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- Final mini-dissertation -

TAX INCENTIVES: ARE THEY AN INSTRUMENTAL FEATURE OF AFRICAN TAX SYSTEMS?

by

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CHAPTER 1

Introduction and project overview

1 CHAPTER 1 – INTRODUCTION AND PROJECT OVERVIEW

1.1 RATIONALE / MOTIVATION FOR THE RESEARCH

Tax policy plays a particularly important role in the design of a tax system that has the ability to finance the essential level of public spending in the most adequate and reasonable way. An effective tax system should be able to raise sufficient revenue to finance expenditures without using exorbitant borrowings, in manners that are reasonable and which do not have discouraging effects on economic activities (Tanzi & Zee, 2002:299).

Tax systems are used by most countries around the world, not only as a means of generating revenue, but also to promote economic development (Lent, 1967:249; Bloch, 1995:28). A global phenomenon adopted to promote economic development is by providing tax incentives to taxpayers to take certain actions seen by the countries as in the national interest (Bloch, 1995:28).

Tax incentives are special elements of the tax code implemented to compete for investors and to encourage certain types of behaviour (Brodzka, 2013:30). In some countries, instruments such as incentives may be seen as counterweight to the investment impediments inherent in the general tax system. However, in other countries, incentives are intended to offset disadvantages that may be faced by investors such as lack of infrastructure, complicated laws and weak administration (Brodzka, 2013:26).

The use of tax incentives by countries is common as they tend to offer encouragement to qualifying taxpayers in the form of, for example, tax reductions or exemptions from taxes for a certain period of time, with a view to inducing investments in the sector of the economy where such incentives are introduced by government (Lent, 1967:249; Siyanbola, Adedeji, Adegbie & Rahman, 2017:79). Countries are likely to use a combination of targeted and

more general incentives, which may be included in the income tax law, the investment and other laws, or simply as government decrees (Zee, Stotsky & Ley, 2002:1479).

According to Brauner in (Brodzka, 2013:32), tax incentives, as pervasive, universal and standardised mechanisms, create a predictable set of encouragements for multinational enterprises (MNEs) searching for an optimal location for their investment and often using tax optimisation practices. As such, tax incentives are viewed as fiscal instruments that enhance foreign direct investments and accordingly have a positive influence on economic growth, which strengthens the country (Brodzka, 2013:32).

Tax incentives are constantly developing and they are an eminent feature of various tax systems in both developed and developing countries (Zee *et al.*, 2002:1479; Klemm, 2010:315). This is not surprising considering the notion that they are an instrumental tool for developing economies that are vulnerable to structural shortfalls (Klemm, 2010:316). Another significant contributing factor to the heightened need viewed by many countries is to attract domestic and foreign investment and to promote economic growth, especially in a world of broadening trade liberalisation and high capital mobility (Zee *et al.*, 2002:1497). The use of tax incentives is widespread, even though there is inconclusive empirical evidence available on the cost-effectiveness of such incentives. Despite the scepticism by many economists on the effectiveness of tax incentives, countries continue to offer tax incentives as a means of attracting domestic and foreign investment (Lent, 1967:249).

All countries strive to increase their revenue base in order to improve their economy represented by the growth in their Gross Domestic Products ("GDP") (Siyanbola *et al.*, 2017:78). Economic growth and development is a goal pursued by all African countries (Munongo, 2015:1). According to ActionAid International and Tax Justice Network Africa (2015:8), most African countries have a weak investment climate, partly due to political and macroeconomic instabilities. As such, governments appear to consider tax incentives as a necessary tool to attract investments that would otherwise not have happened. Munongo (2015:1) further states that the lack of investment in a country creates socioeconomic problems mainly centred on unemployment and poverty. Tax incentives have become the most common tool amongst African countries to attract investments (Munongo, 2015).

Given the role of foreign direct investment in the development process, one of the most important challenges facing Africa is how to attract foreign direct investment ("FDI"). FDI is actively sought by almost all SSA countries, due to the contribution that it can make to their economies (Cleeve, 2008:135). A number of attempts to attract FDI have been made, but most have been unsuccessful due to various factors that work against the business environment for foreign investment (Cleeve, 2008:135). Given the economic, social and political environment in African countries and the need to establish the nature that contribution tax incentives have in bringing in the much needed investments, the tax design strategies of African countries are vital (Munongo, 2015:4). As such the study will focus on tax incentives in African countries.

Even though tax incentives may be seen as a necessary tool for attracting investment in African countries, there are various shortfalls that need to be taken into consideration. First the lack of transparency is a key problem with tax incentives (OECD, 2008; ActionAid International & Tax Justice Network Africa, 2015:8). ActionAid International and Tax Justice Network Africa (2015:8) state that tax incentives are often unaccounted for in the national budget and are not made public, which reduces the accountability of government to their citizens. Klemm (2010:322) further states that the costs of tax incentives are extensive and go beyond immediate loss of revenue.

This study is focused on the history and development of tax incentives in Africa and aims to provide a holistic view of the patterns of incentives offered by African countries and to analyse the issues posed by them. This study further aims to highlight the reasons why tax incentives continue to be a prominent feature of most African countries, regardless of the uncertainty about the effectiveness thereof, which will ultimately add to whether tax incentives are an instrumental feature of tax systems.

The outcomes of this study may provide insights to governments, as they may provide guidance on the benefits and challenges of tax incentives, and what should be considered when structuring the tax incentives regime in those African countries that are determined to maintain the incentives. The results of this study may offer additional guidance on how to improve existing tax incentives offered in African countries, in order to realise the intended governmental objectives. Lastly, the outcomes of this study may guide the direction of future

studies on tax incentives in Africa, and the results of this study may also contribute to the work of future researchers and studies being conducted.

1.2 PROBLEM STATEMENT

Several researches (Lent, 1967; Green & Talmor, 1985; Zee *et al.*, 2002; Peters & Fisher, 2004; Cleeve, 2008; Klemm, 2010; Van Parys & James, 2010; Siyanbola *et al.*, 2017) have conducted studies on the efficacy of tax incentives, the connection with economic growth and the impact that tax incentives may have on tax systems. The existing literature, however, does not have a positive outlook on the use of tax incentives (Zee *et al.*, 2002; Keen & Mansour, 2010; Klemm, 2010). Despite this uncertainty over their effectiveness, tax incentive schemes have been adopted by many African countries (Lent, 1967:249).

The main objective of this study is to provide an overview of the successes and shortfalls of the various tax incentives offered by African economies, in order to determine the fiscal effects they have on tax systems and whether they are an instrumental feature of tax systems.

1.3 RESEARCH QUESTION

Are tax incentives in Africa instrumental to a tax system?

1.4 RESEARCH OBJECTIVES

By conducting a systematic literature review, the following objectives will be addressed in order to answer the research question:

- To explore the history and development of tax incentives in Africa;
- To explore the successes and shortfalls of tax incentives offered by African economies; and
- To draw conclusions as to whether tax incentives can be an instrumental feature to an African tax system.

1.5 STRUCTURE OF MINI-DISSERTATION

This section provides a brief overview of the chapters in this study.

1.5.1 Chapter 1: Introduction and project overview

Chapter 1 is an introduction to the study and provides a background on tax incentives, which is the main research area addressed in this study. The purpose of this study, the problem statement and the research objectives are discussed. This chapter concludes with a brief overview of the chapters in this study.

1.5.2 Chapter 2: Method for conducting the systematic review

Chapter 2 provides an explanation of the research design and methodology used in the study, and provides reasons for the research design and methodology adopted in the study.

The keywords and databases used in the literature search are discussed. The inclusion and exclusion criteria of selected literature that will support the study also forms part of the discussion in Chapter 2.

1.5.3 Chapter 3: Analysis of data and findings

Chapter 3 provides an overview and analysis of the literature on tax incentives and the various aspects of tax systems. Chapter 3 begins with a general overview of the selected literature included as part of this research. This is followed by a detailed overview of the key points of interest on tax incentives in Africa, which result in the conclusion of whether tax incentives are an instrumental feature in a tax system.

1.5.4 Chapter 4: Conclusion

The chapter concludes on the findings of the study by summarising the purpose of the study and how the research question and research objectives were addressed. In addition, this chapter provides the limitations of the study and makes recommendations regarding possible future research and how tax incentives can be structured differently, in order to obtain the intended benefits of introducing tax incentives to the tax system.

CHAPTER 2

Method for conducting the systematic review

2 CHAPTER 2 - METHOD FOR CONDUCTING THE SYSTEMATIC REVIEW

2.1 INTRODUCTION

This chapter begins by explaining the research method adopted in this study. It then moves on to describe the philosophical stance of the study, followed by the nature of the study, the method of reasoning, the time horizon, the unit of analysis and the nature of the data that is used for the study. Furthermore, this chapter provides reasons as to why a systematic review method is used as a research method.

This chapter provides detail on the systematic review by explaining the process and steps involved by focusing on the following: the inclusion and exclusion criteria of the selected literature, the keywords used in order to conduct the search process, the relevant databases used and the method used in analysing the literature. The chapter concludes with a summary of the literature to be reviewed and analysed in this study.

2.2 RESEARCH DESIGN ELEMENTS

2.2.1 Philosophical Stance

Research philosophy deals with the source, nature and development of data. Simply put, it is the researcher's assumption about the way in which data about an aspect should be collected, examined and applied (Research-Methodology.net, 2019c). According to Saunders, Lewis and Thornhill (2009:108), the four main research philosophies are pragmatism, positivism, realism and interpretivism.

A researcher with a pragmatic philosophical stance adopts a thinking style which depends on the research question (Saunders *et al.*, 2009:109). According to Saunders *et al.*

(2009:109), a pragmatist believes that data can be collected from both an objective observable phenomena and from a subjective point of view. The goal is to uncover the practical relevance of knowledge gained from the data with regard to the business problems, and recognises that the results are only a provisional truth aimed at that point in time, which can change over time.

A positivist perspective adopts the philosophical stance of a natural scientist. A researcher with a positivistic philosophical stance aims to uncover the truth by determining the cause- and effect of relationships, in order to predict and control them, so as to generate the findings (Sekaran & Bougie, 2016:28). According to Burke (2007:480), the positivist approach to research can be defined as an approach where facts are clearly defined and results are measurable.

Realism is based on the hypothesis of a scientific approach to the development of knowledge. In terms of this type of study, the researcher believes that there is an objective truth out there, however it relies on the idea of independence of reality from the human mind (Research-methodology.net, 2019b). The researcher's goal is to progress towards the truth, although he/she knows that it is impossible to reach this truth, as the data is inherently flawed, due to the collection thereof being underpinned by subjective emotions (Sekaran & Bougie, 2016:29).

An interpretivist philosophical stance recognises that subjective meaning plays a crucial role in social actions (Walliman, 2015:12). Researchers with an interpretivist philosophical stance acknowledge that the data is subjective in nature and aim to understand the world from peoples' standpoints (Research-Methodology.net, 2019a).

The beliefs of a pragmatic philosophical stance were adopted as the practical thinking style for this study, as the research question is addressed by focusing on analysing tax incentives in Africa and how these affect a tax system. The main objective of this study is to provide an overview of the various tax incentives offered by African economies, in order to determine the successes and shortfalls of the tax incentives offered by African economies and whether they are an instrumental feature of tax systems. The topic of tax incentives has practical relevance to both investors and the government. Given the fact that literature is constantly

evolving, the findings of this study may provide a provisional truth at the current point in time, based on available literature.

2.2.2 Nature of study

Various research designs can be used to study a problem. Hair, Money, Samouel and Page (2007:153) have grouped the different designs into three categories, namely exploratory, descriptive and causal designs.

Hussey and Hussey (1997:10) describe an exploratory study as a study that is normally conducted when there are a limited number of studies which can be referred to for information about the issue. The purpose of this form of study is to identify patterns and ideas, or to formulate hypotheses, as opposed to testing or confirming a hypothesis (Hussey & Hussey, 1997:10).

Descriptive research involves obtaining data that describes characteristics of the topic (Hair *et al.*, 2007:155). Descriptive research attempts to “paint a picture” of a situation by addressing who, what, when and how (Zikmund, Babin, Carr & Griffin, 2013:53).

Causal research has a more scientific approach. It attempts to test whether or not one event causes another (Hair *et al.*, 2007:160).

The nature of this study falls within the ambit of descriptive research. The purpose of this study is not to explore a phenomenon, but rather to make generalised statements from the data collected and provide insight on tax incentives in Africa and their effects on the tax system.

2.2.3 Method of reasoning

The method of reasoning is the process of using existing knowledge in order to draw conclusions, make predictions, or construct explanations (Butte College, 2016). There are three types of reasoning methods that can be used when conducting research. These are deductive reasoning, inductive reasoning and abductive reasoning.

According to Zikmund *et al.* (2013:43-44), deductive reasoning is the process of deriving a conclusion about a specific instance based on a known premise. The researcher takes assumptions and accepts them as being true. From these assumptions, the researcher will logically work towards a conclusion that must be true if the assumptions that were used are true (Leedy & Ormrod, 2010:32).

Inductive reasoning is the opposite of deductive reasoning. With this type of reasoning a general premise is established by researchers on the basis of observing specific facts (Zikmund *et al.*, 2013:44). The researcher uses the specific occurrences to draw conclusions about objects or events (Leedy & Ormrod, 2010:33). Inductive reasoning is when a theory is generated by collecting data and evaluating the data for patterns relevant to the researcher's topic.

Typically when a researcher follows the abductive reasoning approach, they start with incomplete observations and proceed to provide explanations of the outcomes of their observations (Butte College, 2016).

This study can be classified as inductive reasoning, as the study aims to provide insight on the history and the advancement of tax incentives in Africa. It also provides an overview of the tax incentives offered by countries in Africa and considers the effects that these incentives have on the tax system.

2.2.4 Time Horizon

The time horizon for research can either be cross-sectional or longitudinal. A cross-sectional study is one in which a particular phenomenon is observed at a specific time (Saunders *et al.*, 2009:155). The data is collected only once, over a short period of time, before it is evaluated and presented. Thus, a cross-sectional study provides a snapshot of a continuous situation (Hussey & Hussey, 1997:60). A longitudinal study is a study conducted over time. The objective is usually to investigate the same situation on an on-going basis over the timeframe in which the situation runs its course (Hussey & Hussey, 1997:63). Longitudinal studies are applicable when the research question is affected by how things vary over time.

Unlike cross-sectional studies, longitudinal studies involve the collection of data from the same sample at various points in time (Hair *et al.*, 2007:157).

The literature that forms part of this study regarding tax incentives goes back as far as the 1960's (Lent, 1967). The rest of the literature articles considered for this study were conducted from the 1960's to date, as the main objective of this study is to gain an overview of tax incentives in Africa. This literature will assist in understanding the history of tax and whether it can be considered an instrumental feature in the tax system of African countries. Even though the literature to be included in the study covers a long period of time, this study is conducted at a specific point in time. Accordingly, the study qualifies as a cross-sectional study.

2.2.5 Unit of analysis

Hussey and Hussey (1997:66) describe the unit of analysis as the kind of case to which the study relates and to which the research problem refers, and about which data is collected and analysed.

This study will analyse tax incentives in Africa. The objectives of this study are to provide an overview of the tax incentives offered by African countries and to analyse the effect which they have on tax systems. Accordingly, in order to accomplish the objectives of this study, the unit of analysis will be tax incentives in African countries.

2.2.6 Sources of data

The sources of data can be identified as layers around the truth. Primary data is the layer closest to the truth, whereas secondary data is further from the truth, as it is not derived straight from the truth, but rather from the primary data (Leedy & Ormrod, 2010:89). Data obtained from secondary sources may either be qualitative or quantitative in nature (Hair *et al.*, 2013:119).

According to Saunders *et al.* (2009:482), quantitative data is founded on numerical information with numbers being used to derive meanings. The results collected are in

numerical data and an analysis is conducted using diagrams and statistics. On the other hand, one would use words to express the meanings of qualitative research. Qualitative methods are defined as data that is collected on the frequency of occurrence of a phenomenon or a variable (Hussey & Hussey, 1997:140). Hussey and Hussey (1997:140) further state that qualitative methods have been described as a collection of interpretative techniques which seek to describe, decode, translate and otherwise come to terms with the meaning, not the frequency, of certain more or less naturally occurring phenomena in the social world.

Primary data will be not considered for purposes of this study. In attaining the research objectives of this study, the work of previous researchers will be relied on. Thus, secondary sources of data will be considered for purposes of this study and qualitative data will be used for this study. The data collected is non-numerical and has been assessed for quality and interpreted in order to understand the patterns of tax incentives in Africa over the years.

2.3 SYSTEMATIC REVIEW

In order to address the research question, a systematic review research method has been adopted for this study. This is an effective and sufficient research method to address the research question, as it allows one to efficiently identify and evaluate extensive literature.

A systematic literature review is defined as a comprehensive method for analysing literature using a pre-planned approach (Saunders, 2011:602). A systematic literature review has been classified as a primary scientific activity in that the rationale for a systematic literature review is well established (Mulrow, 1994:597). Even though a systematic literature review can require a lot of effort and time, Mulrow (1994:597) states that a systematic literature review is usually affordable and can assist researchers to avoid conducting a study on something that has already been explored.

A systematic review effectively integrates large quantities of data and is able to provide data that can be used for rational decision-making (Mulrow, 1994:597). It involves detailed and comprehensive plans which enable the researcher to decrease unfairness by identifying, evaluating and combining the relevant literature on a specific topic (Uman, 2011:57).

A systematic review can be conducted in various stages. The first stage involves defining the research question. In the second stage the inclusion and exclusion criteria are defined. This is where researchers define the type of literature to be included or excluded, such as type of research method, published or unpublished journal articles and defining the period of review. The third step is developing the search strategy to be adopted and locating the literature (Uman, 2011:57-58). This is followed by an analysis of the selected literature using a clear assessment. The last step involves summarising the evidence and providing findings and recommendations (Saunders, 2011:602).

A systematic review has been adopted for this study as it requires a precise procedure for searching and selecting literature to be included in the review. This could provide insights and guidance to the researcher and allows the researcher to expand on the topic when new information emerges. In the case of tax incentives in Africa, there are valuable insights that could be obtained by the various policy makers. By providing the effects that tax incentives have on tax systems in African countries, the researcher is able to conclude on whether tax incentives are instrumental for a tax system or not.

2.4 IDENTIFICATION AND RECORDING OF ACADEMIC LITERATURE

2.4.1 Databases and information sources

In obtaining the literature that would be relevant for this study, numerous databases were used as part of the research process. Databases available cover most areas of knowledge and can comprise either bibliographic details, full text or factual information (Hussey & Hussey, 1997).

For the purposes of this study, 40 articles were obtained using GoogleScholar, EBSCOHost, ProQuest and ScienceDirect. These databases were selected as they are reputable and are amongst the most comprehensive databases available. Accordingly, they should have sufficient peer-reviewed journals from diverse disciplines to support the research objectives of this study (Wong, Wong & Boon-Itt, 2015:7).

The first step was to perform a search by using the mentioned databases. Following this was an analysis of the constructs contained in the title and abstract of the literature. As a second step, all the identified constructs were used in order to search through the databases again. The third step was to use the reference lists of all the identified literature so as to identify any additional literature. The second and third step were performed to ensure that there was an adequate amount of literature to be included in the study.

GoogleScholar was used as the primary database. All the literature yielded as part of the search results on GoogleScholar was obtained from databases such as EBSCOHost, ProQuest and ScienceDirect, to which the University of Pretoria has access. Once obtained, the literature was downloaded from the respective databases. In instances where the literature was not available from the aforementioned databases, the article was obtained directly from GoogleScholar using the link and source provided by GoogleScholar.

2.4.2 Inclusion – and exclusion criteria

This study contains a number of inclusion and exclusion criteria related to the context, constructs and theoretical aspects of the study, in order to ensure that only relevant literature was included in the analysis process. The search was restricted to the perspective of African countries, as the purpose of the study is regarding the history and development of tax incentives in Africa. The search results also yielded literature relating to developing countries. These articles were included in this study on the basis that some of the African countries may be included in the literature. Therefore, this study did not consider any country other than an African one.

The study is focused on the history of tax incentives. As such, the study is not limited to one type of incentive, as the objective of the study is to get a holistic view and understanding of the types of incentives in Africa, what the purpose of implementing tax incentives in Africa is, and how the tax incentives implemented in Africa have developed over time.

The literature was not limited to a certain period, as the literature relating to the history of tax incentives dates back to the 1960's. During the 1960's, Lent (1967) conducted a study on tax incentives used for investments in developing countries. This would have to be

considered, as it would provide insights on where tax incentives originate and the views of researchers during the time when tax incentives were fairly new.

The type of literature was not limited, however, it mainly consists of published and peer reviewed journal articles. Published and peer reviewed articles are considered reliable, as they are reviewed by several recognised experts in the discipline prior to the article being published, so as to establish whether the article makes a sufficient contribution to knowledge in the discipline. This review process ensures the reliability of the article (University of the Sunshine Coast, 2019).

2.4.3 Keywords

Saunders *et al.* (2009:594) define keywords as the basic terms that describe the research question and objectives, which can be used in combination to search for literature. The key to a successful search is inputting useful keywords. The wrong choice of keywords leads to either too restrictive a list of identified items or, worse still, a list that is too long so as to be fundamentally useless (Hair *et al.*, 2007:122).

The first approach in determining relevant keywords to conduct the search process was to start broad. “History of tax incentives”, “Africa” and “Tax system” were used as the fundamental keywords to observe available literature, taking into consideration the nature of the topic. The search resulted in several journal articles that discuss the use of tax incentives to improve foreign direct investment in developing countries and economic development.

The above keywords were used in different manners, for example using a different combination when searching for literature.

2.4.4 Method for analysis

To get the most effective results the process of identifying, analysing and recording literature is of importance. Academic literature obtained for purposes of this study was analysed to

determine how it assists with achieving the research objectives and addressing the research question.

The nature of this study falls within the ambit of a qualitative research method. Data analysis is vital for reliable qualitative research (Maguire & Delahunt, 2017:3351). There are two types of data analysis techniques which can be used when conducting qualitative research. These are either a thematic (textual) analysis or a statistical analysis. The data analysis technique applicable to this research is a thematic analysis.

A thematic analysis is the process of identifying themes or patterns within the qualitative data which are important. These themes or patterns are used in the research to address the research question (Maguire & Delahunt, 2017:3352). A thematic analysis can be used to make sense of seemingly unrelated material (Komori, Not dated). It is used by researchers to systematically gain insight about an issue form the data gathered (Komori, Not dated).

This type of analysis can be conducted in various steps. The first step entails getting familiar with the data. This constitutes collecting and reading the data (Maguire & Delahunt, 2017:3355). In the second phase, researchers code or organise the data in a systematic way by hand or through a software programme (Komori, Not dated). The third step involves the identification, review and definition of the themes. During this phase the themes and sub-themes are identified by the researcher: these themes are patterns which have appeared from the coded data. Once the themes have been finalised, the researcher writes the description and explains it with quotations from the original document, in order to communicate its meaning to the reader (Komori, Not dated).

The relevant literature for this study was recorded and analysed in an online software programme called Qiqqa, by using pre-determined elements which are discussed in Section 3.2. Qiqqa is a research and reference manager programme (No Author, 2019). Qiqqa can be used by academics, researchers and businesses for the purpose of analysing data. This software is an invaluable tool to work with for the purposes of analysing and recording literature to be included in a research project. It has functions which can search for, read and annotate PDF’s, review one’s work, write up and create bibliographies and can also automatically identify, tag and categorise PDF’s (No Author, 2019).

2.4.5 Summary of literature to be analysed

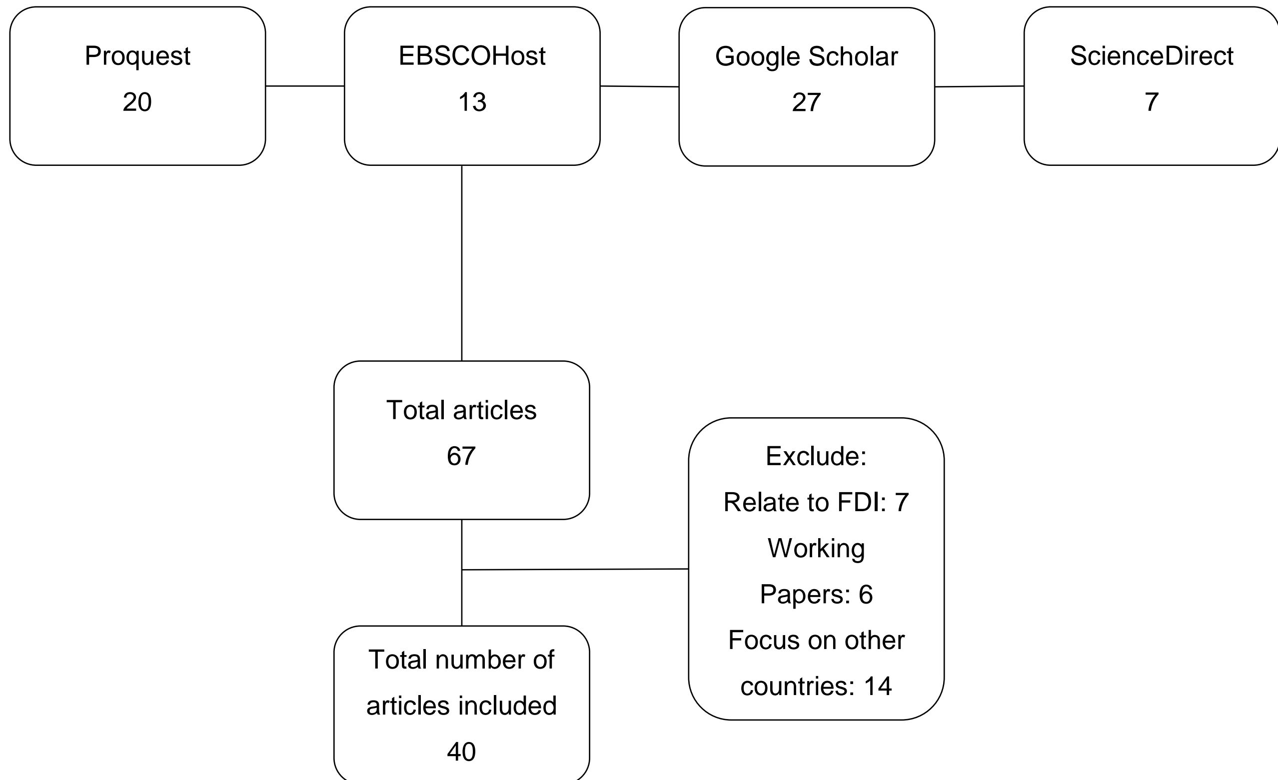
The literature obtained for the purposes of this study consisted of a total number of 40 articles. Several databases were searched in order to obtain the literature to be included in the study. The majority of the literature reviewed was obtained on GoogleScholar and Proquest, with only 6 articles being obtained from EBSCOHost. Table 1 provides a summary of the databases from which the literature was obtained.

Table 1: Literature reviewed

Database	Number of articles reviewed
Proquest	11
EBSCOHost	6
ScienceDirect	2
Google Scholar	21

The search yielded 67 literature sources of which only 40 of the articles were included in the study. Accordingly, 27 literature sources were excluded. The 27 literature sources that were excluded for the purposes of this study were excluded on the basis that 14 of the literature sources were written in a country perspective that was not from an African point of view. Seven of the literature sources were excluded on the basis that their focus was mainly on FDI rather than tax incentives. The literature sources were also excluded as the topic is broader than the topics that are the focus of the study. Six articles were excluded because they were working papers and were not literature from published journal articles. Figure 1 provides a summary of results.

Figure 1: Summary of results



CHAPTER 3

ANALYSES OF DATA & FINDINGS

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3 CHAPTER 3 – ANALYSIS OF DATA & FINDINGS

3.1 INTRODUCTION

This chapter aims to provide an overview of the literature reviewed and analysed in the study. The general overview of the selected literature is provided under the following pre-determined elements: year of publication, country perspective, taxpayer perspective, research classification, research method and the data analysis technique adopted by the selected literature.

First the chapter discusses the purpose of a tax system, the rationale for introducing tax incentives in African countries and the principles of tax incentives in a tax system.

The above is followed by an analysis of the literature on tax incentives in Africa and the effect they have on tax systems. The different ways in which tax incentives can be defined and the intentions for which tax incentives have been implemented in the various African countries are discussed. This chapter also provides a synopsis of the different types of tax incentives commonly used by African countries. Lastly, this chapter concludes with an analysis of the effectiveness and costs of tax incentives in Africa.

3.2 GENERAL OVERVIEW OF THE LITERATURE

This section provides a general overview of the literature included in the study. The 40 selected literature studies were analysed on Qiqqa, according to the following pre-determined elements:

- year of publication of the selected literature;

- the focus of the literature in terms of the country and taxpayer perspective;
- an analysis of the discipline from which the article originated; and
- the research design and methodology used by the researcher in the selected literature.

The year, country and taxpayer perspective were easily identifiable by reading the title and abstract of the article. The discipline adopted was also easily identifiable, based on the journal in which the article was published. The majority of the literature was from an economic perspective, as the literature had been published in economics, finance and accounting journals. The research design and methodology were analysed according to the following elements: research design, data collection and data analysis. The research design refers to the type of research (for example historical research, descriptive research or exploratory research) that is being conducted by the researcher and the type of strategy (for example doctrinal research, a systematic review or field research) that has been adopted by the researcher in each article. The research design elements have been defined in Chapter 2. The data collection method can either be primary or secondary data, or a combination of both, and the data analysis method may be quantitative and/or qualitative.

3.2.1 Year of publication

The literature included in the study was not limited to a certain period, as the literature relating to the history of tax incentives dates back to the 1960's. The study includes literature from 1967 to date. The majority of the literature was published during the periods 2001 – 2010 and 2011 and 2017. Tax incentives are provided extensively by Sub-Saharan African ("SSA") countries today compared to the early 1980's (Keen & Mansour, 2010:582). This is evidenced by the fact that out of the 40 literature studies reviewed, none of the studies were published during the periods between 1971 – 1980 and 1981 – 1990.

According to Keen and Mansour (2010:582) the tax law of SSA countries in the early 1980's shows that some countries provided incentives on an *ad-hoc* basis, and subject only to the authorities' judgement that the investment was favourable for economic development. Accordingly, it is difficult to document the *ad-hoc* incentives that were provided during the 1980's. The results are presented in periods of 10 years and date back to the 1960's. Table 2 is a summary of the results as discussed above.

Table 2: Year of publication of the literature reviewed

Year of publication					
1960 – 1970	1971 – 1980	1981 – 1990	1991 – 2000	2001 – 2010	2011 – 2017
2	0	0	4	19	15

3.2.2 Perspectives

3.2.2.1 Country perspective

The study is focused on the history of tax incentives in Africa and the effect that tax incentives have on tax systems. The search was restricted to the context of African countries and developing countries, as the objectives of the study are more focussed on the history and development of tax incentives in Africa. Accordingly, the majority of literature reviewed is written in the perspective of developing and African countries. Literature studies written in the perspective of developing countries dominated the study, followed by six literature studies written in the perspective of SSA and South Africa, two written in the perspective of Southern Africa and one written in the perspective of Zimbabwe and China. Seven of the literature studies reviewed were not conducted from a specific country perspective, they mainly focussed on what tax incentives are and their objectives.

Tanzi and Zee (2002:299) state that developing countries are generally categorised by a large share of agriculture in total output and employment; large informal sector activities and occupations; many small establishments and a small share of wages in total national income. Literature with a focus on developing countries is included in the study, as all African countries are classified as developing countries. The literature may provide insight on tax incentives in Africa, even though not all developing countries are the focus point of the study.

SSA countries and Southern African countries include countries such as Angola, Botswana, Nigeria, South Africa and Tanzania. As this study does not focus on specific tax incentives offered by specific countries, it was important to include literature that provides a wide overview of the tax incentives in Africa.

One article was written in the perspective of African countries and China. This article was included on the basis that it discusses the successes of Special Economic Zones ("SEZ") implemented by China and how developmental strategy came to Africa using SEZ's (Davies, 2008). This may also provide insight on the impressive successes of various Asian countries, which make extensive use of tax incentives, and is one of the contributing factors for the popularity of tax incentives (Zee *et al.*, 2002:1497). Table 3 provides a summary of the findings as discussed above.

Table 3: Countries considered by the literature reviewed

Country perspective						
Developing Countries	SSA	Southern Africa	Zimbabwe	South Africa	China	No country perspective
15	5	2	1	6	1	10

3.2.2.2 Taxpayer perspective

As mentioned above, this study does not focus on a specific tax incentive. The literature focusses on all tax incentives and is not limited to how a specific tax incentive affects certain taxpayers. Most of the literature consists of research that was not conducted from a specific taxpayer perspective, as the studies provide an overview and effects of tax incentives in general. The researchers' focus was mainly on the objectives, cost-effectiveness and transparency of implementing tax incentives. Some of the authors assess the comparative merits of the alternative forms of tax incentives and how these affect the tax system. They also provide solutions which may be helpful in the process of implementing tax incentives, in order to ensure that the intended objectives of introducing such incentives into the tax system are achieved. The literature with no specific taxpayer perspective has been included as part of the proposed study, as it will assist in obtaining a holistic view of tax incentives in Africa and the effect this may have on the tax system.

Three of the literature studies had a specific taxpayer focus, and considered firms and corporates and the tourism sector, respectively. After having analysed the three literature studies, it was decided to include them on the basis that, even though their focus is on how a certain incentive affects the aforementioned taxpayers, they also provide an overview of tax incentives in Africa. Table 4 provides a summary of the findings as discussed above.

Table 4: Taxpayers that were considered by the literature reviewed

Taxpayer perspective		
No taxpayer perspective	Firms and corporates	Tourism sector
37	2	1

3.2.3 Discipline

Due to the nature of the study, the majority of the literature studies originate from the economic discipline. The economic discipline is concerned with the study of scarcity, the study of how people use resources and respond to incentives, or the study of decision-making (American Economic Association, 2019). The majority of the literature reviewed and analysed was published in economics, finance and accounting journals. Tax incentives have been used by many countries as a tool to improve the economy, and government implements tax incentives as a means of taking actions that they deem as in the national interest (Bloch, 1995:28). Some authors studied the effects of tax incentives on tax systems and economic growth. Accordingly, the relationship between tax incentives and the economy are analysed in order to determine whether tax incentives are to be perceived as measures that promote economic development in countries (Lent, 1967:249). Table 5 is a summary of the findings as discussed.

Table 5: Discipline of article reviewed

Discipline			
Economics	International Tax and Public Finance	Tax	Social Science
35	3	1	1

3.2.4 Research classification

Most of the literature reviewed included in the study consisted of descriptive research studies which analyse the intricacies of tax incentives. They attempt to describe the forms of tax incentives in Africa and their relationship to tax systems. Furthermore, they also describe the advantages and disadvantages of the various types of tax incentives applicable in Africa, with regard to developing nations.

The main objective of the literature reviewed and analysed that was conducted from an experimental point of view, was to analyse the connection between tax incentives and the economy. They also assessed the impact of tax incentives on tax revenues and foreign investment in the country, by using primary data and using a model to determine the effects of tax incentives on investment and the tax system. In two of the studies, a historical research method was applicable. One of the researchers performed an empirical analysis on the effects of fiscal decentralisation in developing countries in the early 2000s (Li, 2016:234). The other study conducted by Blankley and Kahn (2005:151) provides an overview of the history of research and developments in South Africa. Table 6 summarises the above findings.

Figure 6: Research method used in the literature reviewed

Research method		
Historical research	Descriptive research	Experimental research
2	35	3

3.2.5 Research strategy

The research strategy refers to the methodical link between the research design and the research methodology adopted to collect and analyse data. The majority of the literature analysed conducted a systematic review by collecting secondary data, critically analysing research studies and providing the findings either qualitatively or quantitatively (Armstrong, Hall, Doyle & Waters, 2011:147). The researchers' focus was mainly the objectives and cost-effectiveness of tax incentives, the comparative merits of the alternative forms of tax incentives and the importance of tax incentives in a tax system. A systematic review is a relevant research strategy, as it delivers a meticulous summary of all of the available primary research in response to a research question, which supports why most of the studies adopted a systematic research strategy. Five of the studies conducted surveys in order to determine the various forms of tax incentives present in African countries. Case studies were also conducted in order to determine the effects of tax incentives. Table 7 is a summary of the findings.

Table 7: Research strategy used in the literature reviewed

Research strategy		
Systematic	Case Study	Survey research
32	3	5

3.2.6 Data analysis

As mentioned in Chapter 2, data analysis is vital for a reliable qualitative study (Maguire & Delahunt, 2017:3352). There are three types of data analysis techniques which can be used when conducting a qualitative study. These are a statistical technique, a thematic technique or a combination of both. These techniques can be broken down further into various types of analyses that can be performed when doing a statistical or thematic analysis. A statistical analysis is usually concerned with analysing quantitative data, whereas a thematic analysis analyses qualitative data. Typically under a statistical analysis one can perform a descriptive, correlation, regression or factor analysis, and under a thematic analysis one can perform a narrative analysis, a legal analysis, a meta-synthesis or heuristics.

Most of the literature reviewed and analysed in this study adopted a thematic analysis technique. From the 24 articles, 18 articles analysed the data by using a narrative approach, while six performed a meta-synthesis. The researchers tested the theories by observing results of previous researchers and made conclusions and recommendations based on the available secondary data. The 11 articles that adopted a statistical analysis tested the relationship between tax incentives and investment. With the articles that adopted a statistical analysis, 15 performed a descriptive analysis and 1 article performed a correlation analysis. Table 8 is a summary of the findings.

Table 8: Data analysis technique adopted in the literature reviewed

Data analysis			
Narrative analysis	Meta-synthesis	Descriptive analysis	Correlation
18	6	15	1

3.3 TAX INCENTIVES OVERVIEW

The following section begins by explaining the purpose of a tax system and the rationale for introducing and including tax incentives as part of a tax system. This is followed by a discussion of the principles that are considered necessary to be followed when tax policies relating to tax incentives are drafted, in order to ensure that the intended objectives of the tax system are achieved.

The above is followed by an analysis of the literature on tax incentives in Africa and how it correlates with tax systems.

3.3.1 Tax systems

The aim of this section is to understand the purpose of a tax system and why African countries recognise tax incentives as an important feature to a tax system, in order to draw conclusions as to whether tax incentives can be an instrumental feature to an African tax system.

3.3.1.1 Purpose of a tax system

Tax policy is concerned with the design of a tax system that is capable of financing the necessary level of public spending in the most efficient and equitable way possible (Tanzi & Zee, 2002:299). The primary purpose of a tax system is to raise revenue in order to cover the costs of public expenditure (Brunori, 1997:52).Thus, the most important role of a tax system is its revenue-raising function (Brodzka, 2013:28). Brunori (1997:52) further states that a tax system must not only provide for current spending, but also be capable of meeting future revenue needs.

In developing countries with emerging markets, especially those that aim to be integrated with the international economy, tax policy must play a particularly sensitive role. In these countries, the tax system should: (i) raise enough revenue to finance essential expenditures without recourse to excessive public sector borrowings; (ii) raise the revenue in ways that are equitable and that minimise its disincentive effects on economic activities; and (iii) do so

in ways that do not deviate substantially from international norms (Tanzi & Zee, 2002:299). Tax systems also have an important income distribution function. This recognises the general perception that the tax system imposes a fair tax burden, which is essential to the effective operation of a voluntary compliance tax system (Brodzka, 2013:28). Generally a good tax system should be designed so as to ensure predictable revenue for government, be stable and minimise distortions in investment decisions (James, 2009:39).

The establishment of effective and efficient tax systems faces some formidable challenges. The first of these challenges is the structure of the economy that makes it difficult to impose and collect certain taxes. The second is the limited capacity of tax administration (Tanzi & Zee, 2002:299). According to Ruhashyankiko and Stern (2006:1), the fundamental problem that is found is that tax systems are often designed to collect short-term revenues, rather than pursue long-term developmental objectives.

The central government tax systems in many African countries are characterised by an excessive number of different taxes with rate structures that are difficult for taxpayers to understand (Odd-Helge & Lise, 2003:v). Ruhashyankiko and Stern (2006:4) state that experience shows that African policy makers are mainly focused on increasing collection and compliance from a few existing large business taxpayers, rather than attempting to eliminate the distortions and engaging with micro, small and medium businesses. As such, an increased number of different taxes are being implemented and the tax law relating to these taxes is often written in a confusing way and manuals to consult are absent, resulting in discretionary powers by tax enforcers. This leads to tax officials having a discretion over important decisions such as those related to the provision of tax exemptions and the determination of tax liabilities (Odd-Helge & Lise, 2003:v). All these factors contribute to a non-transparent and complicated tax system, where taxpayers are left to the discretionary power of tax officials and a system that is costly to administer and facilitates corruption (Odd-Helge & Lise, 2003:v-vi).

Developing countries, such as African countries, introduce tax incentives in order to attract capital and support economic growth. Tax incentives are often treated by them as counterweight to investment disincentives inherent in the general tax system (Brodzka, 2013:30). Munongo, Akanbi and Robinson (2017:154) state that tax incentives are also used

to counterweight the effects of poor macroeconomies, poor infrastructure and a lack of effective institutions in developing nations, which increase the cost of doing business. By offering tax incentives, many developing countries compensate investors for the structural weaknesses in their economy (Klemm, 2010:316; Kandpal & Kavidayal, 2014:557). Thus reducing tax rates will help to cover losses made by investors (Munongo *et al.*, 2017). Clark, Cebreiro and Böhmer (2007:6) state that policy makers should consider whether the costs of tax incentives, in terms of complexity, neutrality and revenues forgone, offset their intended benefits.

3.3.1.2 Rationale for introducing tax incentives

Both developed and developing countries apply tax incentives in order to encourage FDI, but the types and frequency of the incentives offered may differ substantially amongst different economies (Kandpal & Kavidayal, 2014:557). According to Klemm (2010:316), tax incentives have remained a popular policy tool for attracting FDI. FDI is vital in a developing economy, so developing countries try to attract more FDI in all the different sectors of their economy (Kandpal & Kavidayal, 2014:557).

While granting tax incentives to promote investment is common in countries around the world, available evidence suggests that their effectiveness in attracting investment is often questionable and that their revenue costs could well be high (Tanzi & Zee, 2002).

A tax system with tax incentives is not the worst in response to the pressures of increasing revenue and tax competition. Klemm (2010:316) states that tax competition is another important force for the implementation of tax incentives. Klemm (2010:316) defines tax competition as a process used to attract FDI activity and profit through the reduction of CIT rates. Other reasons for incentives include social goals, such as encouraging economic activity in backwards regions.

3.3.1.3 Principles for tax incentives in a tax system

"The performance and robustness of any tax system or regime needs to be measured against certain basic attributes or qualities" (Nakhle, 2008:11). These attributes or qualities

provide guidance on how a tax system should be constructed, in order to be efficient in its application. It is necessary to follow the principles when tax policies are drafted, in order to ensure that the intended objectives of the tax system are achieved. Tax incentives fall into the broad category of governments' tax systems, thus they are expected to achieve similar objectives, apart from attracting investment (OECD, 2001).

Various researchers (James, 2009; Klemm, 2010; Brodzka, 2013; ActionAid International & Tax Justice Network Africa, 2015) have provided insight and/or guidance on the principles that need to be present in the tax incentive regime, in order for them to achieve the intended benefits in a tax system. World-Bank (2015:25) states that good governance of tax incentives is critical for their effectiveness and efficiency. According to Klemm (2010:323), many of the principles for a good tax system apply to tax incentives, including transparency and predictability. Transparency and predictability are necessary to ensure accountability and to reduce opportunities for corruption. Available literature (James, 2009; Klemm, 2010; Brodzka, 2013) provides useful principles that can guide policy makers on the key considerations that they should undertake when designing incentive programmes to ensure that the tax incentives are efficient and effective (James, 2009; Klemm, 2010; Brodzka, 2013). In particular, effective and efficient incentives should be:

- granted automatically;
- part of the tax code;
- monitored and have control mechanisms in place; and
- measured in order to determine the costs and benefits thereof (James, 2009; Klemm, 2010; Brodzka, 2013).

Each one of the principles identified above will be briefly discussed below.

3.3.1.3.1 Tax incentives should be granted automatically

According to James (2009:34), the eligibility for incentives provided by law should be based on clear criteria and should not be granted through special permission by various agencies: this is referred to as the automatic triggering mechanism (Tanzi & Zee, 2002:318). The automatic triggering mechanism allows the taxpayer to receive the tax incentives provided

for in the tax legislation automatically once it meets the clearly specified qualifying criteria. Accordingly there is not a procedure to apply for them (Tanzi & Zee, 2002:318). Taxpayers in this case directly claim for their tax incentives during tax filing (James, 2009:5). This also ensures prompt decision-making and quick turnaround times for qualifying taxpayers (James, 2009:34).

The discretionary triggering mechanism on the other hand involves approving or denying an application for tax incentives on the basis of the judgement of the relevant incentive-granting authorities (Tanzi & Zee, 2002:318). The tax incentive that the taxpayer may qualify for may be specified in the tax law or investment code, but generally given broad interpretation that requires an approval process (James, 2009:5). This type of triggering mechanism is prone to corrupt practices, as the approval is valuable for investors, and officials administering them have the ability to refuse them (James, 2009:5) and the decision-making process lacks transparency, which could discourage taxpayers (Tanzi & Zee, 2002:319). The eligibility criteria for tax incentives should clearly specify the conditions that the taxpayer needs to satisfy in order to qualify for a tax incentive, with as little room as possible for subjective interpretation or negotiation (World-Bank, 2015:26). To the extent possible, the granting of tax incentives should be based solely on rules rather than discretion (World-Bank, 2015:26).

According to the KPMG Africa Incentive Survey mentioned hereafter, all the countries surveyed have a pre-approval requirement (KPMG, 2016). Due to the lack of transparency in the approval process, this mechanism could encourage corruption and rent-seeking activities.

3.3.1.3.2 Tax incentives should be part of the tax code

Tax incentives should be subject to legislative process and consolidated under the tax law, so that tax authorities can administer them (James, 2009:35; World-Bank, 2015:25). (James, 2009:35) notes that some tax incentives are provided though different statutes, and in extreme cases through individual agreements with investors. These approaches create confusion, whereas including them in the tax code allows the tax administration to administer the tax incentives and limit their abuse (James, 2009:35).

3.3.1.3.3 Monitoring and control mechanisms

ActionAid International and Tax Justice Network Africa (2015:11) state that monitoring tax incentives is a major challenge, as often the legal systems for tax incentives are very weak in regulating them, to ensure that they achieve the specific objectives. In support of the statement above, James (2009:35) states that the tax administration should check that taxpayers receiving the tax incentives satisfy all the requirements of the specified tax incentive. In order to achieve this it should be compulsory for tax returns and more strict information requirements such as complete financial statements and regular audits to be put in place, especially for tax holidays (James, 2009:35).

3.3.1.3.4 Measure the costs and benefits of tax incentives

ActionAid International and Tax Justice Network Africa (2015:12) state that it is hard to obtain the exact figures for revenue losses derived from tax incentives, since many governments do not provide data and no independent analysis is conducted. As such, it is recommended that governments should annually as part of a tax expenditure review, measure the costs as well as the benefits of the tax incentives, so as to establish whether to continue, eliminate or modify the tax incentive (James, 2009:35; World-Bank, 2015).

3.3.2 Tax incentives as a construct

Tax incentives have been widely defined by researchers (Lent, 1967; Zee *et al.*, 2002; Klemm, 2010; Department of Planning Monitoring and Evaluation, 2017; Department of Planning Monitoring and Evaluation, 2018). According to Zee *et al.* (2002:1498), tax incentives can be defined in two ways. This can either be in statutory or in effective terms. In statutory terms, a tax incentive is considered as a special tax provision granted to qualified investment projects as determined, which represents a statutorily favourable deviation from equivalent provisions applicable to those qualified investment projects in general (Zee *et al.*, 2002:1498). However a tax incentive in effective terms is considered to be a special provision granted to qualifying investment projects (Zee *et al.*, 2002:1498). This type of tax incentive would result in a lower effective tax burden on the qualifying projects, compared

to the tax burden that would normally be imposed on the investors in the absence of the special tax provision (Zee *et al.*, 2002:1498).

Defining tax incentives in statutory terms emphasises the policy makers' intentions for granting tax incentives, whereas in defining them in effective terms the effects of the incentives become the focal point (Zee *et al.*, 2002:1498). The distinction between the two definitions highlights a vital point and illustrates that the intentions and effects of tax incentives are not always aligned (Zee *et al.*, 2002:1498). Zee *et al.* (2002:1499) further state that defining tax incentives in statutory terms is appropriate for classifying tax incentives under a common classification, since tax incentives can take numerous forms, even as the statutory tax systems themselves differ greatly across countries.

Klemm (2010:315) defines tax incentives as "all measures that provide explicitly for a more favourable tax treatment of certain activities or sectors, compared to what is granted to general industry". In terms of this definition, generally a reduction in the tax rate or an accelerated depreciation scheme is valid to all firms (Klemm, 2010:315).

According to the Department of Planning, Monitoring and Evaluation (2018:2), the main purpose of an incentive is to change behaviour at the firm level. Conceptually, change occurs by impacting firm profitability either through: (a) reducing costs; (b) increasing costs (in other words a negative incentive); or (c) increasing revenues. Individual incentive programmes, if effective, should result in changed firm behaviour, causing them to invest in capital, labour, inclusion or research and development. At an aggregate level, the response of individual firms results in economy wide effects (Department of Planning, Monitoring and Evaluation, 2018:2).

Tax incentives have been used by countries to achieve various objectives, not all of which are persuasive on theoretical grounds. These include reducing unemployment, promoting specific economic sectors or types of activities and addressing regional developmental needs (Zee *et al.*, 2002:1499). Another main objective of tax incentives in most developing countries is to attract foreign and domestic capital. This enables the countries to improve the profitability of a new business or businesses, which are expanding their existing

business, and which contributes to the country's economic goals (Lent, 1967:251). The objectives are discussed further in Section 3.3.2.2 below.

Tax incentives can take different forms such as tax holidays, preferential tax rates or allowances targeted at certain investment expenditure (World-Bank, 2015), which is discussed in detail in the section to follow.

3.3.3 Typical tax incentives evident in Africa

Tax incentives can be granted in different forms, not all of which are equally cost-effective in achieving their intended goals (Zee *et al.*, 2002:1502). Systematic and comparable information on the extent and nature of the tax incentives in SSA is not readily available (Keen & Mansour, 2010:582). In their study, Keen and Mansour (2010:582) provide an overview of the various tax incentives evident in African countries. These include tax holidays, reduced corporate income tax ("CIT"), investment allowances, investment tax credits and special economic zones ("SEZ").

The section that follows provides an overview of the alternative forms of tax incentives offered by the various African countries.

3.3.3.1 Tax holidays

Tax holidays are the most widely used tax incentives in the developing world, including various African countries. This is regardless of the fact that this type of tax incentive is perceived as the least attractive form of tax incentive (Keen & Mansour, 2010:577). Although tax holidays are the most common type of tax incentives offered by developing countries, they are hardly found in developed countries (Tanzi & Zee, 2002:316).

During the year 2005, tax holidays replaced investment allowances as the most common form of tax incentive provided by African countries (Keen & Mansour, 2010:582). Over two thirds of the countries provided tax holidays, but less than half did so in 1980 (Keen & Mansour, 2010:582). Lent (1967:268) states that typically provision is an outright exemption for approximately 2 - 5 years. Historically, Nigeria, the Ivory Coast and Sierra Leone fell

within this category. Tax holidays in other countries go up to a period of 10 years. African countries that fell within this category would include Ghana (4 – 10 years), Senegal (8 years) and Chad and the Congo (10 – 15 years) (Lent, 1967:268). Even though the extensive use of tax holidays has been reduced, a number of African countries still offer this incentive. These include Ethiopia, the Ivory Coast, Libya, Morocco, Mozambique and Tanzania. Tax holidays are described as the worst tax incentive in terms of benefits to the host nation, and are only attractive if they are long-term. If not, they attract footloose industries (Keen and Mansour, 2009).

Klemm (2010:317) defines tax holidays as a "temporary exemption of a new firm or investment from certain specified taxes, typically at least for corporate income tax". Exemptions on tax holidays are temporary and at times the administrative requirements of certain taxes are removed during the period of the holiday, for example the need to file tax returns (Klemm, 2010:317). Various countries offer partial tax holidays. With this type of tax holiday, reduced obligations are offered to qualifying firms, rather than the full exemption (Klemm, 2010:317). The advantages of tax holidays are that they are simple to administer, have low compliance costs and reduce tax liabilities (Clark *et al.*, 2007:7)

The dangers with tax holidays are that they particularly attract short-term investment and are most attractive to uncommitted companies, which are likely to bring the least benefit to the economy (Keen & Mansour, 2010:578; Klemm, 2010:325). Due to their nature, which is usually exempting profits from certain taxes regardless of the amount, this type of tax incentive tends to benefit investors who anticipate high profits and who would have invested even if there was no such exemption (Zee *et al.*, 2002:1503). Furthermore, tax holidays also have the major disadvantage of exempting profit tax without considering the size of the profit.

This type of tax incentive is open to abuse, undermines tax revenue and encourages tax avoidance, as enterprises that are taxed could enter into economic relationships with companies that are exempt, in order to be able to shift their profits, and this also allows them to redesign their current investment as new investments (Zee *et al.*, 2002:1504; Keen & Mansour, 2010:578). Klemm (2010:325) states that tax holidays seem particularly harmful, regardless of their popularity, and Keen and Mansour (2010:578) state that they pose significant danger to the tax system.

3.3.4 Investment allowance and tax credits

Investment allowances and tax credits can be implemented easily in a transparent and automatic way. They are both reliant on new investment and have both advantages and disadvantages (Klemm, 2010:325). During the 1960's, these types of incentives were offered by Kenya, Uganda and Malawi. Kenya and Uganda offered 20 per cent for industrial and manufacturing machinery and Malawi offered a rate of 10 per cent (Lent, 1967:267).

Investment allowances typically provide for the initial costs of plant and equipment investments to be written off as expense immediately, in addition to the normal allowable depreciation on the cost of such plant and equipment (Zee *et al.*, 2002:1504). According to the United Nations Conference on Trade and Development (2000:21), investment tax credits can operate in two ways: flat or incremental. A flat investment tax credit is applied in the form of a fixed percentage on expenditure incurred by new investments in a year. An incremental investment tax credit has a moving base which is the minimum amount that is not eligible for tax exemption, and tax exemption is applied to the amount in excess of the base amount as a fixed percentage (United Nations Conference on Trade and Development, 2000:21).

In contrast to investment allowances, investment tax credits provide a deduction of a certain portion of an investment from the tax liability (Klemm, 2010:317). The rules relating to excess investment credits (i.e. investment tax credits that are more than the tax liability) vary. In some instances the unused credit may be lost, carried forward or (rarely) refunded (Klemm, 2010:317).

Compared to tax holidays, investment allowances and investment tax credits have numerous advantages (Tanzi & Zee, 2002:316). They are much better at targeting investment and their revenue costs are very transparent and easier to control (Tanzi & Zee, 2002:316; Zee *et al.*, 2002:1504). However, Tanzi and Zee (2002:316) state that there are two notable disadvantages with these two incentives. They distort the choice of capital asset, since a further allowance becomes available each time an asset is replaced (Tanzi & Zee, 2002:317; Zee *et al.*, 2002:1504). Another disadvantage is that investors may abuse the

system by disposing of and acquiring the same asset, in order to be able to claim more than one allowance (Tanzi & Zee, 2002:317; Zee *et al.*, 2002:1504). Safeguards must be built into these investments, in order to ensure that they minimise this danger. This could be achieved by specifying the minimum holding period of the asset or specifying the conditions under which an asset may qualify (Tanzi & Zee, 2002:317).

3.3.4.1 Accelerated depreciation

An accelerated depreciation is defined as an incentive that provides for depreciation more rapidly than the normal depreciation available for the rest of the economy (Klemm, 2010:317). It can be implemented in different ways, which include providing a higher first year allowance, or increasing the depreciation rates (Klemm, 2010:317).

According to Tanzi and Zee (2000, 317), providing tax incentives in the form of accelerated depreciation has the least inadequacies. They are generally least costly and the revenue foregone during the early years is recovered in subsequent years and is likely to bring investments planned for the future to take advantage of the tax incentive (Zee *et al.*, 2002:317). While this treatment does not alter the total amount of capital costs to be depreciated, it increases the present value of the claim by shifting them forward closer to the time of the investment (United Nations Conference on Trade and Development, 2000:20). According to the United Nations Conference on Trade and Development (2000:21), in most countries, unused depreciable capital costs can be carried forward, in some cases indefinitely.

Providing tax incentives in the form of accelerated depreciation has the least shortcomings compared to tax holidays (Tanzi & Zee, 2002:317). Accelerated depreciation has two additional advantages when compared to the other types of incentives. They are generally less costly, as the foregone revenue in the early years is at least partially recovered in subsequent years, and if the acceleration is given temporarily, it is likely to bring more investments planned for the future in order to take advantage of the tax incentive (Tanzi & Zee, 2002:317).

3.3.4.2 Special Economic Zones

Despite the strong economic growth, job creation and poverty remain major challenges for governments in Africa (Gakunu, Demisse, Weigel, Kai & Li, 2015:6) . Gakunu *et al.* (2015:6), state that many countries are looking at China, which has proven over the last three decades that industrialisation can create jobs and allow numbers of people to move out of poverty. An important vehicle for China's economic growth has been the successful use of SEZs since the early 1980s (Gakunu *et al.*, 2015:6).

Special zones are defined as "geographically limited areas in which qualified firms can locate and thus benefit from exemption of varying scope of taxes and/or administrative requirements" (Klemm, 2010:317). Special zones are aimed at exporters located close to a port. However, in some countries qualifying companies can be declared zones regardless of their location (Klemm, 2010:317).

According to Gakunu *et al.*, (2015:9), there are a growing number of SEZs with differing objectives, markets and activities. Special zones may differ in their features and it is not possible to make a general assessment of this incentive (Klemm, 2010:326). In some cases, special zones used for international trading companies may have no effect other than avoiding the hassle of charging import duties on goods as they arrive, and may opt to refund them as they are re-exported (Klemm, 2010:326). Others however provide relief to companies by granting them lower personal income tax and social security contributions for their employees (Zee *et al.*, 2002:585). Broadly SEZs can be grouped into the following categories: Free Trade Zones ("FTZ"), Export Processing Zones ("EPZ") and Multi-purpose zones ("MPZ") (Gakunu *et al.*, 2015:9).

FTZs are a widespread type of SEZs located mostly along seaports, airports, major roads and railroads, or in border regions. FTZs are typically small, fenced-in duty free areas, offering warehousing, storage and distribution facilities for trade (Gakunu *et al.*, 2015:9). Gakunu *et al.* (2015:9) state that EPZs on the other hand offer special incentives and facilities for manufacturing and related activities. They are mainly aimed at export markets. MPZs are generally a much broader concept and typically consist of much larger areas.

They accommodate different types of activity and provide a broad set of incentives and benefits (Gakunu *et al.*, 2015:9).

The use of tax and duty exemptions in SEZ's is fairly popular. This may reflect a move towards containing the tax incentives to certain geographic locations and may minimize their impact of the tax incentives on the wider economy for revenue reasons (James, 2009:4).

3.3.4.3 Reduced CIT

Countries may provide exemptions from, or reduced rates of, corporate income or profits tax to particular types of activity (Easson & Zolt, 2002:19). Reduced CIT is a reduction in the tax rate, typically the corporate income tax rate of a country (Klemm, 2010). Some countries provide a reduced rate of tax for certain types of investment, whereas other countries provide reduced tax rates for investment in particular locations or regions (Easson & Zolt, 2002:19)

3.3.5 Tax incentives in Africa

Section 3.3.3 described the types of tax incentives evident in Africa. The purpose of this section is to understand the landscape of tax incentives offered by African countries. This section also aims to provide an overview of how tax incentives have evolved over the years. It further seeks to establish which tax incentives remain popular according to recent data and which were recently introduced. In order to achieve this section's objectives, the results of the surveys conducted by the United Nations Conference on Trade and Development and KPMG in 2000 and 2016 respectively, are presented below in the form of tables for easy comparison of the tax incentives used by African countries.

Despite the valuable contribution of the above studies, studies providing evidence of the landscape and evolutions of tax incentives using real data in African countries are very scarce (Van Parys & James, 2010). Due to the dynamic nature of legislation in African countries, it is important to rely on the most recent available information about African countries' tax developments. Accordingly the key sources will be the United Nations Conference on Trade and Development (2000) and KPMG (2016). These entities

conducted surveys during the years 2000 and 2016 on tax incentives offered by the various African Countries.

The survey conducted by the United Nations Conference on Trade and Development is the outcome of a survey conducted by the international tax firm of Deloitte & Touche LLP. In addition, a number of experts provided valuable comments and suggestions while the study was being carried out (United Nations Conference on Trade and Development, 2000:4). Accordingly, the results of the survey are considered reliable considering the sources of compiling the data of the various countries.

The information used by KPMG to compile the survey was obtained from the KPMG network of tax professionals across Africa (KPMG, 2016). The KPMG network of tax professionals were requested to submit information on the tax incentives offered by each African country for the years up to and including 2016. The information obtained from the KPMG network of tax professionals across Africa was included as part of the survey. Thus the results of the KPMG survey is the most reliable source of recent development of tax incentives in Africa (KPMG, 2016).

The United Nations Conference on Trade and Development (2000:69) conducted a survey of tax incentive regimes in over 45 countries from all regions of the world, including Africa. The survey included a synopsis of the types of tax incentives offered by 14 African countries. The KPMG (2016) survey also included information of 28 African countries and provided insight on the tax incentive regimes across these countries.

The purpose of this section is not to compare the two surveys, but to provide an overview of how tax incentives in Africa have evolved, and also to provide insights on the types of tax incentives adopted by the various African countries. Even though the United Nations Conference on Trade and Development (2000) conducted a limited survey on the tax incentives in Africa, it provides an overview of the incentives that were historically popular amongst the countries. The two surveys can be used as a tool in order to gain an understanding of the developments of tax incentives in Africa.

The findings of the survey conducted by the United Nations Conference on Trade and Development will be discussed first, followed by the findings of the survey conducted by KPMG.

3.3.5.1 Findings of the survey conducted by the United Nations Conference on Trade and Development

The African countries surveyed in the study have put in place a variety of tax incentives in order to promote regional development. They offer tax incentives such as income tax exemptions or reduced rates of taxes, investment allowances, as well as customs duty exemptions for equipment and goods destined for production in designated areas (United Nations Conference on Trade and Development, 2000:37).

Tax holidays and tax exemptions appear as a common theme amongst the African countries included in the survey. All the African countries surveyed in the United Nations Conference on Trade and Development (2000) offer tax holidays and tax exemptions. The period of the tax holiday and/or exemption in most countries ranges between 5 and 20 years (Egypt), and in many cases is extendable based on certain requirements being met (United Nations Conference on Trade and Development, 2000:37 - 66) .

Reduced corporate rates, targeted to specific sectors/locations are also offered in four countries included in the survey (Ghana, Malawi, Mauritius and Morocco) (United Nations Conference on Trade and Development, 2000:37). The corporate income tax rate in these countries ranges between 35 per cent and 38 per cent and the reduced corporate rates range between 8 per cent and 15 per cent (United Nations Conference on Trade and Development, 2000:47 - 53). The reduced corporate rates are commonly offered as export incentives and are also offered for projects in free trade zones and targeted sectors/locations. For example manufacturing, plantation, timber and tourism are encouraged by offering reduced tax rates (United Nations Conference on Trade and Development, 2000:37).

Export incentives are also offered by the various countries and they either offer exemptions from duty and/or Value-Added Tax (“VAT”) (United Nations Conference on Trade and

Development, 2000:37). The exemptions are offered on exported products or services based on certain requirements by each country.

Nigeria and Uganda appear to be the only two countries offering a research and development (R&D) tax incentive. In Nigeria companies engaged in R&D activities for commercialisation were granted a 20 per cent investment tax credit (United Nations Conference on Trade and Development, 2000:57), whereas in Uganda, 100 per cent of the costs incurred for R&D are deductible (United Nations Conference on Trade and Development, 2000:61). Table 9 summarises the type of tax incentives in the African countries as per the research conducted by the United Nations Conference on Trade and Development, and provides insight on where they are found.

Table 9: Tax incentives used by African countries, 2000

Country	Tax Holiday/Tax Exemption	Reduced tax rate	Investment allowance/ Tax credit	Duty/VAT Exemption/ reduction	R&D Allowance	Deduction for qualified expenses
Angola	X			X		
Cameroon	X		X	X		X
Cote d'Ivoire	X			X		
Egypt	X			X		
Ghana	X	X		X		
Malawi	X	X	X			X
Mauritius	X	X	X			
Morocco	X	X	X	X		
Namibia	X		X	X		X
Nigeria	X		X	X	X	
South Africa	X		X			
Uganda	X		X	X	X	X
Zambia	X		X	X		X
Zimbabwe	X		X	X		X

Source: United Nations Conference on Trade and Development (2000)

3.3.5.2 Findings of the survey conducted by KPMG

In 2016, KPMG published its inaugural Africa Incentive Survey. The purpose of the survey was to understand the landscape of tax incentives offered by African countries, both to local and foreign investors (KPMG, 2016:4). According to KPMG (2016:67), all countries surveyed offer a range of enhanced tax incentives, ranging from accelerated allowances for capital expenditure, special allowances for investments in certain industry sectors (such as manufacturing, infrastructure and tourism), as well as tax holidays ranging from 3 to 10 years.

The introduction of SEZs and Free Port Zones ("FPZ") appears as a common theme amongst African countries, with 21 of the 28 countries surveyed offering SEZ areas as additional incentives for companies to invest in specific regions within a country (KPMG, 2016:67). During February 2016 South Africa also passed into law enabling legislation that saw 15 areas designated as SEZs. Counties such as Swaziland and Zimbabwe were working on similar SEZs to be introduced (KPMG, 2016:67). Generally, the SEZs offer a reduced CIT rate of between 0 per cent to 15 per cent, as well as other benefits such as exemption from Value Added Tax, customs and import/export duties, as well as accelerated capital allowances (KPMG, 2016:67).

According to (KPMG, 2016:67), more than a third of the 28 countries surveyed offer incentives related to traditional manufacturing, with South Africa, Nigeria and Morocco being notably the only three countries in Africa that offer cash grants in addition to tax incentives. Only seven of the African countries have local participation or local job creation requirements for accessing the respective incentives, and South Africa appears to be the only country in Africa that offers a dedicated R&D tax incentive, with an enhanced tax deduction of 150 per cent which is equivalent to that offered by the Organisation for Economic Cooperation and Development ("OECD") countries (KPMG, 2016:67). Table 10 below is the summary of results as per the research conducted by KPMG.

Table 10: Tax incentives used by African countries, 2016

Country	Offer Tax Incentives	Offer Cash Grants	Pre-approval requirement	SEZ/Export Free-zones	Reduced CIT Rate (SEZ/Free Zones)	Training incentive
Algeria	X		X	X	X	
Angola	X		X	X		
Botswana	X		X		X	X
Cameroon	X		X	X	X	
Chad	X		X			
DRC	X		X		X	
Djibouti	X		X	X	X	
Ethiopia	X		X	X	X	
Ghana	X		X	X	X	
Kenya	X		X	X	X	X
Libya	X		X		X	
Malawi	X			X		
Mauritius	X			X	X	
Morocco	X	X	X	X	X	X
Mozambique	X		X	X	X	X
Namibia	X		X	X		X
Nigeria	X	X	X	X	X	X
Rwanda	X		X	X	X	
Senegal	X		X		X	
Sierra Leone	X		X			X
South Africa	X	X	X	X	X	X
Sudan	X		X	X	X	
Swaziland	X			X		X
Tanzania	X		X	X	X	
Tunisia	X	X	X			X
Uganda	X		X	X		
Zambia	X		X	X	X	
Zimbabwe	X		X		X	

Source: KPMG (2016)

3.3.5.3 Conclusion on the empirical evidence on the use of tax incentives in Africa

It can be noted from the two surveys that the use of tax holidays has significantly decreased and SEZs have become the common trend in these African countries. All 14 countries surveyed by the United Nations Conference on Trade and Development offered tax holidays ranging from between 5 and 20 years. Based on KPMG's survey, tax holidays now range from between 3 and 10 years.

The use of SEZs has significantly increased and they generally offer a reduced CIT rate of between 0 per cent to 15 per cent, as well as other benefits such as exemption from Value Added Tax, customs and import/export duties, as well as accelerated capital. South Africa appears to be the only country in Africa that offers a dedicated R&D tax incentive, and Nigeria and Uganda no longer offer this type of tax incentive. A reduction in corporate rates and accelerated depreciation is still the most widely used fiscal incentive.

3.3.6 Effectiveness of tax incentives

Tax incentives should be considered as part of a broader tax policy design (World-Bank, 2015). A good tax system implements taxes that are simple, fair and efficient (World-Bank, 2015). Tax incentives pose a risk of compromising the principles of a good tax system in that they complicate the tax system, create horizontal inequities and misrepresent production efficiency. In addition they may lose revenue that could have been spent more productively (World-Bank, 2015).

One of the main objectives of tax incentives is attracting investments. Tax incentives have been found to be inefficient in attracting investment, in the sense that investments would have been undertaken had there been no incentives provided (World-Bank, 2015). Also the effectiveness of tax incentives varies between counties and sectors. In some countries they may have played a vital role in attracting new investment and promoting economic growth (World-Bank, 2015). The effectiveness of incentives in attracting investment also depends on the international tax rules adopted by the country (World-Bank, 2015).

Even where tax incentives succeed in attracting investment, the costs of the incentives may exceed the benefit derived from the new investment. This is difficult to substantiate, as problems exist in estimating the costs and benefits of tax incentives (Easson & Zolt, 2002). The effectiveness of tax incentives has been the subject of intense debate and little consensus has emerged. Some experts have argued that there is little evidence that tax incentives are effective, and this view has provided considerable technical assistance recommending that governments curtail their use (James, 2009:v).

3.3.7 Costs of tax incentives

According to the United Nations (2018:4), the empirical evidence on the cost-effectiveness of using tax incentives to increase investment is inconclusive. Klemm (2010) states that the costs of tax incentives are wide and go beyond immediate loss of revenue. The costs include distortions to the economy as a result of the preferential treatment of qualifying incentives, the administrative costs and avoiding fraudulent use thereof (Klemm, 2010:322). According to Klemm (2020:322), even pure revenue costs of incentives are difficult to quantify. If tax incentives applied only to investment that would not have taken place, the cost of direct revenue would be nil. However, if incentives were purely redundant and had no effect on investment, then the total revenue given up would be the direct revenue cost (Klemm, 2010:322-323).

The indirect effects must also be considered. Even if taxes are waived on an investment that would not have taken place otherwise, there may be indirect revenue losses, if that revenue crowds out other more highly taxable investment (Klemm, 2010:323).

According to Zee *et al.* (2002:1501) and Clark (2000:6), the associated costs of granting tax incentives can be classified into four main categories, namely: (i) distortions between investments granted with incentives and those without incentives, (ii) forgone revenue (on the assumption that the government operates under a revenue constraint, so that the lost revenue would have to be compensated from alternative distortive taxes), (iii) administrative resources required to administer them, and (iv) the social costs of corruption and/or rent-seeking activities connected with abuse of tax incentive provisions (Zee *et al.*, 2002:1501).

The distortions between investments granted with incentives and those without result in resource allocation (neutrality) costs, as these tax incentives create distortions on investment choices amongst sectors or activities, instead of correcting market failures (Clark *et al.*, 2007:6).

The losses in tax revenue from tax incentives mainly come from three sources. First, the forgone revenue that otherwise would have been collected from the activities undertaken; second, the forgone revenue from projects that would have been undertaken even if the investor did not receive any tax incentives; and third, lost revenue from investors and activities that improperly claim incentives (taxpayers abuse) or shift income from related taxable firms to those firms qualifying for favourable tax treatments (tax planning) (Easson & Zolt, 2002).

Administrative and compliance costs increase with the complexity of the tax system and the tax incentives in terms of the qualifying and reporting requirements of the different tax incentives. Additionally, there is a problem of perception of lack of fairness when targeted incentives are used, which reduces compliance, and therefore increases enforcement efforts (Clark *et al.*, 2007:6).

While these costs could be significant, the benefits to the economy that could solely be attributable to tax incentives are not very clear and easily quantifiable (Tanzi & Zee, 2002:1501). Hence, the cost-effectiveness of tax incentives is often questionable (Zee *et al.*, 2002:1501).

Tax incentives also inevitably induce socially unproductive rent-seeking behaviour. As soon as the incentive system gets going, those who are fortunate enough to have captured the rents will have inherent interest to maintain the *status quo* (Zee *et al.*, 2002:1501). This explains, apart from economic reasons, why it is so difficult in reality to terminate or even phase out tax incentives once they are granted, even if such incentives are formally time-bound (Zee *et al.*, 2002:1501).

What is known for sure is the fact that tax incentives introduce complexity into the tax system, as tax authorities add the special rules to the regular ones. This complexity imposes

additional costs both on administrators and taxpayers. It also increases the uncertainty of tax results (Brodzka, 2013:33). As such, there is a strong need for developing countries to bear in mind the necessary conditions when granting tax incentives (Brodzka, 2013:33).

3.4 RESEARCH ETHICS

Research ethics relate to how appropriate the researcher is in relation to the rights of those that have become the main subject of a study being conducted (Saunders *et al.*, 2009:184). This specifically relates to the manner in which the researcher defines and clarifies the research topic, designs the research and gains access to the data, gathers information, analyses and stores the data, and writes up the research findings in a morally responsible way (Saunders *et al.*, 2009:184).

This study adheres to the plagiarism declaration of the University of Pretoria. Furthermore, this study uses only secondary data sources, and the work of previous researchers has been appropriately acknowledged in the study.

3.5 SUMMARY

A variety of tax incentives have become more widespread and acceptable in African countries. For instance, in the 2000's, the majority of the African countries offered tax holidays and only a few countries adopted tax free zones. The number of countries in sub-Saharan Africa granting tax holidays has since decreased and the establishment and implementation of SEZs has grown further. There is also evidence, however, that the average length of tax holidays has declined somewhat in the various countries. The use of accelerated allowances for capital expenditure and reduction in CIT still remains popular amongst the African countries.

Despite the popularity, the effectiveness of providing tax incentives remains questionable. It has been subject to intense debate, however little consensus has emerged. Some experts have argued that there is little evidence that tax incentives are effective. However, previous studies done on tax incentives show that the tax incentives do not necessarily increase the flow of investment into the countries and therefore do not deliver the intended purpose.

Policy makers are encouraged to consider the costs of fiscal and financial incentives, in terms of complexity, neutrality and revenues forgone, in order to ensure that they yield the intended results. As per the analysis performed, it was noted that there are certain principles to guide policy makers on how to try and ensure that tax incentives are efficiently and effectively used in a tax system: (i) tax incentives should be granted automatically, (ii) tax incentives should be part of the tax code, (iii) monitoring and control mechanisms should be in place, and (vi) the costs and benefits of tax incentives should be measured.

CHAPTER 4

CONCLUSION

4 CHAPTER 4 - CONCLUSION

4.1 INTRODUCTION

The main purpose of this study was to analyse whether tax incentives are an instrumental feature in a tax system. Chapter 1 provided an introduction to the study and explained the rationale and purpose for the study. Chapter 2 dealt with the research design and methodology adopted in the study, followed by the data analysis and findings which were discussed in Chapter 3. Chapter 3 provided a general overview and key points of interest in the selected literature used as analysis for this research. It also presented an evaluation of the work of other researchers, in order to provide an overview of the existing literature on tax incentives and tax systems.

In this chapter, the study is concluded by summarising how the research question and research objectives were addressed. Conclusions are drawn, based on the research results. Lastly, the limitations of the study are discussed and recommendations are made regarding possible future research.

4.2 HOW THE RESEARCH QUESTION WAS ANSWERED

The research question that the study intended to address was whether tax incentives are an instrumental feature to a tax system. In addressing the research question, the study followed a qualitative research methodology that used secondary data in order to explore the concept of tax incentives in African tax systems. The secondary qualitative data used in the research was systematically reviewed and presented in the format of a descriptive study.

First the study sought to understand the history and development of tax incentives in Africa. The types of tax incentives typically used by African countries were identified in Section

3.3.3 as tax holidays, investment allowances and tax credits, accelerated depreciation, special economic zones and reduced CIT. These types of tax incentives were defined and the advantages and disadvantages thereof were discussed. The types of tax incentives evident in various African countries during the years 2000 and 2016 were analysed in Section 3.3.4, based on the results of the surveys conducted by the Conference on Trade and Development and KPMG. It was found that the use of tax holidays has significantly decreased and SEZs have become the common trend in these African countries. Furthermore, the average length of tax holidays has declined somewhat in the various countries. The use of accelerated allowances for capital expenditure and reduction in CIT still remain popular amongst the African countries.

The second objective was to explore the successes and shortfalls of tax incentives. The effectiveness and costs of tax incentives were discussed in Sections 3.3.6 and 3.3.7 respectively. The study found that the effectiveness of tax incentives is inconclusive and that there is little evidence that tax incentives are effective. With regard to the cost of tax incentives, the study found that the complexity of tax incentives adds additional administration cost for both the administrators and taxpayers. The associated costs of granting tax incentives were identified and discussed in Section 3.3.7 as distortions between investments granted with incentives and those without incentives, forgone revenue, administrative resources required to administer them, and the social costs of corruption and/or rent-seeking activities connected with abuse of tax incentive provisions.

The last objective was to draw conclusions as to whether tax incentives can be an instrumental feature to a tax system. The purpose of tax systems was discussed in Section 3.3.1.1 as a tax system that is capable of financing the necessary level of public spending, and it was also found that a tax system plays an important role in respect of its revenue-raising function. In essence, a tax system should raise enough revenue to finance essential expenditure and should raise this revenue in ways that are equitable. It was found that the rationale of introducing tax incentives in the tax system of the various African countries is to attract and promote investment in the country. This objective links directly to the revenue raising function of tax systems if tax incentives are designed, implemented and administered properly within the tax system. The empirical evidence on the effectiveness and costs of tax

incentives is inconclusive. As such it is difficult to conclude on whether the revenue generated through tax incentives exceeds the cost of granting them.

In order to ensure that tax incentives achieve the intended benefits, the study found that there are certain principles that can guide policy makers on how to efficiently and effectively incorporate tax incentives into a tax system. These principles were identified and discussed in Section 3.3.1.3 as: tax incentives should be granted automatically, tax incentives should be part of the tax code, monitoring and control mechanisms should be in place, and the costs and benefits of tax incentives should be measured.

Tax incentives are perceived to have an important role in attracting investments and this objective links directly to the revenue-raising function of a tax system. However, even though tax incentives are considered as a necessary tool for attracting investments, there are various shortfalls that need to be considered. Currently the effectiveness of tax incentives is inconclusive and there is little evidence that tax incentives are effective. Various researchers have provided guidance on how tax incentives can be effectively and efficiently incorporated into a tax system, in order to ensure that the intended objectives of including tax incentives as part of a tax system are achieved. Accordingly, there is an opportunity for African countries to better align tax incentives to their tax systems, in order to achieve the intended results.

4.3 RECOMMENDATIONS & LIMITATIONS

One of the most important limitations of this study was that the research focused on African countries. All other countries in the world were specifically excluded from this study. Furthermore, the access to and search of scientific databases was restricted to the databases to which the University of Pretoria has access.

The study has identified the principles that can guide policy makers on how to efficiently and effectively incorporate tax incentives into a tax system, in order to ensure that the intended objectives of tax incentives are realised. The outcomes of this study may indicate the direction of future research on tax incentives in African countries, specifically on the effectiveness and costs of tax incentives. Currently the costs and effectiveness of tax

incentives is inconclusive, and as such, empirical evidence is required in order to understand the costs associated with tax incentives and the effectiveness thereof in tax systems. In order to fully understand the effect of tax incentives on a tax system, tax incentives should be investigated separately in developed and developing countries, as the objectives for implementing tax incentives in each country may not be the same. For policy makers the study may provide guidance on how to improve the current tax policies in African countries by taking into consideration the principles identified in relation to the design, implementation and administration of tax incentives that have been made part of their tax systems.

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5 REFERENCES

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