

**NEW ZEALAND’S TAX REWRITE PROGRAM –
IN PURSUIT OF THE (ELUSIVE) GOAL OF SIMPLICITY**

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Abstract

New Zealand embarked on a project to rewrite its core taxation legislation in 1993, anticipating that this project would be completed in five years. Thirteen years later in 2006 the Income Tax Act is nearing completion, but other core revenue acts have yet to “leave the starting blocks”. The cost of the project to date is approximately \$10 million for Inland Revenue in terms of drafting-related costs, plus yet to be quantified compliance costs for taxpayers and tax advisors. Empirical research provides some evidence of improvement in readability (as measured by the Flesch Reading Ease Index, Flesch-Kincaid Grade Level Index and Cloze Procedure - proxies for improved understandability of the Income Tax Act), suggesting that some progress has been made towards the goal of simplicity. Continual change of the underlying legislation through remedial legislation and new initiatives, especially welfare tax expenditures, undermines this effort and appears to have contributed to the “blow out” in the rewrite time frame in addition to underestimating the size of the project.

1.0 Introduction and background

1.1 The rewrite project - 1992 to 2002

The core concepts within New Zealand's ("NZ's") income tax legislation in 1992, the Income Tax Act 1976 ("the ITA 1976"), can be traced back to 1891. The structure on which the ITA 1976 was based has existed since 1916, when the Land and Income Tax Act comprised 43 pages and 169 sections. Since that time layers and layers of major changes and new groups of tax rules have been added to the legislation (encompassing a more comprehensive measure of income, reflecting the changing nature of tax and business in NZ), with the result that the Income Tax Act 2004 comprises over 2000 pages of text, and several flow diagrams within the core provisions. New Zealand's Income Tax Act has been recast on several occasions but it was not until the 1990s that it was comprehensively reviewed from a fundamental structural and presentational perspective, with the result being the Income Tax Act 1994 ("the ITA 1994") and more recently the Income Tax Act 2004 ("the ITA 2004").¹

By way of background the Valabh Committee suggested in its final report in 1992² that NZ's existing income tax legislation be reorganised and subsequently rewritten. The NZ Government readily accepted this recommendation, and moved immediately to establish a working party to oversee the reorganisation phase of the proposal.

The Working Party on the Reorganisation of the Income Tax Act 1976-1993 (the "Working Party")³ was delegated the task of reorganising the ITA 1976 and the Inland Revenue Department Act 1974 ("IRDA 1974") into three new statutes:

1. The ITA 1994, which would contain the necessary rules for taxpayers to calculate their tax liabilities;
2. The Tax Administration Act 1994 ("TAA 1994"), which would set out the administrative aspects of tax collection; and
3. The Taxation Review Authority Act 1994 ("TRAA 1994"), which would govern the role of the Taxation Review Authorities and the appeal process.

The aim of the reordering exercise (the first stage of the rewrite process) was to provide a more logical and coherent scheme and structure to the income tax legislation. Furthermore, following the Valabh Committee's recommendation, the

¹ For further background discussion see AJ Sawyer, "Comment: Rewriting the Income Tax Act 1994- The Income Tax 'Act' 2002", (2003) Vol 9:1 *New Zealand Journal of Taxation Law and Policy*, 12-25; and AJ Sawyer, "Rewriting Tax Legislation: Reflections on the NZ Experience", (2003) Vol 57:12 *Bulletin for International Fiscal Documentation*, 578-588.

² Consultative Committee on the Taxation of Income from Capital (the Valabh Committee), *Final Report of the Consultative Committee on the Taxation of Income from Capital*, (Government Printer, Wellington, October, 1992).

³ Working Party on the Reorganisation of the Income Tax Act 1976-1993, *Second Report of the Working Party on the Reorganisation of the Income Tax Act*, (Government Printer, Wellington, September, 1993).

existing core provisions were isolated when the ITA 1976 was reorganized as the ITA 1994, partly to assist the second stage of the rewrite process, but also as part of the functional organisational approach of the new legislation. The NZ Government also adopted a recommendation to undertake the rewriting in stages, with the intention of reducing the various costs⁴ generally incurred by taxpayers and society. The NZ Government reasoned that a rewrite in stages would make the task more manageable, allow taxpayers time to absorb the changes gradually, permit the development of guidelines for the drafting of legislation at each stage, and allow opportunities for consultation with the private sector at each stage of the rewrite. It was concluded that this approach would minimise educational costs incurred by taxpayers and improve draft legislation at an early stage to reduce compliance costs.

The Working Party fulfilled its obligations in 1994, when the bills reorganising the existing tax legislation were passed into law.⁵ Although the reorganisation process did not change the existing law,⁶ the format of the ITA 1994 differs significantly from that of its predecessor. In particular, the ITA 1994 has a new alphanumeric numbering system. It also groups the core provisions of the legislation together near the front of the ITA 1994, where previously they were scattered throughout its entirety. Likewise, the definitions in the legislation have been grouped together for ease of use, near the end of the legislation in Part O.

At the conclusion of the reorganisation of the income tax legislation, the Organisational Review Committee emphasised the need for the rewrite of the ITA 1994 to be given high priority.⁷ This call was heeded, and the NZ Government issued a discussion document in December 1994 dealing with the issues involved in the rewrite process.⁸ The discussion document set out the proposed course for the rewrite process, commenting that a gradual rewrite was desirable to allow taxpayers time to adjust to the changes. Accordingly, the rewrite was intended to take place over a period of four to five years, with the first phase being the reorganisation of the ITA 1976 and IRDA 1974 into the ITA 1994, TAA 1994 and TRAA 1994, the second phase involving the rewrite of the core provisions of the ITA 1994, and the third and fourth phases progressively rewriting the remainder of the ITA 1994 (including enacting the ITA 2004).

1.2 *The rewrite project – 2002 to 2006*

The rewrite project over the last five years has focused on refining the new structure and progressively redrafting Parts A to E of the Act using plain language (English) drafting techniques, incorporating this into the new ITA 2004 (enacted on 7 May

⁴ For example, compliance, administrative, and legal costs.

⁵ Income Tax Bill 1994, Tax Administration Bill 1994 and Taxation Review Authorities Bill 1994.

⁶ See A Nannestad, "Reading the 1994 Tax Legislation", [1995] 1 *New Zealand Tax Planning Report*, 5.

⁷ Sir Ivor Richardson, *Organisational Review of the Inland Revenue Department: Report to the Minister of Revenue (and on tax policy, also to the Minister of Finance) from the Organisational Review Committee*, (Wellington, Government Printing Office, April, 1994).

⁸ B Birch, and W Creech, *Rewriting the Income Tax Act 1994 - Objectives, Process, Guidelines: A Discussion Document*, (Government Printer, Wellington, December, 1994).

2004). Furthermore, prior to, and consequent to, the enactment of the ITA 2004, the following documents have been issued for purposes of consultation:

- a discussion document on the possible structure and content of Parts C, D, and E and their relationship to the new core provisions;⁹
- two issues papers identifying policy issues that had arisen in the course of rewriting;¹⁰ and
- an exposure draft of the rewritten legislation;¹¹
- an exposure draft on Part I – treatment of tax losses;¹²
- an exposure draft on Part H: Taxation of certain entities;¹³
- an exposure draft on Part G: Avoidance and non-market transactions;¹⁴
- an exposure draft on Part F: Recharacterisation for certain arrangements and entities;¹⁵
- an exposure draft on Part K: Credits of tax under family income assistance scheme and Part L: Credits of tax and other credits;¹⁶
- an exposure draft on Part M: Memorandum accounts;¹⁷ and
- an exposure draft on Part N: Tax collection rules and Part O: Definitions and related matters.¹⁸

Most recently, on 15 November 2006, the Income Tax Bill 2006 (“the 2006 Bill”) was tabled in Parliament, the culmination of 15 years work. The 2006 Bill, some 2700 pages in length, rewrites content from Part F to the end of the ITA 2004, with the rewrite of the earlier Parts having been enacted in the ITA 2004. The 2006 Bill also

⁹ *Rewriting the Income Tax Act: Parts C, D and E, A discussion document*, September 1997.

¹⁰ *Rewriting the Income Tax Act: Parts C, D and E; Issues Paper 1*; March 1998. *Rewriting the Income Tax Act: Parts C, D and E; Issues Paper 2*, June 1998.

¹¹ *Rewriting the Income Tax Act; Exposure Draft*, September 2001. This is in three volumes, with volume two containing the draft rewritten Parts A to E of the Income Tax Act 1994.

¹² *Rewriting the Income Tax Act 1994: Exposure Draft Part I*; September 2004.

¹³ *Rewriting the Income Tax Act 1994: Exposure Draft Part H*; March 2005.

¹⁴ *Rewriting the Income Tax Act 1994: Exposure Draft Part G*; August 2005.

¹⁵ *Rewriting the Income Tax Act 1994: Exposure Draft Part F*; November 2005.

¹⁶ *Rewriting the Income Tax Act 1994: Exposure Draft Part K and Part L*; December 2005.

¹⁷ *Rewriting the Income Tax Act 1994: Exposure Draft Part M*; March 2006.

¹⁸ *Rewriting the Income Tax Act 1994: Exposure Draft Part N and Part O*; June 2006.

re-enacts and consolidates Parts A to E and renumbers various sections in those Parts. The 2006 Bill also introduces a small number of intended changes to the legislation, all of which have been presented for public consultation.

Thus to summarise the discussion to date, the task of rewriting the Income Tax Act is being undertaken in stages. The first stage was the reorganisation of the ITA 1976 and IRDA 1974, which resulted, inter alia, in the enactment of the ITA 1994, TAA 1994 and TRAA 1994. This stage was completed in 1994. The second stage, the rewrite of the core provisions of the ITA 1994, was completed in 1996. The Income Tax Bill 2002 (“the 2002 Bill”), which rewrites Parts A to E and Y of the ITA 1994, is the third stage of the project, leaving approximately half of the ITA 2004 to be rewritten, concluding with the fourth stage, the 2006 Bill.

In the Regulatory Impact and Business Compliance Cost Statement accompanying the 2002 Bill the stated public policy objective is to ensure that NZ’s income tax legislation is clear¹⁹ and in the 2006 Bill this was extended to be not only clear but easily understood by its readers.²⁰ Only one feasible option to achieve this objective is presented, namely to rewrite the legislation and to undertake this in stages. Officials continued to hold the view that the income tax statute is too large to be rewritten all at once, preferring to retain the progressive rewriting approach.

The 2002 Bill became known as the ITA 2004 once it was enacted. The exposure drafts on rewriting Parts F to O were introduced as legislation via the 2006 Bill in mid November 2006, representing the conclusion of the rewrite of the ITA 2004. Nevertheless this leaves the remaining key revenue acts, namely the TAA 1994, TRAA 1994 and the Goods and Services Tax Act 1986 (“the GSTA 1986”) yet to be rewritten.

The 2006 Bill contains a number of intended changes, along with an expansion of the former parts L, M and N to incorporate Parts O and R, necessitating that the former definition Part O be moved to a new location, namely Part Y. Part Z now contains the transitional provisions. Officials also note that the options for this last stage of the rewrite were:²¹

- 1 To amend the current Act by replacing Parts F to O and consequentially amending the schedules and Parts A to E;
2. To introduce a new Act which re-enacts Parts A to E (and consolidates amendments made to those parts since 1 April 2004), rewrites Parts F to O, and makes all necessary consequential amendments, including renumbering.

¹⁹ NZ Government, *Explanatory Note: Regulatory Impact and Business Compliance Cost Statement to the Income Tax Bill 2002* (2002), 6.

²⁰ NZ Government, *Explanatory Note: Regulatory Impact and Business Compliance Cost Statement to the Income Tax Bill 2006* (2006), 6.

²¹ See n 20, 6-7.

Officials concluded, correctly in my view, that the extent of the post 2004 amendments to Parts A to E and the extent of the consequential amendments throughout the process made the second option the only realistic choice.

New Zealand has not been alone in seeing the need for rewriting its tax legislation. Similar work has been undertaken in Australia and the United Kingdom (“UK”), although in the former the rewrite process is effectively on a ‘permanent hold’ while more radical changes to the tax system are debated. In the UK the Tax Law Rewrite Project (“the TLRP”) has published a further Income Tax Bill for a final round of public consultation that closed on 31 May 2006. This bill is the third in a series of bills dealing with income tax and when enacted will complete the TLRP’s work on income tax, with corporation tax the next area.²² Further discussion on developments in other countries is beyond the scope of this paper, although some evidence of a qualitative comparative nature is provided in section 3 of this paper.

1.3 *The Rewrite Advisory Panel*

The Rewrite Advisory Panel (“the Panel”) was established in 1995, consisting of one representative each from the New Zealand Institute of Chartered Accountants (“NZICA” – formerly the Institute of Chartered Accountants of New Zealand – represented by Craig Macalister), the New Zealand Law Society (“NZLS” – represented by Casey Plunket), the Inland Revenue Department (“IRD” – represented by Robin Oliver) and the Treasury (represented by David Snell). It is chaired by former President of the Court of Appeal, the Rt Hon Sir Ivor Richardson. The Panel’s initial brief or purpose was to consider and advise on issues arising during the rewriting of the ITA 1994.

When reporting back the ITA 2004, the Finance and Expenditure Committee (“the FEC”) noted that unintended changes in the law may arise from the difference in language between the old and new Acts notwithstanding the best efforts of the drafters to avoid this. Thus the FEC proposed the appointment of an independent committee to review submissions regarding any differences between the two Acts and to recommend appropriate action, suggesting that the Panel take on this role, a recommendation that was subsequently adopted.²³

A formal process was called for to identify such issues with the Panel to deliberate and refer them to the Government for consideration. Consequently the Panel has two core functions in this regard:²⁴

²² For further discussion on the early stages of the comparative rewrite processes in Australia, New Zealand and the United Kingdom, see S James, A Sawyer and I Wallschutzky, “The Complexities of Tax Simplification: Progress in Australia, New Zealand and the United Kingdom”, (1998) Vol 14:1 *Australian Tax Forum*, 29-68.

²³ See Rewrite Advisory Panel, “Process for resolving potential unintended legislative changes in the Income Tax Act 2004 (RAP 001)”, (2004) Vol 16:6 *Tax Information Bulletin* (July) 35-38.

²⁴ See the Panel’s website at: <http://www.rewriteadvisory.govt.nz>, where the Panel’s brief is set out and a log of issues available for review.

- to ensure that there is a procedure in place to identify any policy issues that might arise from the rewrite drafting instructions or draft legislation and to refer such policy issues to the Government with relevant comments; and
- to act as a “steering committee” and report periodically to the NZ Government on the achievement by the project team of pre-determined milestones and adherence to agreed processes, including adequate public consultation.

Upon identification of an unintended legislative change, the NZ Government would decide whether to:

- enact an amendment to reinstate or modify the meaning of the pre-existing law, or
- permit the unintended change to be retained in the legislation.

The NZ Government will also decide whether the issue merits wider consultation under the generic tax policy process (“the GTPP”),²⁵ such as whether a government discussion document is warranted. The Panel provided the NZ Government with critical assistance in the development of the 2002 Bill and continues to provide an important source of resolving potential unintended changes from the rewriting process, particularly since the enactment of the ITA 2004 in May 2004.

In a joint presentation by NZICA and NZLS made during 2005,²⁶ there had been 41 submissions. Of the 41 submissions made, 27 have been considered by the Panel, one has been withdrawn, and the balance are either under consideration by Officials, or awaiting a decision of the Panel. Of the 27 submissions that have been considered, 16 have resulted in recommendations for amending legislation (including the recommended addition of a reference to an intended change in Schedule 22A), and 11 have not resulted in any change. The level of submissions and consequential number of recommendations for changes, emphasises the importance of the Panel’s contribution to the rewrite project.

1.4 *Early commentary on the rewrite project*

Some commentators have a preference for a complete rewrite in one step, rather than what they see as a piecemeal approach. For instance, Prebble²⁷ observes that a piecemeal approach is fraught with dangers, including a long drawn-out process of up to ten years with legislation in a state of flux. Prebble suggests as an alternative rewriting process of running parallel to the existing statute a rewritten statute,

²⁵ For further discussion on the GTPP, see AJ Sawyer, “Broadening the Scope of Consultation and Strategic Focus in Tax Policy Formulation: Some Recent Developments”, (1996) Vol 2:1 *New Zealand Journal of Taxation Law and Policy*, 17-39.

²⁶ Craig Macalister and David McLay, *Income Tax Act 2004: The Scorecard to Date* (2005) (NZICA and NZLS). This presentation is derived from Craig Macalister and David McLay, *2004 Income Tax Act: Continuing Professional Development paper PD-S.783* (August, 2005).

²⁷ J Prebble, “Evaluation of the New Zealand Income Tax Law Rewrite Project from a Compliance Cost Perspective”, (2000) Vol 54 *Bulletin for International Fiscal Documentation* 290, 298.

publishing drafts for comment. In my view (which I have expressed elsewhere²⁸), this approach also has its dangers if the rewrite process is not completed. The Australian approach of running two Acts in parallel and leaving the process in limbo is testament to this risk.

The rewriting process has as one of its aims to make the legislation clearer which should result in an overall reduction in business compliance costs. The reorganisation of material into a consistent structure and rewriting in plain language will make it easier for readers to locate all the material they need to read and potentially to understand what they read, thus in the longer term saving both time and cost. The NZ Government's key objective in rewriting the ITA 1994 is to make the legislation clear and easy to read without changing the substance of the content of the current legislation. Nevertheless, the intention of the rewrite process is not to eliminate all complexity and inconsistency from the legislation because the subject matter is inherently complex. The challenge "... is to ensure that the complexity results from the concepts rather than the way the information is presented."²⁹ The issue of inherent complexity is exacerbated by the use of fictions and the "ectopian nature" of income tax law, a concept promoted by Prebble.³⁰

Summarising this section of the paper, NZ announced that it would be commencing a program of reorganising and rewriting its tax legislation in the early 1990s with the ensuing project to be completed over a four to five year period commencing in 1993. The aim of the rewrite project is to reorganise, renumber and rewrite NZ's income tax (and related) law in order that it may be more easily understood by those who need to read it and that the associated costs of compliance will be reduced. As at late 2006 the project is nearing completion (with respect to the Income Tax Act) by the introduction of the 2006 Bill but has barely started with respect to other revenue statutes. New Zealand is not alone in this process but remains the most advanced compared with Australia and the UK. The Rewrite Advisory Panel was set up in 1995 to consider potential unintended changes to the law caused by the rewrite project, and has received numerous requests, particularly since 2004.

The remainder of this paper is structured as follows. Section 2 evaluates the costs involved in the rewriting process to date, comparing this with the initial expectations. This section also considers the compliance costs, costs of the rewrite project, and the blow-out in time frame for the project. Section 3 examines the research directed at measuring the effectiveness of the rewrite project to improve understandability as measured through readability. Section 4 considers the impact that the increased use of tax expenditures is having on complexity, while section 5 offers some concluding comments and recommendations for further research.

²⁸ See AJ Sawyer, "Rewriting Tax Legislation: Reflections on the NZ Experience", (2003) Vol 57:12 *Bulletin for International Fiscal Documentation*, 578-588.

²⁹ See J James and B Cumberland, "Tax Update" [2001] *New Zealand Law Journal* 406, 406.

³⁰ J Prebble, "Parsons Address: Income Taxation: A Structure Built on Sand" (2002) Vol 24 *Sydney Law Review* 301.

2.0 Evaluating the costs of the rewrite process

The costs of the rewrite project largely fall into two categories: compliance costs of taxpayers and the administrative costs of the IRD (the rewrite project costs itself) and the Panel's costs.³¹

2.1 Compliance costs

To date there is no empirical evidence of the impact on compliance costs associated with the rewrite project other than early comment incorporated into the Regulatory and Business Compliance Cost Statement comprising part of the 2002 Bill. The Regulatory and Business Compliance Cost Statement to the 2002 Bill notes:³²

“Making the law clearer will result in an overall reduction in business compliance costs. The reorganisation of material into a consistent structure, and its rewrite in plain language, will make it easier for readers to locate all the material they need to read and to understand what they read. As a result, taxpayers will not need to consult tax professionals as often as they do now, and tax advisers will be able to understand and apply the law more quickly. For similar reasons, it will also lower the costs for Inland Revenue Department staff and for the courts.” (emphasis added)

Likewise in the 2006 Bill Officials state in the Regulatory and Business Compliance Cost Statement:³³

“The new Act will not change the compliance costs associated with the underlying policy of the current Act. This is because it will not alter existing policy content or regulatory requirements, apart from a small number of minor policy modifications. ...

As with any new law, the new Act will initially cause increased costs to the community. ...

The rewritten legislation will increase compliance costs in the short term. It reorganises the legislation in the current Act into a more consistent framework and rewrites it in plain language. As a result, users of the legislation will incur increased compliance costs during a transitional period in relearning its structure and language and in becoming familiar with the relevant case law.

All taxpayers and their advisors will be affected by the new Act. However, *the persons most affected will be advisors on income tax matters.* During the transition from the current Act to the new Act, there will be an increase in

³¹ The costs of the Panel are not anticipated to be significant relative to the compliance costs of taxpayers and the administrative costs of the IRD and hence are not considered further in this paper.

³² NZ Government, *Explanatory Note: Regulatory Impact and Business Compliance Cost Statement to the Income Tax Bill 2002*, (2002), 7.

³³ NZ Government, *Explanatory Note: Regulatory Impact and Business Compliance Cost Statement to the Income Tax Bill 2006*, (2006), 5, 7-8.

compliance costs for existing users. They will need to update their knowledge of the legislation to take into account the new placement and organisation of provisions and the language used in the rewritten Parts, and to deal with any impacts these changes have on existing case law. It is not possible to quantify this increase because there is no way of estimating the behavioural responses of users or the issues they will face. *Practical experience with the new legislation is the only way to determine the size of the increase in compliance costs.*” (emphasis added)

These statements acknowledge that the ITA 2004 and the ITA 2006 (once it is enacted) will initially cause increased costs to the community since existing users will need to update their knowledge of the legislation to take into account the new placement of provisions and the language used in the rewritten Parts. However, Officials are of the view that the benefit of clear legislation will arise in the longer term through making the law clearer, which they claim is supported by the comments in Appendix H of the Organisational Review Committee’s report.³⁴ In this report the Organisational Review Committee states that tax legislation was very difficult to read and understand, and this must have a direct bearing on the cost of administering and complying with the legislation. Officials suggest that the reorganisation of material into a consistent structure, and its rewrite in plain language, will make it easier for readers to locate all the material they need to read and to understand what they read. Furthermore, Officials consider that there will be a reduction in net administration and compliance costs in the longer term. Empirical research needs to be undertaken to assess these claims concerning compliance costs and benefits.

2.2 Administrative costs

The rewrite project was initially envisaged to take four to five years to rewrite the ITA 1994 (following the first stage of the reorganisation), with the other key revenue acts to follow (in particular, the TAA 1994 and the GSTA 1986). By year five, when the process was originally anticipated to be complete, the legislation had been reorganised and the core provisions rewritten, with the first issues papers emerging on matters arising involving the rewriting Parts C, D and E. The remaining Parts F to O have been rewritten through the introduction of the 2006 Bill. While no public projections of the total administrative costs of the project have been provided, the total costs of the project to date (including estimated costs), are set out in Table 1:³⁵

³⁴ Sir Ivor Richardson, *Organisational Review of the Inland Revenue Department: Report to the Minister of Revenue (and on tax policy, also to the Minister of Finance) from the Organisational Review Committee*, (Wellington, Government Printing Office, April, 1994).

³⁵ Source of data is the Inland Revenue Department’s Annual Reports for the years ending 30 June 1994 to 30 June 2005 (inclusive), plus the IRD’s Forecast Report for the years ending 30 June 2005 and 30 June 2008 (stating projected figures). Copies of these reports are available from the IRD and for recent reports are available on-line from the IRD’s website at: <http://www.ird.govt.nz> under “business reports”.

* It should be noted that as from the 2004 year the IRD does not separately state the costs of the rewrite project but rather includes it in the figure for legislative drafting. These figures are estimates only using actual data from the more recent years and considering the level of activity in terms of exposure drafts in the three most recent years.

Table 1: Expenditure on the Rewrite Project: 1995 to 2006 (nominal dollars):³⁶

| Year ending 30 June | Annual Expenditure \$000 | Cumulative Expenditure \$000 |
|--------------------------------|-------------------------------------|---|
| 1995 | 768 | 768 |
| 1996 | 1,467 | 2,235 |
| 1997 | 933 | 3,168 |
| 1998 | 1,052 | 4,220 |
| 1999 | 1,309 | 5,529 |
| 2000 | 838 | 6,367 |
| 2001 | 1,298 | 7,665 |
| 2002 | 483 | 8,148 |
| 2003 | 385 | 8,533 |
| 2004* | 300 | 8,833 |
| 2005* | 350 | 9,183 |
| 2006* | 450 | 9,633 |
| Average annual / Total | \$803 | \$9,633 |

Thus the total cost of the rewrite project to the year ended 30 June 2006 is an estimated \$9.6 million. This accounts for the work on reorganisation and rewriting up to and including Parts C, D and E, plus exposure drafts on Parts F to O (which have been included in the 2006 Bill). With the rewriting task on the ITA 1994/2004 nearly complete (Parts F to O have been incorporated into the 2006 Bill), the costs for embarking on rewriting the TAA 1994, and perhaps the TRAA 1994 and the GSTA 1985, can be expected to be in the millions of dollars as well (should these statutes actually be formally included in a future rewrite project). The total direct cost (not including taxpayers' compliance costs, normal consultation and submissions costs on exposure drafts and bills, etc) can be expected to reach conservatively approximately \$15 million (in nominal dollars). One can justifiably ask; has it been (or will it eventually be) worth the expense? Officials somewhat nebulously contend this can only be assessed in the longer term.

To summarise, the administrative costs (and period of work) of the rewrite project have "ballooned" beyond the original budget to a figure approaching NZ\$10 million as at June 2006, yet New Zealand continues to "box on" (as is the UK), notwithstanding Australia's decision to "put on hold indefinitely" the Tax Law Improvement Project (TLIP).

³⁶ Based on a table in AJ Sawyer, "Rewriting Tax Legislation: Reflections on the NZ Experience", (2003) Vol 57:12 *Bulletin for International Fiscal Documentation*, 578-588, updated for more recent data.

2.3 *An external review – NZICA and NZLS*

In their appraisal of the rewrite project, NZICA and NZLS are of the view that the plain language drafting style is ‘refreshing’, but that it not devoid of ambiguity.³⁷ NZICA and NZLS believe that the drafting style and structure of the ITA 2004 are very good, with some of the legislative provisions vastly improved in readability. Nevertheless, these organisations consider that some rewritten provisions are not improvements, with a number of annoying issues arising. On balance their representatives combined view is that the ITA 2004 is an improvement, but whether it results in reduced compliance costs is too early to assess.

In its submission on the Taxation (Annual Rates, Savings Investment, and Miscellaneous Provisions) Bill, NZICA observes that the Panel has identified that the ITA 2004, as originally enacted, contains some unintended changes in legislative outcomes. The Panel recommended that these changes in outcome be corrected, with effect from the beginning of the 2005-06 income year.³⁸ Unsurprisingly NZICA stated that it supports the Panel processes and notes the “good work” that the Panel is doing.

In their overall assessment, Macalister and McLay are of the view that the ITA 2004 scores 85-90 percent for clarity, 85-90 percent for ease of application, and 75-80 percent for preservation of the effects of the ITA 1994, giving an overall B+ grade. In my view this assessment is rather harsh – I would consider a more appropriate assessment to be an overall A-, implying a very good effort but with some room for improvement. Their assessment does not incorporate a cost/benefit analysis.

2.4 *Other issues*

The process has produced clearer legislation in terms of shorter sentences and marginally improved readability, yet there has been several iterations of sections as they were first reorganised, then revised with the rewritten core provisions and most

³⁷ Craig Macalister and David McLay, *Income Tax Act 2004: The Scorecard to Date* (2005) (NZICA and NZLS). This presentation is derived from Craig Macalister and David McLay, *2004 Income Tax Act: Continuing Professional Development paper PD-S.783* (August, 2005).

³⁸ NZICA, Submission to the Finance and Expenditure Committee on Taxation (Annual Rates, Savings Investment, and Miscellaneous Provisions) Bill (2006) (July). The panel identified that the provisions affected are:

- section DB 9B (Base price adjustment under old financial arrangement rules);
- section DB 36 (Bribes paid to public officials);
- section EE 33 (Transfers of depreciable property between associated persons in a nonqualifying amalgamation);
- section EX 36(1) (Immigrant’s accrued superannuation entitlement exemption),
- section EY 8(3)(b) (Meaning of life insurance),
- section FC 21(3) (Amounts derived by non-residents from renting films),
- section NG 1(2) (Application of NRWT rules),
- section OB 1 (Definition of fixed rate share), and
- schedule 22A (Identified policy changes).

In addition, some corrections to cross-references and terms used in sections EX 52, EX 53, OD 5(6F), and OD 8(3) are being made.

rewritten yet again through the rewriting of Parts C to E. Policy changes have been introduced and debated, compliance costs have undoubtedly increased, a number of binding rulings and cases have been rendered redundant (with the process of applying for and issuing binding rulings revamped as a result of first stage of the rewrite process). Not surprisingly, a need has arisen for judicial interpretation of the rewritten provisions, along with increased use of the Panel.

Concurrently there have been legislative amendments undertaken for other policy reasons, requiring incorporation, including the formalisation of self assessment and the removal of many of the Commissioner's discretions.³⁹ By adopting a piecemeal approach to rewriting the legislation, this has necessitated more transitional and savings provisions (predominantly located in Part Y) between the various iterations of the legislation at each stage of the rewrite process.

As noted previously the rewrite project was originally envisaged to be a five year task, commencing in 1994 and to be completed by 1999. It was originally intended to focus on correcting errors and converting the text via plain English drafting. However, throughout the process numerous policy issues have emerged and through attempts to address these (via the release of issues papers, and exposure drafts of legislation), the process has been considerably slowed. It is now 13 years on and the ITA 1994/2004 has just been completely rewritten through the introduction of the 2006 Bill.

As noted by Sawyer,⁴⁰ a major lesson to be learnt is that it is all too easy to underestimate the size and scope of a project at an early stage before the true nature of its breadth and implications are revealed. One could ask whether the project would have been commenced at all had the extent of the policy issues been known at the outset, and now one may also ask whether the process will go beyond rewriting the ITA 1976 into the ITA 1994/2004/2006. However, even without the benefit of hindsight, one would be naive in the least to not have expected policy issues to arise in the process of redrafting complex legislation, which was incoherent in parts and originally drafted over many decades.

Further issues arising from the rewrite project involve the applicability of existing case law to the rewritten provisions (which may lead to applications for status rulings) and the need for adequate transitional and savings provisions. These provisions need to be robust to preserve existing case law and policy, as well as to allow retrospective legislation if there is an inadvertent change. Even with the enactment of the ITA 2004, the single largest statute yet to be enacted by the NZ Parliament (the 2006 Bill once enacted as the ITA 2006 will be a third larger than the ITA 2004!), there remains

³⁹ Other major changes include: the new tax dispute resolution process in 1996; the new civil and criminal penalties regimes in 1997; consequences of the Inquiry into the Operations of the IRD in 1999; GST and FBT reviews in 1999/2000; various tax simplification initiatives from 1992 to 2005; and a further FBT review in 2005/2006. For a more comprehensive analysis of announcements of changes since mid 1999, see the IRD's tax policy website at: <http://www.taxpolicy.ird.govt.nz> under "news".

⁴⁰ See n 36.

plenty of reading ahead for tax advisers in order that they become familiar with the rewritten Parts F to O of the ITA 2004 which now appear in the 2700 page 2006 Bill.

3.0 Research evaluating the effectiveness of the rewrite project

3.1 Prior published readability studies – Flesch Reading Ease formula

Research directed at measuring whether the rewritten legislation to date has achieved its aims of increasing understandability and reducing compliance costs provides weak support of the rewrite project's "success" to date. For instance, Richardson and Sawyer⁴¹ make the following observation:⁴²

"It is interesting to note that both the reorganisation and rewrite phases of the simplification of New Zealand's income tax legislation have contributed to the reduction in the average sentence length. It was expected that the rewrite process would result in such a reduction, but the dramatic effect that the reorganisation of the legislation had on reducing average sentence length was not predicted."

In terms of readability, one measure frequently used is the Flesch Reading Ease Score.⁴³ In their study on the core provisions and reorganisation phases, Richardson and Sawyer⁴⁴ found that in comparison to the Tan and Tower study in 1992,⁴⁵ the overall readability, as measured by the Flesch Reading Ease Score, has improved significantly, from a mean of less than 2 to a combined mean of over 16. It was noted that the readability scores for the interpretation provisions (Part A) are significantly higher than for the core provisions (Part B). Also, the average sentence length was in the range of 40 to 50 words per sentence, which is much closer to the suggested benchmark of 30 words than the ITA 1976 achieved.

Richardson and Sawyer⁴⁶ also observe that the extent to which the reduction in average sentence length in the legislation will improve the readability of NZ's tax laws is debatable. Although it is unquestionable that a reduction in average sentence length from over 300 words per sentence to around 50 will increase readability, the results must be interpreted with caution. In particular, sentence length is only one of the variables thought to play a role in determining the readability of a passage of text.

⁴¹ M Richardson and A Sawyer, "Complexity in the Expression of New Zealand's Tax Laws: An Empirical Analysis" (1998) Vol 14:3 *Australian Tax Forum* 325.

⁴² See n 41, 349.

⁴³ See R Flesch, *How To Write Plain English*, (Harper and Row, New York, NY, 1979). The Flesch Reading Ease Score measures sentence length and the number of syllables to determine readability, and is represented by The Flesch Reading Ease Score = $206.835 - 0.846w1 - 1.015sl$, where: $w1$ = number of syllables per 100 words; and sl = average sentence length in words. For discussion on the use of the Flesch Reading Ease Score in the tax context, see LM Tan and G Tower, "The Readability of Tax Laws: An Empirical Study in New Zealand", (1992) Vol 9 *Australian Tax Forum*, 355, 361-363; and Richardson and Sawyer, n 38, 336-338.

⁴⁴ See n 41.

⁴⁵ Tan and Tower, n 43.

⁴⁶ See n 41.

For NZ's tax legislation (and for many other countries as well), other factors likely to impact on readability include the background knowledge of the reader, the language used, the organisation of the material, and the addition of the various flow diagrams in the rewritten core provisions. The Richardson and Sawyer study does not take into account such factors, thus the results should be interpreted with care.

A comparative analysis and discussion is undertaken by Smith and Richardson⁴⁷ who employ the Flesch Reading Ease index on the rewritten Australian tax legislation, along with the Flesch-Kincaid Grade level index.⁴⁸ The authors contrast their results with the prior New Zealand studies, and also conclude that while there has been some improvement in readability in the Australian income tax legislation, the results fall well short of acceptable benchmarks.

3.2 Recent unpublished readability research - Flesch Reading Ease formula

The most recent research in this area on New Zealand tax legislation was conducted by Pau.⁴⁹ Her results indicate that further improvements in the readability of the income tax legislation have occurred through the rewriting of parts A – E and the enactment of the ITA 2004. In relation to the rewritten Parts A and B, the Flesch Reading Ease Score has increased slightly and the average sentence length has been further shortened. While the Flesch Reading Ease Score has increased, it is interesting to note that the F-KGL Index has increased for both Parts A and B. Pau's analysis of Parts C and D indicates that the rewrite has significantly improved the readability, with the average Flesch Reading Score increasing from 17 to approximately 40. In addition, the average sentence length has reduced to approximately 30 words per sentence, which represents a reduction of approximately 55 percent from Richardson and Sawyer and an achievement close to the benchmark. However, the improvement in the readability of Part E has not been as dramatic compared to Parts C and D.

Pau comments that the readability of the 28 new sections in the ITA 2004 (that were not in the ITA 1994) were analysed in accordance with the guidelines provided by the Working Party.⁵⁰ These new sections average 34 words per sentence, compared to the 30 words recommended by the Working Party.⁵¹ However, six of the sections exceeded the Working Party's guideline by over 50 percent. The Flesch Reading Ease Score for the new sections ranges from 0 to a score as high as 76.5, with an average of 37.3.

⁴⁷ D Smith and G Richardson, "The Readability of Australia's Taxation Law and Supplementary Material: An Empirical Investigation" (1999) Vol 20:3 *Fiscal Studies* 321.

⁴⁸ The Flesch Kincaid Grade Level Index also measures readability, and is calculated as follows: F-KGL Index = 0.39 (words/sentence) + 11.8 (syllables/word) – 15.59.

⁴⁹ C Pau, Complexity of the New Zealand Tax Laws: An Empirical Study, *B Com Honours paper*, (Department of AFIS, University of Canterbury, 2006).

⁵⁰ Working Party on the Reorganisation of the Income Tax Act 1976-1993, *Second Report of the Working Party on the Reorganisation of the Income Tax Act*, (Government Printer, Wellington).

⁵¹ See n 50.

Pau concludes⁵² that the rewrite project has so far been successful in improving the overall readability of the income tax legislation, evidenced by an increase in the Flesch Reading Ease Score from 1.03⁵³ to 41.7. In addition, there has been steady improvement in the Flesch Reading Ease Score of the Income Tax Act from 1976 to 1994, and also to the 2004 version. Pau comments that even though the readability of the ITA 2004 is not as spectacular as the readability of the Australian's Income Tax Assessment Act 1997, the results do show a remarkable improvement in the NZ income tax legislation following the reorganisation of the ITA 1976 and the rewrite of Parts A to E of the ITA 1994. The considerable increase in the Flesch Reading Ease Score is largely due to a significant reduction in the average sentence length from 324 words⁵⁴ to 34 words per sentence, representing a total reduction of 90 percent from the ITA 1976 to the ITA 2004. However, she notes that 13 of the 54 existing sections have increased its sentence length, with 5 of the sections having an increase of over 50 percent. Moreover, the percentage of passive sentences used has increased for 5 of the 54 sections. These are a cause for concern, given that the rewrite intends to make use of shorter sentences and active voice.

An important observation is made by Pau such that the decrease in the Flesch Reading Ease Score for a number of sections is the result of a shift in the use of semicolons in the ITA 1994 to the use of colons in the ITA 2004. This implies that future rewrites should make use of semicolons rather than colons as this appears to improve the readability of the section.⁵⁵

Pau's results provide evidence that the readability of ITA 2004 is now comparable to the Australian Income Tax Assessment Act 1997. Smith and Richardson⁵⁶ reported a Flesch Reading Ease Score of 46.42 and an average of 22.27 words per sentence, compared to the Flesch Reading Ease Score of 41.7 and an average of 34 words per sentence reported in this study. While the Flesch Reading Ease Score and the sentence length indicate a better readability for the Australian Income Tax Assessment Act 1997, the F-KGL Index score (after rounding to the nearest grade level) shows that an 11th grade student⁵⁷ can understand both the NZ and the Australian income tax legislation.

However, Pau acknowledges that the results of her study should be interpreted with caution; this applies to any study utilising readability formulae, including the Flesch Reading Ease Score. The Flesch Reading Ease Score, F-KGL Index, sentence length and percentage of passive sentences utilised in her study are not comprehensive

⁵² See n 49, 25-27.

⁵³ As reported in Tan and Tower, see n 43, 367.

⁵⁴ As reported in Richardson and Sawyer, see n 41, 344.

⁵⁵ See n 49, 27.

⁵⁶ See n 47, 330.

⁵⁷ This is based on the US grade level. This is equivalent to Form 4 in New Zealand.

measures of readability. Redish and Selzer⁵⁸ assert that readability formulae are inadequate measures of how difficult technical material is to read on the grounds that readability formulae do not take into account the content, organisation and layout of reading material. In addition, other factors that can also impact on readability such as the frequency of changes, the background knowledge of the reader, the interest of the reader and the use of diagrams and flowcharts, has not been taken into consideration. For example, a university undergraduate student with a degree in accountancy should find the income tax legislation easier to understand than an undergraduate student with a degree in psychology.⁵⁹

Pau acknowledges that readability is only one measure of tax complexity. Other factors such as the frequency of rewrites have an impact and have not been considered in her study. While the rewrite of the tax legislation has improved readability, the same cannot necessarily be said for the complexity of a tax system. The reorganisation of the ITA 1976 and IRDA 1974 into the ITA 1994, TAA 1994 and TRAA 1994, and the subsequent enactment of the ITA 2004, has meant that users of the NZ's income tax legislation have had to keep up to date with the changes made in each version of the legislation and become familiar with the ITA 2004. Simplifying the tax system in the long term may have compromised the complexity in the short term.⁶⁰

3.3 *Inland Revenue commissioned research - Interviews*

In March 2006 the Rewrite Advisory Panel, in conjunction with IRD tax policy officials, commissioned Richard Castle, a Wellington-based lawyer (but non-tax specialist), to undertake a staged, post-publication review of the ITA 2004. The first stage was to identify the various methodologies available for evaluating the readability of the legislation (although readability formulae and a full empirical survey with questionnaires were excluded from consideration).⁶¹ The six possible scenarios considered by Castle (namely: report by a single expert; report by a panel of experts; report by a single expert with core reference group; report by a single expert with linguist support; qualitative study; and a limited quantitative study) were evaluated. Table 2, based on Castle's *Methodology Report*, sets out the evaluation of the relative merits of the six possibilities against a number of criteria. The criteria have all been assumed to be of equal importance and given a value of 1 to 5 where 1 is weak and 5 strong. For example high cost = 1, high credibility = 5. The results are shown in order of score, with the top scoring possibility first.

⁵⁸ J Redish, and J Selzer, "The Place of Readability Formulas in Technical Communication", 1985, *Technical Communication*. Retrieved from <http://www.rbainformationdesign.com.au/Readability%20Formulas.pdf>.

⁵⁹ See n 49, 26.

⁶⁰ See n 49, 26.

⁶¹ R Castle, *Income Tax Act 2004: Parts A to E – A Model for a Review* (April 2006); this is known as the "Methodology Report".

Table 2: Results of Methodological Evaluation (Source Castle, p 68)

| | Cost | Time | Test-ability | Manage-ability | Credibility | Final Score |
|---|------|------|--------------|----------------|-------------|-------------|
| Single expert with linguist support | 3 | 4 | 5 | 4 | 4 | 20 |
| Single expert | 5 | 5 | 0 | 5 | 2 | 17 |
| Single expert with core reference group | 4 | 4 | 1 | 4 | 3 | 16 |
| Qualitative study | 1 | 3 | 4 | 3 | 5 | 16 |
| Limited quantitative study | 2 | 2 | 5 | 3 | 3 | 15 |
| Panel of experts | 2 | 3 | 1 | 4 | 3 | 13 |

Castle's preferred alternative was accepted by the IRD and as the expert, in his second (and very comprehensive report), he provides an overview of what is meant by readability (and how it may be operationised with respect to the ITA 2004), and reviews improvements since the ITA 1976 and the ITA 1994.⁶² Three key questions (in relation to the IRD's drafting approach in the ITA 2004) were asked by Castle in his review:⁶³

1. How much have we improved?
2. Are we following our own precepts?
3. Are we as good as we could be?

In relation to the first question Castle concludes the answer is "immeasurably", with the entire approach in the ITA 2004 "utterly different" to the 1994 Act. Castle also concludes with respect to the second question that the IRD drafters have followed their precepts "almost to the letter". In response to the third question, Castle compared excerpts of the ITA 2004 with Australia's Income Tax Assessment Act 1997 and the UK's Income Tax (Earnings and Pensions) Act 2003. In his eleven person study of managers (comprising eleven mature people who are used to dealing with complex tasks but with no specific tax expertise, all recruited from the Wellington region), the Australian legislation was preferred, with the author's personal preference being for the UK legislation.

The expert linguistic support is provided by Jacqueline Harrison, Head of School at Unitec's School of Communication.⁶⁴ In her report, she commences with a

⁶² R Castle, *The Income Tax Act 2004: Parts A to E – A post-implementation review: A Report to the Inland Revenue Department* (September 2006).

⁶³ See n 62, 58-59.

⁶⁴ J Harrison, *The Readability of the Income Tax Act 2004: A Report to Inland Revenue for the Rewrite Advisory Panel* (October 2006).

comprehensive review of the prior readability literature, including a discussion of the Cloze Procedure. She concludes⁶⁵ that the prior studies have reinforced the validity of the Cloze Procedure as a useful means of judging comprehension of a particular text for a particular reader. The various controversies over what type of comprehension the Cloze Procedure actually measures are beyond the scope of her report, but she observes that a substantial number of researchers agree that it measures understandability rather than readability.⁶⁶ In the next section her findings are reviewed.

3.4 Further readability research – Cloze Procedure method

Other methods of readability may be employed, such as the Cloze Procedure,⁶⁷ which involves the removal of every fifth word of a passage and then asking participants to identify the missing words through inserting the “correct” text in the standard length of blanks (about 15 spaces). The word “cloze” derives from “closure” - the term that gestalt theory uses to describe the natural desire of people to complete unfinished but obvious patterns.

An early study utilising this approach was conducted in Australia by Wallschutzky.⁶⁸ Wallschutzky’s study suggests that the rewritten substantiation provisions that would comprise part of the then yet to be enacted Income Tax Assessment Act 1997 were not significantly easier to read by the subjects than the legislation in place prior to the rewrite (the Income Tax Assessment Act 1936).⁶⁹

The Cloze Procedure has recently been applied in NZ against the rewritten ITA 2004 through research commissioned by the IRD.⁷⁰ The target readers in Harrison’s Cloze Procedure testing were 103 specialist taxation practitioners from Auckland, Wellington, Hamilton, and Whangarei (the distinct lack of any South Island participants is noted). The participants were selected as those people that must consult New Zealand income tax legislation as part of their regular work.

Harrison took random selected sections approximately 50 pages apart from Parts A-E of the ITA 2004 (as these were the rewritten sections), which comprised some 837 pages after allowing for the Table of Contents. Since some pages did not contain enough continuous prose for applying the Cloze Procedure (known as “clozing”), and

⁶⁵ See n 64, 11.

⁶⁶ MJ Jones, and PA Shoemaker, “Accounting narratives: a review of empirical studies of content and readability”, (1994) Vol 13 *Journal of Accounting Literature* 142- 185.

⁶⁷ The Cloze Procedure measures the ability of the reader to correctly replace the missing words from a selection of text. For further information on the Cloze procedure, see JR Bormuth, “Factor validity of Cloze tests as measures of recording comprehension ability”, (1969) Vol 4 *Reading Research Quarterly*, 358-365; and MM Dupuis, “The Cloze test procedure as a predictor of comprehension in literature”, (1980) Vol 74 *Journal of Educational Research*, 27-33.

⁶⁸ See I Wallschutzky, “TLIP – Stage 1 – Benchmarking” (1995) Vol 12:2 *Australian Tax Forum*, 115.

⁶⁹ This remains the relevant legislation for some parts of the income tax system in Australia.

⁷⁰ See n 64.

others contained definitions and lists, Part A was excluded from her study. Extracts from the ITA 1976 were included as a means of comparison (but not the ITA 1994). With the reduction in the desired number of participants to the eventual group of 103 the number of extracts was reduced to 24, 8 from the ITA 1976 and 16 from the ITA 2004. Two versions (“a” and “b”) of each extract were prepared, with the first replacement starting at a different word in each version to address the possibility that a particular version required replacements for words that were more difficult to guess than another version. This resulted in 48 different cloze exercises, comprising 24 “a” versions and 24 “b” versions. With a sample of over 100 participants is a reasonable size from which comparisons can be made between the extracts of legislation, although a larger size would have permitted more extracts to be evaluated.

In her controlled testing environment Harrison scored only exact replacements as correct, but allowed variations on spelling. She adopted Bormuth’s 1967 model,⁷¹ with her results showing that extracts from the ITA 2004 (average score of 68.1 percent) were more understandable for intended readers than were extracts from the ITA 1976 (average score 62.5 percent). The ITA 2004 average score was 5.6 percentage points higher than for the average score for the ITA 1976 extracts. Furthermore, the range of scores for the 8 extracts taken from the ITA 1976 was from 47.4 percent to 67.9 percent. Seven of these were above Bormuth’s “independent” level of 57 percent (equivalent to 90 percent comprehension at adult level) and the other was within Bormuth’s “instructional” (75 percent comprehension) range. The ITA 2004 combined scores ranged from 51.7 percent (instructional) for 1 extract to 79.1 percent (although one score on the ITA 2004 ‘b’ version scored 40.2 percent, which is lower than Bormuth’s 44 percent instructional). Hence the results suggest that the rewritten legislation (ITA 2004) may be easier for its primary users to read than the ITA 1976.⁷²

Harrison observes that a major disadvantage of the Cloze Procedure is that it does not provide any explanation as to the difficulties of particular extracts and versions.⁷³ However, one obvious consideration Harrison’s notes is a word that most, if not all, participants failed to enter correctly. In the ITA 1976 section 30 version “a”, there were two words in the first sentence that no participant guessed correctly, namely “shortly” and “behalf”. Harrison also states that there could be many reasons for the varying levels of difficulty between cloze versions. She also suggests that rather than speculate on the causes, it could be more useful to triangulate the data by applying a second readability-evaluation technique to these sections in a future study, a recommendation with which I concur. Nevertheless she cautions that unless the combined score for both versions of the legislation is very low relative to other sections, such further analysis does not seem justified.⁷⁴

⁷¹ JR Bormuth, “Comparable cloze and multiple-choice comprehension test scores”, (1967) Vol 10 *Journal of Reading*, 291-299.

⁷² J Harrison, *The Readability of the Income Tax Act 2004: A Report to Inland Revenue for the Rewrite Advisory Panel* (October 2006), 18.

⁷³ See n 72, 17.

⁷⁴ See n 72, 18.

While Harrison’s findings are important and support earlier research using the Flesch Readability Index and the F-KGL Index, it is important to note that the comparison is the ITA 1976 to the ITA 2004 – the reorganised ITA 1994 was not compared using the Cloze Procedure, and prior research suggests that the reorganisation itself may have a significant impact on readability. The Cloze Procedure should also be employed against the 2006 Bill to ascertain primarily if other rewritten parts have improved in their readability.

Thus to summarise this section, empirical research of both a quantitative and qualitative nature provides evidence of an improvement in the readability of the Income Tax Legislation from the ITA 1976 to the ITA 1994 and ITA 2004, using the proxies of readability indices and the Cloze Procedure. Further research is needed on the ITA 2006 once it is enacted along with triangulation of previous results using a further readability measure/method.

4.0 Continual amendment and the impact of the growing use of the tax system to deliver welfare programs and tax expenditures

New Zealand’s tax legislation has experienced constant change since the rewrite project commenced in 1994, with at least two annual tax bills introducing both remedial changes and substantive changes to existing tax regimes, along with new regimes such as the dispute resolution regime, civil and criminal penalties regimes, minor beneficiary rules, attribution rules, trans-Tasman imputation and franking credit recognition. Most of these major changes have been based on the outcome of earlier discussion documents and ensuing consultation. A number of new double tax agreements have been concluded.⁷⁵ Further tax simplification initiatives, including compliance cost research, have permeated throughout this period. In sum, tax advisors and taxpayers, as well as officials, have been required to devote their efforts to responding to these developments, along with the ongoing rewrite project. It is also worth noting that the IRD is also responsible for drafting tax legislation, not Parliamentary Counsel’s drafting office staff.

The IRD also has responsibility for administering the Child Support system (including legislation), various welfare-related programs, such as the Working for Families scheme, the Child, Family and Parent Tax Credit schemes, Parental Leave entitlements, and the Student Loans scheme. In its briefing to the incoming Minister of Finance in 2005 the Commissioner of Inland Revenue (“the Commissioner”) states:⁷⁶

“The main roles that Inland Revenue undertakes include:

- collecting tax, child support and student loan payments

⁷⁵ For a more comprehensive analysis of the changes since mid 1999, see the IRD’s tax policy website at: <http://www.taxpolicy.ird.govt.nz>, under “news”.

⁷⁶ Commissioner of Inland Revenue, *Briefing for the Incoming Minister of Revenue: 2005* (2005) Inland Revenue, 6.

- making payments such as tax refunds and rebates, family assistance (including the *Working for Families* package), child support and paid parental leave
- advising the government, together with the Treasury, on tax policy and social policy measures that interact with the tax system.”

It is most interesting to note the major role that social policy plays for the IRD, with the IRD now having the responsibility for a number of NZ Government initiatives, expanding its functions such that it is no longer just a tax collection agency; it is also a major player in the provision of the NZ Government’s social support programmes. A major component of the 2002-2005 tax policy work program was tax expenditures-related, namely:⁷⁷

“**Social cohesion:** Improving incentives for beneficiaries to enter paid employment and relieving child poverty were the objectives behind the Working for Families reform enacted last year. A bill before Parliament proposes further improvements to the way that child support is administered by giving liable parents who have defaulted on their payments an incentive to re-enter the system.”

Later in the briefing the IRD notes that the targeting of assistance such as through the Working for Families package is a difficult area in which there are no easy solutions.⁷⁸ High effective marginal tax rates (EMTRs) are a consequence of targeting income assistance. If income assistance were not targeted, then the IRD claims that fiscal costs would increase. The only ways of reducing EMTRs are either to deliver less in the way of family assistance or to make family assistance less closely targeted.

The ongoing work effort required to implement the Working for Families reforms is considerable, with the IRD:⁷⁹

- required to make significant system changes to support the various programmes;
- expecting to experience considerable growth in customer contacts across its functions; and
- required to work closely with the Ministry of Social Development (“MSD”) to ensure that customers receive a seamless service across both agencies.

The IRD will be “tied up” with this work to 1 April 2007, with the introduction of further increases in family support rates (as part of phase three of Working for

⁷⁷ See n 76, 15.

⁷⁸ See n 76, 25-28.

⁷⁹ See n 76, 41-42.

Families package). The growth in the social support customer base has grown at twice the rate of taxpayers (18 percent compared to 9 percent).⁸⁰

A further initiative that relates to tax expenditures as a result of late amendments to the original proposal is the KiwiSaver scheme,⁸¹ which is theoretically a voluntary scheme where employees elect to contribute 4 or 8 percent of their gross salary. Employees are automatically enrolled when they commence new employment and will have eight weeks to opt out. As a sweetener to encourage employees to remain in (or even to join the scheme) the Government is providing a \$1000 contribution and paying some scheme fees in order to improve the returns for savers. To entice employers to promote the scheme the Government announced that employer contributions to KiwiSaver schemes will be exempt from tax (SSCWT – specified superannuation contribution withholding tax), subject to a cap of the lesser of the employee’s contribution or 4 percent of their gross salary or wages. As part of a political compromise there is a mortgage diversion facility, where by part of a person’s KiwiSaver contribution can go towards paying off the mortgage on their home.

According to the National Party’s Associate Finance Spokesperson Craig Foss, the IRD is planning to hire 300-400 staff to administer the KiwiSaver scheme, increasing total staff numbers by around 8 percent. This information was apparently “let slip” by an IRD staff member at the Association of Superannuation Funds Conference in October 2006.⁸² Mr Foss said that the hiring plan “shows how complex the Government anticipates KiwiSaver will be to administer. ... We’re all paying for that complexity through these new IRD staff.” The Commissioner of Inland Revenue (Commissioner), David Butler, advised Parliament that this estimate was arrived at before the mortgage diversion facility was added, with this addition expected to add greatly to the complexity of administration. Final staff requirement figures are expected in December 2006. Overall, it is clear that this Government-imposed initiative will further refocus and possibly divert existing (and new) IRD resources and personnel.

What appears to be missing from all of the Government’s analysis and approach is whether the tax system itself can be modified to provide some targeted assistance, such as through:

- reducing marginal rates at the lower end (that is, lower the 19.5 percent marginal rate to say 15 percent and possibly the 33 percent rate to 30 percent);

⁸⁰ See n 76, 43. See also the IRD’s 2006 Annual Report; Inland Revenue, *Annual Report 2006* (IRD, Wellington, 2006), 22.

⁸¹ Refer to the KiwiSaver Act 2006 and KiwiSaver regulations (approved 27 November 2006), and see also the new website: <http://www.kiwisaver.govt.nz>.

⁸² Rob Hosking, “IRD hiring hundreds for KiwiSaver”, (2006) *The National Business Review* (November 17) 13.

- increasing the thresholds at which the marginal rates apply (such as increasing the 33 percent rate \$NZ50,000 and the 39 percent rate to commence at \$NZ75,000⁸³); and/or
- introducing a tax free threshold (such as for the first \$NZ6,000).

Such options have been consistently opposed or ignored by governments over the last decade. Rather the approach has been to continually expand tax and tax-related legislation through more and more welfare-based initiatives, in addition to regular tax base maintenance legislative developments and at least two annual tax bills introducing several hundred amendments and hundreds of pages of new legislation each time. To add further “drag” to the process of simplifying the legislation, the IRD has been required to divert more resources into welfare-based initiatives and remedial legislative changes, away from the rewrite project, adding to the “blow out” in the time frame for the project. This has also seen other projects put on hold, such as the proposed targeted tax amnesty.⁸⁴

5.0 Conclusions, limitations and future research

The NZ Government’s key objective in rewriting the ITA 1976 and IRDA 1974 is to make the legislation clear and easy to read without changing the substance of the content of the current legislation (except in limited identified circumstances). It anticipates the rewritten legislation will lead to greater certainty and less litigation. Evidence to date indicates that the rewrite project will result in some changes to the law. Most of these changes have been signalled in exposure drafts, discussion documents and in the commentary on the 2002 Bill. Inevitably there will also be some changes which have not been signalled adequately or are inadvertent, necessitating remedial legislation – the Panel is dealing with these unintended changes. Notwithstanding the NZ Government’s assertions to the contrary, the ITA 2004 (along with the rewrite of Parts F to O forming part of the 2006 Bill – to be known as the ITA 2006), will result in increased compliance costs as it will be necessary for advisers to review all transactions to confirm that the new legislation will not impact on the tax treatment and to become familiar with the new section locations and groupings. Significant benefits, if they are to accrue, will not arise until the longer term, perhaps in the next 5-10 years.

Overall, it is clear that the NZ Government is committed to reducing the complexity in NZ’s tax laws. The results of the studies conducted to date on readability of NZ’s

⁸³ Abolishing the 39 percent rate and aligning the top marginal rate with the corporate tax rate and trustee rate, as recommended by the Tax Review 2001, is an issue beyond the scope of this paper; see further Tax Review 2001, *Final Report*, (Government Printer, Wellington, October, 2001).

⁸⁴ For a discussion of the tax amnesty proposal, see A Sawyer, “Targeting Amnesties at Ingrained Evasion – A New Zealand Initiative Warranting Wider Consideration?”, (2005) Vol 3 *Journal of the Australasian Tax Teachers Association*, 84-119; and AJ Sawyer, “Industry Partnerships and Targeted Amnesties at Ingrained Evasion – A New Approach to an Old Problem?” (2006) Vol 16 *Revenue Law Journal*, forthcoming. However, in a recent discussion document the Government has signalled that the proposal will be advanced further as part of its latest review of the compliance and penalties regime; see M Cullen and P Dunne, *Tax penalties, tax agents and disclosures: A Government discussion document* (October 2006), 32-33.

tax legislation (Tan and Tower,⁸⁵ Richardson and Sawyer,⁸⁶ and Pau⁸⁷ using predominantly the Flesch Readability Index; Castle⁸⁸ using an interview approach with non-tax professional managers and Harrison⁸⁹ using the Cloze Procedure) have provided some preliminary evidence that the NZ Government's effort has been successful so far in terms of improving the readability of the tax laws. However, future research could provide more conclusive evidence as to whether the rewrite process has in fact reduced the complexity of tax laws. The results of Pau's study also show that different drafting styles can affect the readability of income tax legislations when applying the Flesch Readability Index. For example, the use of semicolons instead of colons, the use of shorter sentences and active voice, and the use of alphanumeric numbering can improve the readability of legislation. Hence, as Pau suggests, the NZ Government should take this into consideration when drafting other tax legislations, such as the GSTA 1985.⁹⁰ Furthermore, Harrison suggests future research should employ a further proxy method to allow for triangulation of results.⁹¹

Nevertheless, the NZ Government considers the rewrite process to be successful if the rewritten income tax legislation is accepted by all main users as clearer and easier to apply.⁹² Pau suggests that this implies that future research could identify all main users of the income tax legislation and examine, via a survey, their perceived view of the usability and readability of the legislation. Since the rewrite project is only partially completed, future research could replicate the work of Tan and Tower,⁹³ Richardson and Sawyer,⁹⁴ and Pau⁹⁵ once the income tax legislation is fully rewritten, such as testing the Income Tax Act 2006 when it is enacted, using readability formulae. Such research would provide a more complete picture with regards to the effectiveness of the rewrite process in improving the readability of the income tax legislation. Future research, in assessing the readability of the remaining parts of the

⁸⁵ LM Tan and G Tower, "The Readability of Tax Laws: An Empirical Study in New Zealand", (1992) Vol 9 *Australian Tax Forum*, 355.

⁸⁶ M Richardson and A Sawyer, "Complexity in the Expression of New Zealand's Tax Laws: An Empirical Analysis" (1998) Vol 14:3 *Australian Tax Forum* 325.

⁸⁷ C Pau, Complexity of the New Zealand Tax Laws: An Empirical Study, *B Com Honours paper*, (Department of AFIS, University of Canterbury, 2006).

⁸⁸ R Castle, *The Income Tax Act 2004: Parts A to E – A post-implementation review: A Report to the Inland Revenue Department* (September 2006).

⁸⁹ J Harrison, *The Readability of the Income Tax Act 2004: A Report to Inland Revenue for the Rewrite Advisory Panel* (October 2006).

⁹⁰ See n 87, 27.

⁹¹ See n 89, 18.

⁹² B Birch and W Creech, *Rewriting the Income Tax Act 1994 – Objectives, Process, Guidelines: A Discussion Document*, December 1994, Government Printer, Wellington.

⁹³ See n 85.

⁹⁴ See n 86.

⁹⁵ See n 87.

ITA 2004 (Parts F to O – or more correctly parts F to Y of the Income Tax Bill 2006), should identify whether the improvements to readability already identified are continuing to be achieved.

Importantly, future research needs to develop processes to capture the impact of other factors affecting understandability, such as the frequency of changes, the background knowledge of the reader, the interest of the reader and the use of diagrams and flowcharts. Furthermore, Redish and Selzer⁹⁶ suggest that instead of using readability formulas, user-oriented testing should be used to test the usability of technical documents. Therefore, future research could perform a comparative analysis of the readability of the ITA 1976, ITA 1994, ITA 2004 and ITA 2006 (once enacted) using more user-oriented research methods. Importantly other forms of research into the understandability generally of the tax legislation has commenced, such as through use of the Cloze Procedure by Harrison⁹⁷ on the ITA 1976 and ITA 2004, providing encouraging results for the drafters in terms of improved readability. Specifically future research should also follow Harrison's⁹⁸ recommendation and utilise the Cloze Procedure on the ITA 2006 and compare this with extracts from the ITA 1976, ITA 1994 and ITA 2004.

Lastly, and by no means less significantly, future research should also be undertaken into quantifying the compliance cost impact of the rewrite project, once the long term benefits have been achieved.

Looking further afield, it should not be lost on the tax legislation drafters that New Zealand is not the only common law nation that has been involved in rewriting their income tax legislation, with Australia and UK major players. Research by Castle⁹⁹ suggests that expert yet non-tax professional managers prefer the Australian rewritten legislation and the author himself the UK legislation.

To conclude, thirteen years since its commencement in 1993, the rewrite project, in particular the rewriting of the ITA 1994 and ITA 2004 is nearing completion with the last exposure draft released and draft legislation tabled in mid November 2006 as the 2006 Bill. With no official statement concerning whether the remaining revenue acts will be rewritten, this suggests that the NZ Government may have “lost its nerve” to see the original project through to fruition, which implicitly at least, also involved rewriting the portions of the ITA 1976 and IRDA 1974 not included in the ITA 1994, namely the TAA 1994 and TRAA 1994. Calls for rewriting the GSTA 1985 has come from the highest judicial level with a member of the Supreme Court recently stating

⁹⁶ J Redish and J Selzer, “The Place of Readability Formulas in Technical Communication”, 1985, *Technical Communication*. Retrieved from <http://www.rbainformationdesign.com.au/Readability%20Formulas.pdf>.

⁹⁷ See n 89.

⁹⁸ See n 89.

⁹⁹ See n 88.

that: "... once the Income Tax Act rewrite is done the team should move on to the GSTA 1985 as it has never been a user-friendly statute".¹⁰⁰

This paper has examined the "success" of the rewrite project in New Zealand, in the context of other policy developments (such as increased use of the tax system for social expenditures), and concludes that the rewrite has made marginal progress in taking the tax system closer to the (elusive) goal of simplicity of tax legislation, but cannot be termed a conclusive success or failure since we are yet to experience the "benefits" of clearer legislation. Constant change and other major tax developments have focussed attention to other areas as the long and drawn out rewrite project "plods along" to (an incomplete) "completion."

¹⁰⁰ Judge P Blanchard, "Some Basic concepts of New Zealand GST", Presentation based on a paper presented at the *Twenty Years of GST: The Best Path Forward Conference* (Wellington, 16-18 November 2006).