EMPLOYMENT TAX INCENTIVE: RESPONSE TO PUBLIC COMMENTS

PRESENTATION TO STANDING COMMITTEE ON FINANCE

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national treasury
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REPUBLIC OF SOUTH AFRICA

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Introduction

- South Africa has one of the highest rates of unemployment worldwide
- Young inexperienced workers have few credible ways to signal to employers that they will be productive – difficult to get in the door

- Government proposes a cost-sharing mechanism with private sector to hire young and less experienced workers
- Cannot address all structural issues in the youth labour market, rather it is a temporary programme to stimulate demand for young workers
- Complement to skills upgrade programmes (on the job training, soft skills)
- Simplicity, to implement quickly and easily

- Not a panacea, but part of package of measures
- Experimental, will review and adjust after monitoring and evaluation

Conceptual: Public consultation process

- *The Bill should also be subject to consultation within NEDLAC as it has a major socio-economic impact on the labour component of the economy.*

  Not accepted.

  - Published a discussion paper in February 2011
  - Comments on the discussion paper came from community organisations, business fora, individual employers and individuals
  - Extensive consultation with stakeholders, through the NEDLAC process.
  - Resulted in numerous changes to the incentive design, including mechanisms to detect abuse, penalties for abuse, containing the risk of early schooling exit, changes to the age range of eligible workers and mechanisms to cut deadweight loss.
  - Money Bills deal with the imposition of taxes or allocation of public funds
  - This Bill does not rewrite or reinterpret any labour law or regulation
  - Therefore not compelled to be approved by Nedlac, according to the Nedlac Law.
  - Parliament only body to approve, reject or amend bills
  - Support broad objective of National Youth Accord, but Parliamentary process must take precedence

Conceptual: Potential economic impact

- *Incentive in SEZs and designated industries likely to destroy employment*

  Not accepted.

  – South Africa competes for investment with other countries.
  – Offer a suite of incentives to companies in SEZs, most are capital intensive
  – Most of these incentives result in capital-intensive investment.
  – We want to attract investment with inclusive economic benefits.
  – Most are greenfield investments, with net job creation.
  – DTI to set criteria for SEZ investments to counter abuse

- *Difference in cost for the employer between the two categories. Will place downward pressure on the wages of unsubsidised workers.*

  Not accepted.

  - Conscious decision to target hiring entry level, inexperienced workers
  - Current market wages between R1 500 to R3 500 per month.
  - Workers who will not qualify for the incentive are older, have lower rates of unemployment and longer experience.
  - Shortage of skilled and experienced workers, wages are unlikely to adjust downward.
  - Wages are sticky

Conceptual: Implications for labour relations

- *Will result in the displacement of older and unsubsidised workers and move to a greater use of atypical employees, putting pressure on the rights of the workforce.*

  <u>Not accepted.</u>

  - False premise that labour is a uniform factor of production,
  - Workers are not completely substitutable
  - Specific provisions to penalise employers who displace workers to get the incentive
  - Bill has no impact on labour legislation, cannot weaken the rights of the workforce

- *The proposal could lead to the creation of a two-tier labour market in relation to wages, benefits and overall employment conditions*.

  <u>Not accepted.</u>

  - Does not relax current labour law or regulations in any way
  - Prescribed non-wage benefits will still be required
  - Employer will merely be able to share a portion of the cost with government.

Skills development and training

- *The incentive is not linked to mandatory skills development or training*

  Accepted.

  - Not able to implement immediately.
  - Further consultation (with for example Department of Higher Education, labour, employers) and legislative amendments to other Acts of Parliament may be required
  - This proposal can therefore be considered for enactment in the second phase of the tax incentive programme.
  - In the meanwhile, government intends to encourage all employers accessing the tax incentive to take up training programmes.
  - The Bill will be amended to allow the Minister to prescribe by regulation any conditions that may be required of employers in relation to training of their employees.

Proposed legislative changes: Eligible employees

- *Age range does not include school leavers*
- Accepted: The minimum was adjusted to 18 years to ensure that the incentive does not interfere with school attendance, but that newly matriculated workers are included.

- Other comments that were accepted:
- Workers with an asylum seeker permit will be included.
- Only intended to apply in respect of employees that are natural persons.
- Age of the employee to be determined at the end of a particular month.

- Suggestions that were not accepted:
  - Have at least a Grade 12 or equivalent qualification.
  - Connected persons' requirement removed or narrowed.
  - Associated institution definition narrowed or removed

Proposed legislative changes: Eligible employers

- Comments that were accepted and changes to be made.
- Include sole proprietors.
- Definition of ‘employee’: has a direct contract of employment and employer pays the remuneration
- Accommodate registration for PAYE, even if it isn’t required
- Minister of Finance consult with Ministers of Labour and Trade & Industry to designate industries

- Suggestions that were not accepted:
  - Narrower definition of tax compliance
  - Rather set off against income tax liability

Proposed legislative changes: Income range and value of incentive

- Accepted: Grossing-up and grossing-down mechanism will be adjusted for mechanism portions of a month. Employers can determine method, but must apply consistently

- Suggestion that were not accepted:
  - Increase applicable income range
  - Slow down tapering

  Reasons:
    - *Target: entry level, inexperienced workers, current wages are R1 500 to R3 500 per month.*
    - *Workers who earn R4 000 to R6 000 per month are usually better skilled and experienced.*
    - *Employers more willing to pay an additional amount for these attributes and employees with such characteristics are more likely to find employment, diminishing the need for an incentive.*
    - *Tapering of the incentive avoids an immediate cut-off, which would distort payment behaviour by employers.*
    - *Skilled and experienced workers in short supply, wages not under pressure*

Proposed legislative amendment: References to labour laws

- Suggestions that were accepted:
- Significant revisions to sections 5 & 6 in order to ensure that the scope is appropriate and consistent with labour laws
  - Include wage setting through collective agreements, sectoral determinations, bargaining councils and Ministerial extensions
  - Displacement: include other forms of resolution of disputes (e.g. agreement)

- Suggestions that were not accepted:
  - Include non-wage benefits as requirement for ‘minimum wage’

Proposed legislative changes: Anti-abuse and penalties

- Suggestions that were <u>accepted:</u>
- Displacement penalty:
  - In order not to disadvantage workers, only exclude employers at the direction of the Minister.
  - Penalty amount will be set at R30 000 per dismissed employee, in order for penalty not to be out of relation to the size of transgression
- Minimum wages penalty:
  - Based on amounts claimed for workers who were not paid stipulated minimums,
  - Impose a penalty of 200% (100% repayment plus 100% penalty) of the incentive for month(s) where the employer was in breach
  - Exclusion for employees and periods in breach

- Suggestions that were <u>not accepted:</u>
  - Burden of proof for displacement should be on employer
  - Employers to explain dismissals 6 months prior to implementation

Proposed legislative changes: Administration and legislative drafting

- Suggestions that were accepted:
- If the employer fails to claim incentive, amount may be rolled over
- Tax exemption of income from this incentive
- Reset balance to zero if reimbursement took place

- Suggestions not accepted
  - Move date of implementation to 1 March 2014

Monitoring and enforcement

- SARS will enforce anti-abuse provisions
  - With information from Department of Labour
  - With information from labour authorities
  - With information from any other third party

- National Treasury and SARS will monitor the incentive closely through the bi-annual reporting requirements for
  - Effectiveness (job creation)
  - cost effectiveness (revenue forgone)
  - Social and economic impact (longer term job prospects)

- Findings will be shared with interested stakeholders and the public

END

ANNEXURE: Incentives for businesses

- Tax incentives
  - Accelerated depreciation for mining, manufacturing, renewable energy, etc.
  - Industrial policy - SIP & 12i
  - MIDP / APDP
  - Learnership allowance – tax incentive
  - Urban development zones (buildings)
  - Research & Development
  - Film incentive
  - Small business corporations
  - Energy efficiency savings tax incentive (regulations nearly finalised)
  - International shipping
- On budget allocations – cash grants, DTI
  - Manufacturing Competitiveness Enhancement Programme (MCEP)
  - The Clothing and Textiles Competitiveness Programme (CTCP)
  - Automotive Investment Scheme (AIS) – part of APDP

Tax incentives - businesses

- Tax incentives to support manufacturing sector:

	Strategic investment programme (SIP) – s12G	**Industrial Policy Projects – s12I**
Objective	▪ Compliment DTI incentives to ↑ investment ▪ ↑ competitiveness ▪ ↑ employment	Support investment (brownfield and greenfield) in manufacturing assets that improve the productivity of the manufacturing sector
Fiscal commitment	<u>Investment allowance</u> of R10bn: R3bn forgone tax revenue over 4 years (Jan 2002 – 31 Jul 2005)	<u>Investment allowance</u> of R20bn: R5.6bn forgone tax revenue over 5 years (2 Nov 2010 – 31 Dec 2015) <u>Training allowance</u>: R36 000 per employee p.a.
Tax expenditure	Funding exhausted. Tax exp 2009/10 = R215m Tax exp 2010/11 = R138m	Just over 50% of the allowance has been approved to date Should translate into tax exp of R2.8bn
Scoring mechanism (qualifying or preferred status) administered by Adjudication Comm (DTI, NT, SARS)	▪ Products / processes new to SA competitiveness ▪ Value-added processes ▪ Acquiring goods & services from SMMEs ▪ Adding to physical infrastructure of SA (available to general public) ▪ Direct / indirect employment creation	▪ Innovative processes ▪ Improved energy efficiency (emphasis on cleaner production technology) ▪ Business linkages ▪ Acquiring goods & services from SMMEs ▪ Direct employment creation ▪ Skills development ▪ Location in IDZ
Sectors represented	Predominantly chemicals and metals / meals fabrication	Chemical / biofuel; agro processing; paper and pulp; cement and ceramics

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Tax incentives - businesses

- Accelerated depreciation for mining (100%); manufacturing assets (40:20:20:20), renewable energy (50:30:20)
- MIDP / APDP – Motor vehicles
  - Tax expenditure (customs duties & excise): R12.6bn (2009/10) and R22.6bn (2010/11)
- Learnership allowance
  - 2002, encourage on-the-job training and enhance skills capacity
  - Tax expenditure: R644m (2009/10) and R501m (2010/11)
- Urban Development Zones
  - Accelerated depreciation to encourage the refurbishment of inner cities and stimulate low-cost residential housing; New buildings (20% 1st year and 8% for 10 years)
  - Tax expenditure: R238m (2009/10) and R354m (2010/11)
- Special Economic Zones (SEZs)
  - VAT and customs relief (similar to that for the current IDZs)
  - Businesses operating within approved SEZs (by MoF) will be eligible for two additional tax incentives:
    - accelerated depreciation allowances on capital structures (buildings)
    - certain companies (carrying on qualifying activities within an approved SEZ) will be subject to a reduced corporate tax rate (i.e. 15 per cent instead of 28 per cent).

Tax incentives - businesses

- Research & Development
  - 100% expenditure deduction, plus additional 50% (subject to adjudication)
  - Tax expenditure: R714m (2009/10) and R416m (2010/11)
- Film production allowances
  - Tax expenditure: R180m (2009/10) and R2m (2010/11)
- Small Business Corporations
  - A graduated rate income structure for qualifying small business corporations (0%, 7%, 21% & 28%) with turnover below R20 million
  - Immediate expensing of investment by qualifying (manufacturing) small business corporations from 1 March 2001.
- Energy efficiency saving tax incentive
  - Aimed at helping to address climate change related challenges through improvement in energy use and address energy security concerns
  - The value of the incentive (i.e. a tax deduction) is 45 cents per kwh saved
  - Legislation in place and Regulations to effect the incentive await publication
  - The EES incentive will run until January 2020

Tax expenditure: 2009/10 & 2010/11

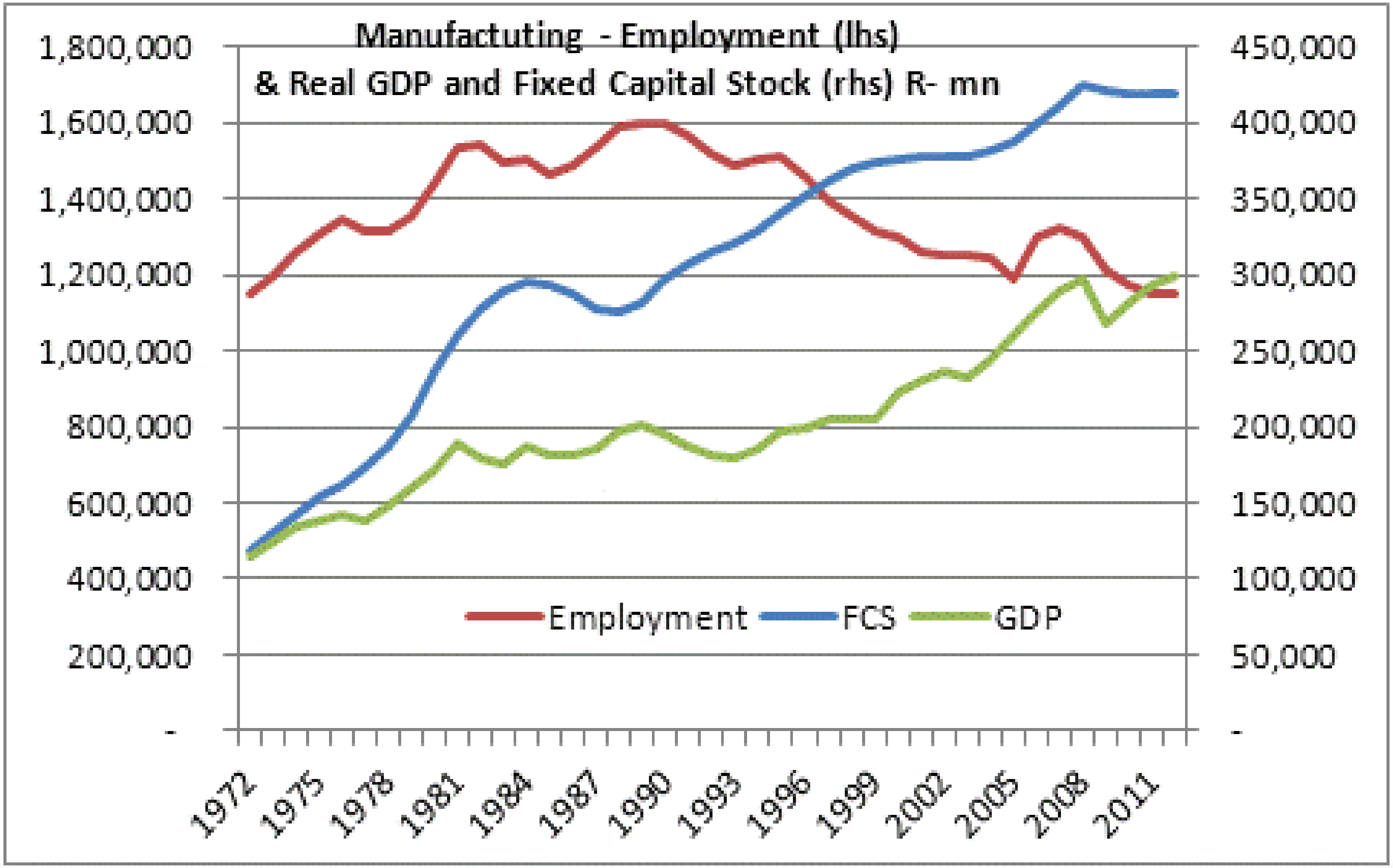
R million	2009/10	2010/11
Corporate income tax		
Small business corporation tax savings	1,330	1,343
-reduced headline rate	1,307	1,321
-s12E depreciation allowance	23	22
Research and development (R&D)	714	416
Learnership allowances	644	501
Strategic Industrial Policy	215	138
Film incentive	180	2
Urban development zones (UDZ)	238	354
Total: Corporate income tax	**3,321**	**2,754**
Customs Duties and Excise		
Motor vehicle industry (MIDP, including IRCCs)	12,673	22,645
Textile and clothing industry (Duty Credits - DCCs)	2,231	1,621
Furniture and fixtures industry	153	562
Other customs	787	2,801
Diesel refunds (mining, agriculture and fishing)	1,295	1,283
Total Customs and excise	**17,139**	**28,912**

(Budget Review 2013, page 179)

Incentives – cash grants : DTI programmes

- Manufacturing Competitiveness Enhancement Programme (MCEP)
  - available to all manufacturers (except automotive and clothing and textiles).
  - does not directly target employment, but to be eligible the company has to maintain employment levels compared to employment levels prior to receiving the incentive.
- The Clothing and Textiles Competitiveness Programme (CTCP)
  - aimed at structurally changing the clothing and textiles manufacturing industries by providing funding assistance to invest in competitiveness improvement interventions
  - consists of two major programmes.
    - Competitiveness Improvement Programme (CIP): seeks to foster the clustering of firms through grant funding (cost-sharing of 75 – 95 per cent of qualifying project costs).
    - Production Incentive Programme (PI) is based on a 7.5% incentive on manufacturing value addition of qualifying competitiveness improvement interventions.
- Automotive Production and Development Programme (APDP)
  - Based on 4 pillars:
    - Automotive Investment Scheme (AIS) that offers a taxable cash grant of 20% on investment in new a plant and machinery
    - Tariffs
    - Production Incentive (PI) that replaces the import credit rebate credit certificate (IRCC) to encourage local component production
    - Vehicle Assembly Allowance (VAA) that replaces duty free allowance (DFA)

Manufacturing Employment, Real GDP and Fixed Capital Stock – R mn (2005 prices)



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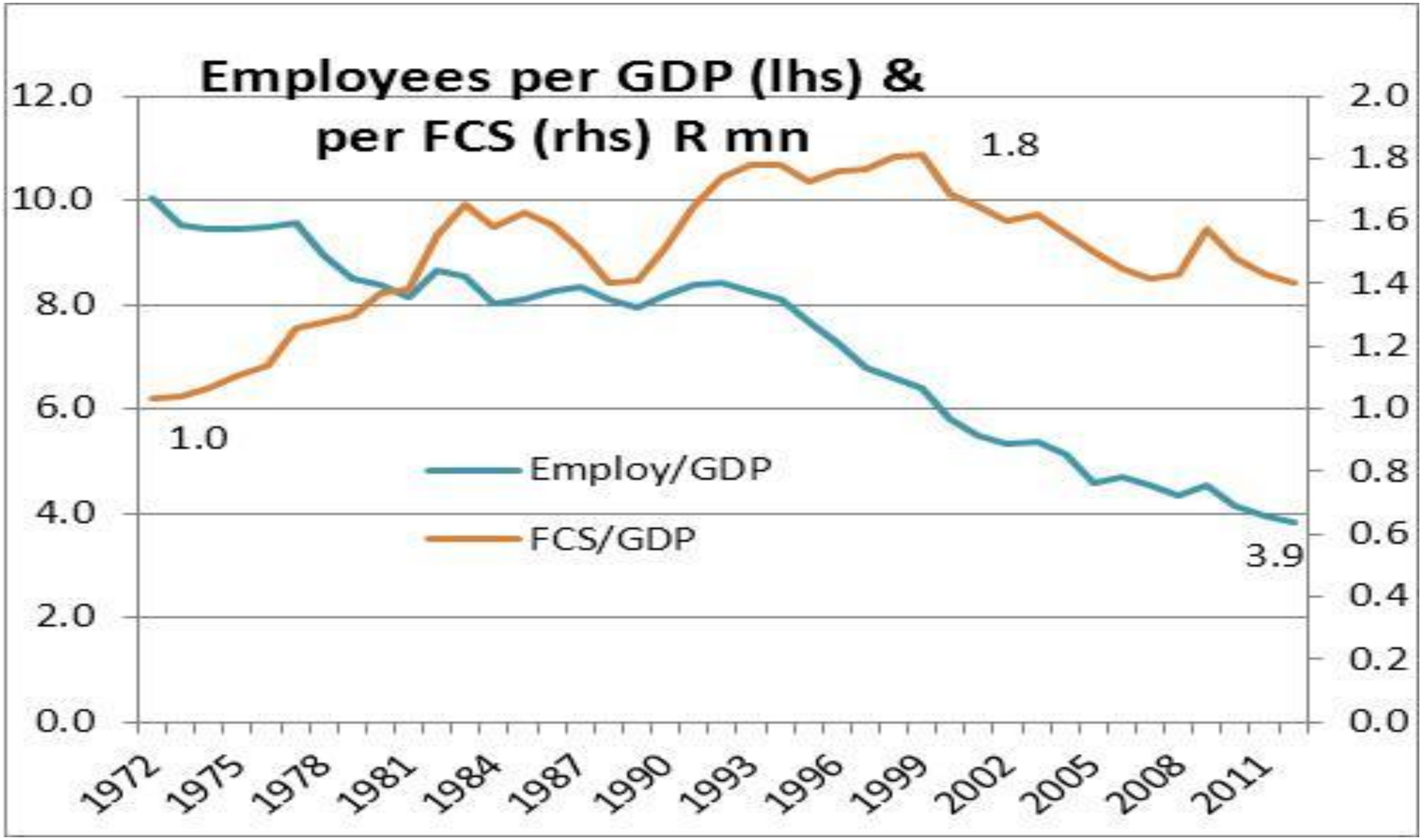
Employees per GDP & per Fixed Capital Stock per GDP– R mn



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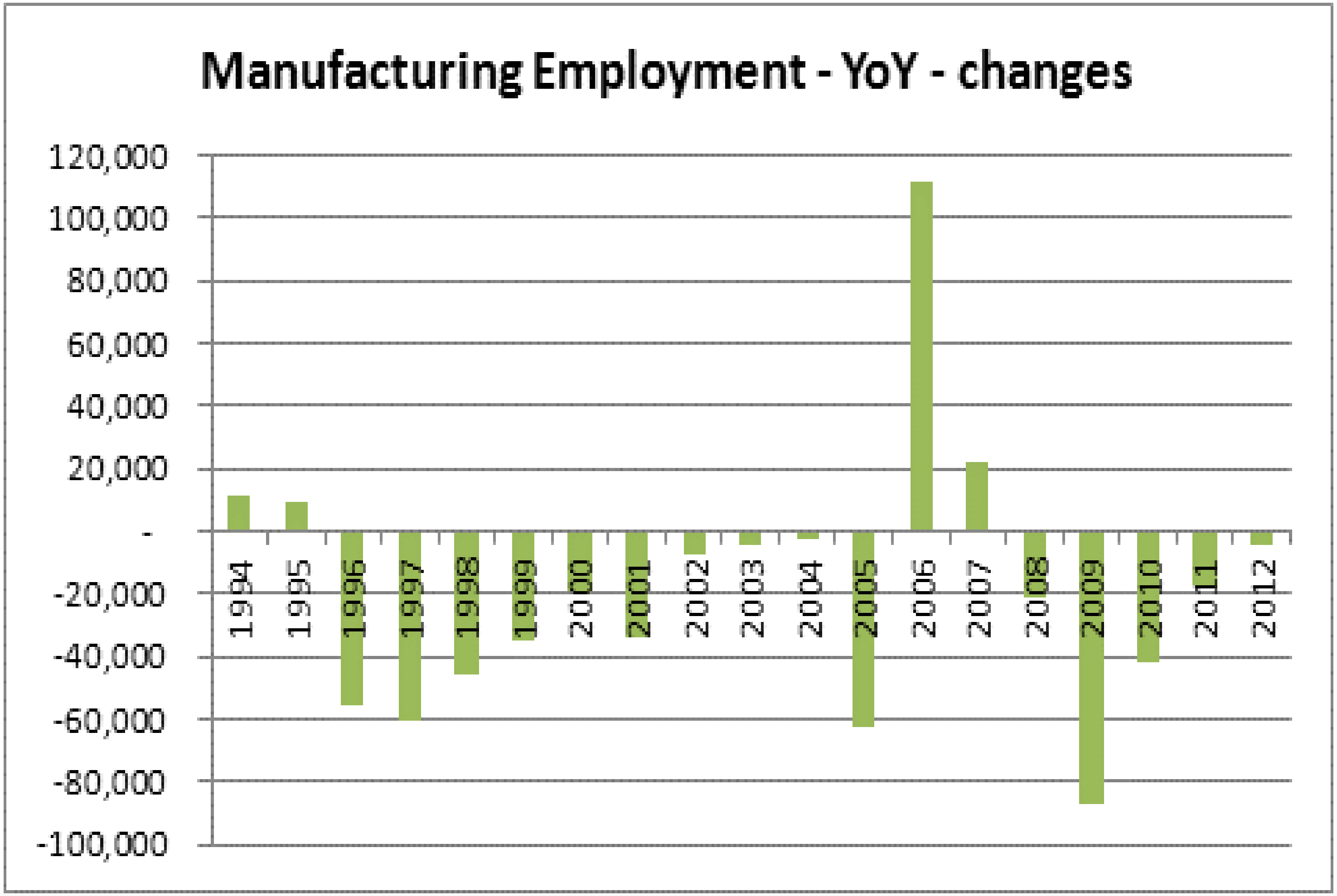
Manufacturing employment



Manufacturing sector – 1994 to 2012

	GFCF	GDP	Emp - YoY	FCS - YoY	Emp - YoY/ GFCF	Emp - YoY/GDP	Emp- YoYFCS - YoY
2009	57,562	267,723	-86,843	-3,915	-1.51	-0.32	22.18
2005	54,838	259,101	-62,216	6,884	-1.13	-0.24	-9.04
1997	40,556	205,293	-60,920	10,116	-1.50	-0.30	-6.02
1996	39,348	199,882	-55,735	11,753	-1.42	-0.28	-4.74
1998	39,466	204,794	-45,366	6,899	-1.15	-0.22	-6.58
2010	59,488	282,509	-41,477	-3,416	-0.70	-0.15	12.14
1999	39,437	205,974	-34,996	4,276	-0.89	-0.17	-8.18
2001	42,359	229,698	-33,700	2,683	-0.80	-0.15	-12.56
2008	73,886	297,889	-20,739	14,178	-0.28	-0.07	-1.46
2000	39,922	222,666	-19,442	2,308	-0.49	-0.09	-8.42
2011	65,698	292,733	-16,850	689	-0.26	-0.06	-24.46
2002	41,094	236,133	-7,777	-675	-0.19	-0.03	11.52
2003	42,565	232,581	-3,888	-888	-0.09	-0.02	4.38
2012	68,271	299,705	-3,888	990	-0.06	-0.01	-3.93
2004	49,987	243,965	-2,592	4,556	-0.05	-0.01	-0.57
1995	36,917	197,156	9,073	11,731	0.25	0.05	0.77
1994	30,622	185,135	11,665	7,596	0.38	0.06	1.54
2007	65,422	290,246	22,035	12,105	0.34	0.08	1.82
2006	61,845	275,782	111,470	10,964	1.80	0.40	10.17