can be written in a more traditional style. For example TR 2002/11 has a short three-line quote from a case decided in 1948 that has a Flesch Score of 29.5, which is at the ‘very difficult’ level of readability. Also, public rulings can address specific anti-avoidance provisions and the factual scenarios described can involve complex transactions and structures. For example TR 2002/6 discusses the circumstances when ostensibly independent businesses act in concert with each other, which involves a complex trading arrangement.

Of particular note is that the section in the legislation describing low cost assets which was found to have a readability score of 72.6. As this section does not seem particularly easy to read to the authors, it is submitted that the exceptionally low rate of 10 words per sentence contributed more to this score, than did the actual ease of readability. This is an example of a situation where although the Flesch Readability Index may be initially useful in quantifying the readability of written material; it is not always wholly accurate given that certain factors such as unusual sentence length

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208 See Appendix B, Table B1. The section in question is s 328-180 of the ITAA 1997.
can distort the calculated score. However, the majority of the resultant Flesch Scores appears to describe the readability of the material more accurately. The point to be made here is that whilst the Flesch Readability Index does not always give ‘true’ results, it is nonetheless quite reliable for a quantifiable perspective on readability.

Similar to the non-commercial loss results, the average number of words per sentence and the incidence level of passive voice sentences were found to be of an excellent standard indicating that neither element increases the complexity of the given readings. This might suggest that the underlying policy is what is causing most of the complexity observed.

5.2 **A Subjective Analysis of whether the Specific TLIP Drafting Principles have been applied to the New Measures inserted into the ITAA 1997**

To assess whether the TLIP drafting principles were observed when Divisions 35 and 328 were enacted, a subjective analysis was undertaken to compare the legislation as it stands against the TLIP drafting principles. The means by which this task was undertaken was through observation. This analysis has been summarised in Table 4 – Compliance of Division 35 with TLIP Drafting Principles and Table 5 – Compliance of Division 328 with TLIP Drafting Principles.
Table 4 – Compliance of Division 35 with TLIP Drafting Principles

<table>
<thead>
<tr>
<th>Area</th>
<th>Description</th>
<th>Observed</th>
<th>Evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>STRUCTURE</td>
<td>Pyramid – conceptual structure</td>
<td>YES</td>
<td>Division being a specific provision is located in the ‘third layer’ of the 1997 Act.</td>
</tr>
<tr>
<td></td>
<td>Definitions asterisked</td>
<td>YES</td>
<td>‘Business’ indicated by an asterisk in section 35-5.</td>
</tr>
<tr>
<td></td>
<td>Definitions located at end</td>
<td>YES</td>
<td>The asterisked definitions were located in section 995-1 of the Act in the general dictionary.</td>
</tr>
<tr>
<td></td>
<td>Guides used</td>
<td>YES</td>
<td>Section 35-1 provides a guide to the Division.</td>
</tr>
<tr>
<td>NUMBERING</td>
<td>Bifurcated (2 components) section numbering</td>
<td>YES</td>
<td>All section numbers of Division 35 are bifurcated.</td>
</tr>
<tr>
<td></td>
<td>Gaps of at least 5 numbers left between Parts, Divisions &amp; sections</td>
<td>YES</td>
<td>Gaps of exactly 5 spaces were observed between each section number.</td>
</tr>
<tr>
<td></td>
<td>Sub-subparagraphs not to be used</td>
<td>YES</td>
<td>None were observed.</td>
</tr>
<tr>
<td></td>
<td>Cross-referencing</td>
<td>YES</td>
<td>Section 35-10 referred to the tests located in other sections.</td>
</tr>
<tr>
<td>LANGUAGE</td>
<td>Active tense</td>
<td>YES</td>
<td>100 per cent active voice observed in readability analysis.</td>
</tr>
<tr>
<td></td>
<td>First person eg. “you”</td>
<td>YES</td>
<td>Observed in sections.</td>
</tr>
<tr>
<td></td>
<td>Consistent definitions</td>
<td>YES</td>
<td>No incidence of inconsistent definitions usage was observed.¹</td>
</tr>
<tr>
<td>LAYOUT</td>
<td>Use of extra white space, both in the margins and before each paragraph</td>
<td>YES</td>
<td>The text is sufficiently spaced out.</td>
</tr>
</tbody>
</table>

¹ Note within the Division the definition of ‘STS average turnover’ is used consistently. However, the idea of small business turnover being $1 million is inconsistent when compared to other tax legislation. Example: for GST purposes while annual turnover of $1 million is also referred to, it is not calculated on an average basis: see section 29-40 of the A New Tax System (GST) Act 1999. This inconsistency of thresholds or measures between the different tax legislation does not assist with compliance costs.
Table 5 – Compliance of Division 328 with TLIP Drafting Principles

<table>
<thead>
<tr>
<th>Area</th>
<th>Description</th>
<th>Observed</th>
<th>Evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>STRUCTURE</td>
<td>Pyramid – conceptual structure</td>
<td>YES</td>
<td>Division 328 being a specific provision is located in the ‘third layer’ of the 1997 Act.</td>
</tr>
<tr>
<td></td>
<td>Definitions asterisked</td>
<td>YES</td>
<td>For example ‘STS taxpayer’ was asterisked in section 328-105.</td>
</tr>
<tr>
<td></td>
<td>Definitions located at end</td>
<td>YES</td>
<td>The asterisked definitions were located in s 995-1 of the Act in the general dictionary.</td>
</tr>
<tr>
<td></td>
<td>Guides used</td>
<td>YES</td>
<td>A guide to the provision is provided in Subdivision 328-A.</td>
</tr>
<tr>
<td>NUMBERING</td>
<td>Bifurcated (2 components) section numbering</td>
<td>YES</td>
<td>Bifurcation was observed in all section numbering.</td>
</tr>
<tr>
<td></td>
<td>Gaps of at least 5 numbers left between Parts, Divisions &amp; sections</td>
<td>NO</td>
<td>The existence of sections 328-243, 328-247, 328-253, 328-257 meant that gaps of 5 spaces were not present between each section number. However, these sections were introduced after the original enactment of the provision and illustrate the reason why they allowed a gap for insertions.</td>
</tr>
<tr>
<td></td>
<td>Sub-subparagraphs not to be used</td>
<td>YES</td>
<td>None were observed.</td>
</tr>
<tr>
<td></td>
<td>Cross-referencing</td>
<td>YES</td>
<td>Observed in the Note to section 328-175(3).</td>
</tr>
<tr>
<td>LANGUAGE</td>
<td>Active tense</td>
<td>YES</td>
<td>100 per cent active voice observed in readability analysis.</td>
</tr>
<tr>
<td></td>
<td>First person eg, ‘you’</td>
<td>YES</td>
<td>Observed.</td>
</tr>
<tr>
<td></td>
<td>Consistent definitions</td>
<td>YES</td>
<td>No incidence of inconsistent definitions usage was observed.</td>
</tr>
<tr>
<td>LAYOUT</td>
<td>Use of extra white space, both in the margins and before each paragraph</td>
<td>YES</td>
<td>The text is sufficiently spaced out.</td>
</tr>
</tbody>
</table>

Based on the results of the analysis as listed in Tables 4 and 5, it appears that the TLIP drafting principles were used when drafting Divisions 35 and 328. However, with an average Flesch Reading Ease Score of 32.8 observed for the non-commercial loss legislation, it could be inferred that the use of the TLIP drafting principles did not result in the legislation being simplified to
an acceptable standard as the readability of the legislation is considered to be ‘difficult’. Note though that a general reading ease of difficult is quite acceptable for legislation as the ultimate readers of it should be educated to the necessary level.

For the STS legislation, an average Flesch Reading Ease Score of 46.1 was observed, and from this it can be inferred that the use of the TLIP drafting principles resulted in the legislation being simplified to an almost acceptable standard for professional advisors, but not taxpayers with Grade 10 to Grade 12 education or less. However, it is submitted that the STS legislative provisions are not easy to understand, which is in part due to the complexity of how the provisions interact with each other, rather than the drafting principles used. Such a conclusion is of concern when combined with criticisms that the actual operation of the provision is complex.

Note that in contrast, the average Flesch Reading Ease Score for the 1997 Act was 46.42 compared to 38.44 for the 1936 Act. This result would indicate that the TLIP drafting principles are responsible for increase in readability of the rewritten legislation, as the underlying policy was unaffected by the rewrite. Nonetheless, the use of the Flesch Readability Index is only one measure of assessing the ease of understanding of written material. It is submitted that the use of the TLIP drafting principles is still valuable, as it results in legislation being drafted into an easier structure to work with. Readers only need compare the appearance of the 1936 and 1997 Acts to verify this claim.

6. Conclusion
The TLIP was commenced with the ambitious aim of rewriting the 1936 Act into plain English, thereby allowing for greater understandability of the legislation and hopefully how it operates. This aim recognises the rule of law’s principle of formal legality, which requires that laws are drafted so that they are clear and specific as to their operation. The existence of

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209 As previously stated this result is similar to prior studies on the readability of the rewritten provisions of the 1936 Act, which found the ease of reading at a ‘difficult’ standard. See: David Smith and Grant Richardson, above n 9.

210 Refer to prior discussion of literature criticising the actual operation of the non-commercial loss and STS provisions.

211 David Smith and Grant Richardson, above n 10.

212 See Tax Law Improvement Project, above n 13, pp 200–201. The mandate of the TLIP team was only to reword, renumber and restructure the 1936 Act.
the principle of formal legality is imperative for taxpayers to be able to understand the tax system and how it may apply to them.

Whilst TLIP was abandoned before the rewrite of the income tax legislation was complete, it was submitted that the taskforce did formulate a considered drafting system that should improve the readability of tax legislation when the principles are used. This system included the four TLIP drafting principles of structure, numbering, language and layout.

The results of this study have found that the TLIP drafting principles are still being utilised when new provisions are being drafted for inclusion into 1997 Act. Of the new legislation studied, the readability is at an average level of 32.8 and 46.1 for the non-commercial loss and STS provisions respectively. Such a level means a minimum education level of a university undergraduate, which is above the average education level of Australians. However, it is submitted by the authors that the average taxpayer would not attempt to read taxation legislation, and the more pertinent audience are the taxpayers’ advisors. These advisors would be university graduates, which would indicate that the non-commercial loss and STS measures have been drafted to their requisite level of comprehension. This conclusion is consistent with the recent review by the Board of Taxation of the non-commercial loss provisions, where it concluded that ‘the legislation and guidance material are expressed in a clear, simple, comprehensible and workable manner’.213

An important finding of this study is that public rulings and determinations issued by the Tax Office were generally written at a lower level of comprehensibility requiring an education level of a university undergraduate. This is of particular concern as these rulings discuss provisions that are aimed at small businesses, a sector where compliance costs are regressive. Such a finding might not be surprising to someone who has a cursory look at, for example, the 177 paragraphs of TR 2002/11. It is submitted by the authors that such a result is inconsistent with the notion that taxpayers are more likely to read these public rulings and fact sheets than the legislation. Indeed the Tax Office in drafting fact sheets intends them to be for the easy dissemination of information to taxpayers. Such a result is unfortunate, although in respect of public rulings and determinations, this may be influenced by the fact that they involve the application of the law to scenarios – and such an analysis can be complicated, requiring a synthesis of legislative and case law with factual

213 Board of Taxation, above n 137, at p 6.
circumstances. Additionally, public rulings can contain direct quotes from judgements that may not be written with any simplicity of expression, adding to the overall difficulty in reading the ruling. Furthermore, the low readability of the ATO Interpretative Decisions is unfortunate, as their public release is suppose to enable taxpayers to understand the Tax Office’s internal guidelines in making decisions. The drafting of these Interpretative Decisions appears to be affected by the desire to ensure that the privacy of the original taxpayer is maintained, which may negatively impact on the ease of readability.

It will be interesting to see if the implementation of the new ruling system from January 2006 will see an improvement in the future of the readability of rulings, as readability is essential if the new regime is going to improve certainty. The Tax Office should consider whether the readability of their public rulings and determinations could be improved given their intended audiences.

Whilst the recent project announced to eliminate surplus inoperative legislation\(^{214}\) is a positive move in at least reducing the size of the income tax legislation, it is hoped that the TLIP drafting principles continue to be utilised for new legislation in the future, as they appear to improve readability.

\(^{214}\) Peter Costello, Treasurer, above n 122.
Appendix A

The Flesch Readability data for the Non-commercial Loss Provisions and Associated Written Material

Table A1 – The Readability of Selected Sections from Division 35 ITAA97

<table>
<thead>
<tr>
<th>Division 35 ITAA97</th>
<th>Name</th>
<th>Flesch Score</th>
<th>Words Per Sentence (average)</th>
<th>Passive Voice %</th>
</tr>
</thead>
<tbody>
<tr>
<td>35-5</td>
<td>Object</td>
<td>16.9</td>
<td>33.0</td>
<td>0</td>
</tr>
<tr>
<td>35-10</td>
<td>Deferral of deductions from non-commercial business activities</td>
<td>31.0</td>
<td>19.8</td>
<td>0</td>
</tr>
<tr>
<td>35-15</td>
<td>Modification if you have exempt income</td>
<td>44.7</td>
<td>30.0</td>
<td>0</td>
</tr>
<tr>
<td>35-20</td>
<td>Modification if you become bankrupt</td>
<td>50.4</td>
<td>35.3</td>
<td>0</td>
</tr>
<tr>
<td>35-25</td>
<td>Application of Division to certain partnerships</td>
<td>50.4</td>
<td>34.0</td>
<td>0</td>
</tr>
<tr>
<td>35-30</td>
<td>Assessable income test</td>
<td>39.1</td>
<td>80.0</td>
<td>0</td>
</tr>
<tr>
<td>35-35</td>
<td>Profits test</td>
<td>0.0</td>
<td>95.0</td>
<td>0</td>
</tr>
<tr>
<td>35-40</td>
<td>Real property test</td>
<td>53.9</td>
<td>26.7</td>
<td>0</td>
</tr>
<tr>
<td>35-45</td>
<td>Other assets test</td>
<td>49.3</td>
<td>29.6</td>
<td>0</td>
</tr>
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Table A2 – The Readability of Tax Office Publications on Non-Commercial Losses

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<thead>
<tr>
<th>Tax Office Publications (Fact Sheets)</th>
<th>Flesch Score</th>
<th>Words Per Sentence (average)</th>
<th>Passive Voice %</th>
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<tr>
<td>Non-commercial losses: the profits test – fact sheet</td>
<td>48.4</td>
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<td>Non-commercial losses: the assessable income test – fact sheet</td>
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<td>Non-commercial losses: Commissioners discretion – fact sheet</td>
<td>42.5</td>
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<td>Non-commercial losses: the other assets test – fact sheet</td>
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<td>Non-commercial losses: overview – fact sheet</td>
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<td>Non-commercial losses: partnerships – fact sheet</td>
<td>42.9</td>
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<td>Non-commercial losses: the real property test – fact sheet</td>
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<td>Non-commercial losses: similar business activities – fact sheet</td>
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### Table A3 – The Readability of ATO Interpretative Decisions on Non-Commercial Losses

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<th>Words Per Sentence (average)</th>
<th>Passive Voice %</th>
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<tr>
<td><strong>ATO ID 2001/295</strong> – Pre 2000/2001 carried forward business losses and Division 35</td>
<td>25.3</td>
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<td><strong>ATO ID 2002/44</strong> – Commissioner’s discretion in section 35-55 of the ITAA 1997 – no objective expectation</td>
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<td>29.9</td>
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<td><strong>ATO ID 2002/701</strong> – Commissioner’s discretion- Special Circumstances – expectation of taxation profit not decisive</td>
<td>21.5</td>
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<td><strong>ATO ID 2003/62</strong> – Non Commercial Losses: assessable income test – income from a personal income protection insurance policy is not income from a business activity</td>
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<td><strong>ATO ID 2003/88</strong> – Non Commercial Losses: Employment income and the Exception to Division 35</td>
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<td><strong>ATO ID 2003/89</strong> – Non Commercial Losses: assessable income test – income ‘from’ a business activity</td>
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<td><strong>ATO ID 2003/279</strong> – Non Commercial Losses: Assessable income test – whether an increase in the value of trading stock on hand for an income year is assessable income ‘from’ the business activity</td>
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<td><strong>ATO ID 2003/288</strong> – Non Commercial Losses: Assessable income test – whether a balancing adjustment is income ‘from’ the business activity</td>
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<td><strong>ATO ID 2003/329</strong> – Non Commercial Losses: Commissioner’s discretion – Sale of business activity as a going concern in the lead time</td>
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<td><strong>ATO ID 2003/332</strong> – Non Commercial Losses: whether business bank interest is assessable income from the business activity</td>
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<td><strong>ATO ID 2003/363</strong> – Non Commercial Losses: Lead Time Discretion – commercially viable period – purchase of business activity</td>
<td>21.3</td>
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<td><strong>ATO ID 2003/374</strong> – Non Commercial Losses: Real Property Test – Partnership assets</td>
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<td><strong>ATO ID 2003/407</strong> – Non Commercial Losses: profits test and change of business ownership</td>
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<td><strong>ATO ID 2003/426</strong> – Non Commercial Losses: bounties, subsidies and grants – assessable income ‘from’ the business activity</td>
<td>26.3</td>
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<td><strong>ATO ID 2003/569</strong> – Non Commercial Losses: is exempt foreign employment income included as income ‘from’ a business activity</td>
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ATO ID 2003/570 – Non Commercial Losses: is exempt foreign employment income included as assessable income from an unrelated source
ATO ID 2003/603 – Non Commercial Losses: Commissioner’s discretion – objective expectation of profit – cessation of business
ATO ID 2003/629 – Non Commercial Losses: lead time discretion – plant disease affecting the ‘commercially viable period’
ATO ID 2003/630 – Non Commercial Losses: Assessable income test – reasonable estimate
ATO ID 2003/631 – Non Commercial Losses: forestry – business not being carried on
ATO ID 2003/961 – Non Commercial Losses: loss deferral rule – long-term averaging of primary producers’ tax liability
ATO ID 2003/963 – Non Commercial Losses: artist exception – does incidental arts work in a business qualify the activity for the exception?
ATO ID 2003/1005 – Non Commercial Losses: other assets test – assets that have been pooled under the Simplified Tax System (STS)
ATO ID 2004/11 – Non Commercial Losses: ‘other assets test’ – rally cars
ATO ID 2004/112 – Non Commercial Losses: Farm Management Deposit withdrawal – assessable income ‘from’ the business activity
ATO ID 2004/262 – Non Commercial Losses: assessable income – whether Landcare grant is income ‘from’ the business activity
ATO ID 2004/468 – Non Commercial losses: artist exception – whether artist’s manager or agent is conducting a ‘professional arts business’
ATO ID 2004/506 – Non Commercial Losses: Other Assets test – valuation of trading stock
ATO ID 2004/510 – Non Commercial Losses: Property test and partly used dwelling for business
ATO ID 2004/642 – Non-commercial losses: do the beneficiaries of a discretionary trading trust carry on a business activity?
ATO ID 2004/644 – Non-commercial losses – real property test and land adjacent to a dwelling
ATO ID 2004/715 – Non Commercial Losses: other assets test – ‘similar rights’

AVERAGE

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Table A4 – The Readability of Public Rulings on the Non-Commercial Losses

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<tr>
<th>Public Rulings</th>
<th>Flesch Score</th>
<th>WPS (average)</th>
<th>Passive Voice %</th>
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<td>TR 2001/14 – Division 35 – non-commercial business losses</td>
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<td>TR 2003/3 – Income tax: Non-commercial losses – application of subsections</td>
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Appendix B

The Flesch Readability data for the STS provisions and associated written materials

Table B1 – The Readability of Selected Sections from Division 328

<table>
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<tr>
<th>Section</th>
<th>Name</th>
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<th>WPS (average)</th>
<th>Passive Voice %</th>
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<td>328-5</td>
<td>What this Division is about</td>
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<td>328-50</td>
<td>Objects of this Division</td>
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<td>328-105</td>
<td>STS accounting method</td>
<td>51.7</td>
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<td>328-110</td>
<td>When you start being an STS taxpayer</td>
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<td>328-115</td>
<td>When you stop being an STS taxpayer</td>
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<td>328-175</td>
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<td>328-190</td>
<td>Calculation</td>
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<td>Opening pool balance</td>
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<td>328-200</td>
<td>Closing pool balance</td>
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<td>328-210</td>
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<td>328-215</td>
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<td>328-225</td>
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<td>Trading stock for STS taxpayers</td>
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<td>Adjustments in certain cases</td>
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<td>Value of trading stock on hand</td>
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<td>328-365</td>
<td>Eligibility to be an STS taxpayer</td>
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<td>328-370</td>
<td>Meaning of STS average turnover</td>
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<td>328-375</td>
<td>Meaning of STS group turnover</td>
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<td>328-380</td>
<td>Grouped entities</td>
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<td>328-435</td>
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<td>328-440</td>
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Table B2 – The Readability of Tax Office Publications on the STS

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<th>Tax Office Publications (Guides, Fact Sheets &amp; Worked Examples)</th>
<th>Flesch Score</th>
<th>WPS (average)</th>
<th>Passive Voice %</th>
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<tbody>
<tr>
<td>The Simplified Tax System: A guide for tax agents and small businesses (NAT 6459)</td>
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<td>Simplified tax system – simplified capital allowances (depreciation) rules (NAT 9077)</td>
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<td>Simplified tax system – cash accounting method (NAT 3957)</td>
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<td>Simplified tax system – overview (NAT 3956)</td>
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<td>Prepaid expenses – taxpayers in the simplified tax system (NAT 7545)</td>
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<td>Simplified tax system: reconstituted partnerships – rollover relief – fact sheet</td>
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<td>Simplified tax system: simplified trading stock rules (NAT 4107)</td>
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<td>Simplified tax system: what is in it for my business (NAT 4590)</td>
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<td>Simplified tax system: building and construction calculating taxable income under the STS – worked example (NAT 3522)</td>
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<td>Simplified tax system: cleaner calculating taxable income under the STS – worked example (NAT 3521)</td>
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### Table B3 – The Readability of ATO Interpretive Decisions on the STS

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<th>WPS (average)</th>
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<td><strong>ATO ID 2003/38</strong> – Simplified Tax System (STS) – five year restriction on re-entry</td>
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<td><strong>ATO ID 2003/90</strong> – Simplified Tax System (STS): Disposal of trading stock</td>
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<td><strong>ATO ID 2003/91</strong> – Income tax: Simplified Tax System (STS): trading stock rules – STS taxpayers that elect to treat trading stock as disposed of at a closing value, other than market value</td>
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<td><strong>ATO ID 2003/389</strong> – Simplified Tax System (STS) capital allowances – continuing STS pool deductions after a business ceases</td>
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### Table B4 – The Readability of Public Rulings on the STS

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<th>Passive Voice %</th>
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<tbody>
<tr>
<td><strong>TR 2002/6</strong> – Income tax: Simplified Tax System: eligibility – grouping rules (*STS affiliate, control of non fixed trusts)</td>
<td>31.0</td>
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<td><strong>TR 2002/11</strong> – Income tax: Simplified Tax System eligibility – STS average turnover</td>
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### Table B5 – The Readability of Tax Determinations on the STS

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<th>Flesch Score</th>
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<tr>
<td><strong>TD 2003/25</strong> – Income tax: Simplified Tax System (STS): does paragraph 328-105(1)(a) of the Income Tax Assessment Act 1997 (ITAA 1997) apply to an amount received by an STS taxpayer, but not yet derived as ordinary income under the ordinary operation of section 6-5 of the ITAA 1997?</td>
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<td><strong>TD 2003/29</strong> – Income tax: Simplified Tax System: can an entity that has notified the Commissioner of its choice to stop being an STS taxpayer for an income year, later cancel that choice for that year?</td>
<td>28.1</td>
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<td><strong>AVERAGE</strong></td>
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