

# **TAX INCENTIVES THAT SUPPORT JOB CREATION IN SOUTH AFRICA – A COMPARATIVE STUDY AMONGST BRICS**

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## **ABSTRACT**

### **TAX INCENTIVES THAT SUPPORT JOB CREATION IN SOUTH AFRICA – A COMPARATIVE STUDY AMONGST BRICS**

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South Africa's unemployment rate is amongst the highest in the world. It accounts for approximately two percent of global unemployment. The South African government has recognised the importance of job creation and expressed its willingness to help create more jobs. A comprehensive set of policies is necessary to expand long-term job growth in South Africa. Thus, the government should identify and implement new and effective policies that will help create more jobs.

In this study, the tax incentives available to support job creation in Brazil, Russia, India and China and South Africa (BRICS), are researched. The purpose of this study is to perform a comparison of the tax incentives available to support job creation in South Africa with the tax incentives available to support job creation in the BRIC countries. The first objective of the comparison was to evaluate whether the tax incentives that are available to support job creation in South Africa are on par with those available to support job creation in the BRIC countries. The second objective of the comparative study was to identify tax incentives that are available in BRIC countries for job creation that are not available in South Africa so that the government may consider whether these incentives are feasible in South Africa.

It was found that the tax incentives that support job creation in South Africa are in some instances on par with, and in some instances even exceed, the tax incentives that are available to support job creation in the BRIC countries.

The tax incentives identified in this study that are available to support job creation in Brazil, Russia, India and China but that are not available in South Africa include:

- Tax incentives and other incentives for special economic zones or free trade zones provided by Brazil, Russia, India and China;
- Tax incentives for businesses operating in enterprise zones provided by India and China;
- Reductions in payroll taxes for certain labour absorbing sectors provided by Brazil and Russia;
- Tax incentives for employing additional workmen provided by India and China; and
- Tax incentives that support youth employment provided by Brazil and China.

The South African government should consider the feasibility of implementing these incentives from a South African perspective in order to further assist with its job creation endeavour in South Africa.

**KEY WORDS:**

Tax incentives

Unemployment

Job creation

Youth

## **OPSOMMING**

### **BELASTINGAANSPORINGS WAT WERKSKEPPING IN SUID-AFRIKA BEVORDER – ‘N VERGELYKENDE STUDIE TUSSEN BRICS LANDE**

deur

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Suid-Afrika's werkloosheidskoers is van die hoogste in die wêreld. Dit verteenwoordig ongeveer twee persent van wêreldwye werkloosheid. Die Suid-Afrikaanse regering het die belangrikheid van werkskepping erken, en sy gewilligheid om meer werkgeleenthede te skep, bevestig. 'n Omvattende beleidsraamwerk is nodig om die langtermyn groei in werkgeleenthede in Suid-Afrika te bevorder. Die regering behoort derhalwe nuwe en effektiewe programme om werkskepping te bevorder, te identifiseer en te implementeer.

In hierdie studie word die belastingaansporings wat werkskepping in Brasilië, Rusland, Indië, China en Suid-Afrika (BRICS) bevorder, nagevors. Die doel van hierdie studie is om 'n vergelyking te doen van die belastingaansporings wat beskikbaar is om werkskepping in Suid-Afrika te ondersteun, met die belastingaansporings om werkskepping te bevorder in die BRIC lande. Die eerste oogmerk met die vergelyking was om te evalueer of die belastingaansporings wat beskikbaar is om werkskepping in Suid-Afrika te ondersteun vergelykbaar is met wat beskikbaar is om werkskepping in die BRIC lande te bevorder. Die tweede oogmerk van die vergelykende studie om belastingaansporings wat in die BRIC lande beskikbaar is om werkskepping te bevorder, wat nie in Suid-Afrika beskikbaar is nie, te identifiseer sodat die regering kan oorweeg of hierdie aansporings haalbaar is in Suid-Afrika.

Daar is bevind dat die belastingaansporings wat beskikbaar is om werkskepping in Suid-Afrika te ondersteun, in sommige gevalle vergelykbaar, en in ander gevalle selfs beter is, as die belastingaansporings wat in die BRIC lande beskikbaar is om werkskepping te bevorder.

Die belastingaansporings in Brasilië, Rusland, Indië en China wat nie in Suid-Afrika beskikbaar is nie, en wat in hierdie studie geïdentifiseer is, sluit in:

- Belasting- en ander aansporings vir spesiale ekonomiese sones of vrye handelzones, wat beskikbaar in Brasilië, Rusland, Indië en China;
- Belastingaansporings vir ondernemings wat besigheid doen in sekere ondernemingszones, wat beskikbaar is in Indië en China;
- Verminderings in salarisbelasting vir arbeidsintensiewe sektore, wat beskikbaar is in Brasilië en Rusland;
- Belastingaansporings om addisionele werkers in diens te neem, wat beskikbaar is in Indië en China; en
- Belastingaansporings wat die indiensneming van jeugdige ondersteun wat beskikbaar is in Brazil en China.

Die Suid-Afrikaanse regering moet oorweeg om die haalbaarheid van die implementering van hierdie aansporings van 'n Suid-Afrikaanse perspektief ten einde verder te help met sy werkskepping poog om in Suid-Afrika.

**SLEUTELWOORDE:**

Belastingaansporings

Werkloosheid

Werkskepping

Jeug

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## TABLE OF CONTENTS

CHAPTER 1 .....	1
INTRODUCTION .....	1
1.1 BACKGROUND .....	1
1.2 PROBLEM STATEMENT .....	4
1.3 PURPOSE STATEMENT .....	4
1.4 RESEARCH OBJECTIVES .....	5
1.5 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY .....	6
1.6 DELIMITATIONS .....	7
1.7 ASSUMPTIONS .....	8
1.8 DEFINITION OF KEY TERMS.....	8
CHAPTER 2.....	11
LITERATURE REVIEW .....	11
2.1 INTRODUCTION .....	11
2.2 TAX INCENTIVES AS AN INSTRUMENT FOR JOB CREATION.....	11
2.3 ADVANTAGES OF TAX INCENTIVES.....	12
2.4 DISADVANTAGES OF TAX INCENTIVES.....	13
2.5 CONCLUSION.....	14
CHAPTER 3.....	16
TAX INCENTIVES THAT SUPPORT JOB CREATION IN SOUTH AFRICA.....	16
3.1 INTRODUCTION .....	16
3.2 SECTION 12H – LEARNERSHIP ALLOWANCE .....	17
3.2.1 Background .....	17

3.2.2	Effectiveness .....	18
3.3	SECTION 12I – INDUSTRIAL POLICY PROJECTS .....	19
3.3.1	Background .....	19
3.3.2	Effectiveness .....	20
3.4	INDUSTRIAL DEVELOPMENT ZONES .....	20
3.4.1	Background .....	20
3.4.2	Effectiveness .....	21
3.5	SPECIAL ECONOMIC ZONES .....	22
3.5.1	Background .....	22
3.5.2	Effectiveness .....	23
3.6	CONCLUSION.....	24
CHAPTER 4.....		26
TAX INCENTIVES THAT SUPPORT JOB CREATION IN BRAZIL .....		26
4.1	INTRODUCTION .....	26
4.2	SUPERINTENDENCE OF AMAZONAS DEVELOPMENT (SUDAM) AND SUPERINTENDANCE OF NORTHEAST DEVELOPMENT (SUDENE).....	27
4.2.1	Background .....	27
4.2.2	Effectiveness .....	28
4.3	MANAUS FREE TRADE ZONE.....	29
4.3.1	Background .....	29
4.3.2	Effectiveness .....	29
4.4	BRASIL MAIOR (GREATER BRAZIL).....	30
4.4.1	Background .....	30
4.4.2	Labour-intensive industries.....	30
4.4.3	Regional incentives .....	31
4.4.4	Effectiveness .....	31
4.5	STATE / LOCAL TAX INCENTIVES.....	31
4.5.1	Background .....	31



4.5.2	Effectiveness .....	33
4.6	YOUTH EMPLOYMENT INCENTIVES .....	33
4.6.1	Background .....	33
4.6.2	Effectiveness .....	34
4.7	CONCLUSION.....	34
CHAPTER 5.....		35
TAX INCENTIVES THAT SUPPORT JOB CREATION IN RUSSIA .....		35
5.1	INTRODUCTION .....	35
5.2	SPECIAL ECONOMIC ZONES .....	35
5.2.1	Background .....	35
5.2.2	Effectiveness .....	37
5.3	REDUCED SOCIAL CONTRIBUTION RATES.....	38
5.3.1	Background .....	38
5.3.2	Effectiveness .....	39
5.4	REGIONAL TAX INCENTIVES.....	39
5.4.1	Background .....	39
5.4.2	Effectiveness .....	40
5.5	TAX INCENTIVES FOR THE EMPLOYMENT OF DISABLED PERSONS .....	40
5.5.1	Background .....	40
5.5.2	Effectiveness .....	40
5.6	CONCLUSION.....	40
CHAPTER 6.....		42
TAX INCENTIVES THAT SUPPORT JOB CREATION IN INDIA .....		42
6.1	INTRODUCTION .....	42
6.2	EXPORT PROCESSING ZONES.....	43
6.2.1	Background .....	43
6.2.2	Effectiveness .....	43

6.3	ELECTRONIC HARDWARE TECHNOLOGY PARK / SOFTWARE TECHNOLOGY PARK.....	45
6.3.1	Background .....	45
6.3.2	Effectiveness .....	46
6.4	SPECIAL ECONOMIC ZONES .....	47
6.4.1	Background .....	47
6.4.2	Effectiveness .....	48
6.5	DEDUCTION IN RESPECT OF EMPLOYMENT OF NEW WORKMEN.....	52
6.5.1	Background .....	52
6.5.2	Effectiveness .....	52
6.6	DEDUCTION OF EXPENDITURE INCURRED ON SKILL DEVELOPMENT PROJECT.....	52
6.6.1	Background .....	52
6.6.2	Effectiveness .....	53
6.7	CONCLUSION.....	53
CHAPTER 7.....		55
TAX INCENTIVES THAT SUPPORT JOB CREATION IN CHINA.....		55
7.1	INTRODUCTION .....	55
7.2	SPECIAL ECONOMIC ZONES .....	55
7.2.1	Background .....	55
7.2.2	Effectiveness .....	56
7.3	ENTERPRISE ZONES AND INDUSTRIAL FREE ZONES.....	59
7.3.1	Background .....	59
7.3.2	Effectiveness .....	60
7.4	SELF-EMPLOYED GRADUATES .....	60
7.4.1	Background .....	60
7.4.2	Effectiveness .....	61
7.5	RE-EMPLOYMENT OF LAID-OFF WORKERS.....	61

7.5.1	Background .....	61
7.5.2	Effectiveness .....	62
7.6	DISABLED WORKERS .....	62
7.6.1	Background .....	62
7.6.2	Effectiveness .....	63
7.7	CONCLUSION.....	63
7.8	SUMMARY .....	63
CHAPTER 8.....		65
COMPARISON OF TAX INCENTIVES THAT ARE AVAILABLE TO SUPPORT JOB CREATION IN SOUTH AFRICA, BRAZIL, RUSSIA, INDIA AND CHINA.....		65
8.1	INTRODUCTION .....	65
8.2	COMPARISON OF THE TAX INCENTIVES AVAILABLE TO SUPPORT JOB CREATION IN SOUTH AFRICA, BRAZIL, RUSSIA, INDIA AND CHINA ....	66
8.3	SUMMARY OF COMPARATIVE STUDY .....	72
8.3.1	Tax incentives for employing additional workmen .....	72
8.3.2	Tax incentives for youth employment .....	72
8.3.3	Tax incentives for skills development .....	73
8.3.4	Tax incentives for employing disabled workers .....	74
8.3.5	Reductions of payroll taxes .....	74
8.3.6	Industrial Development Zones and Export Processing Zones .....	75
8.3.7	Enterprise Zones / Export Oriented Units / New Tech and High-Tech Enterprises / Hardware Technology Parks / Software Technology Parks ....	76
8.3.8	Special Economic Zones and Free Trade Zones .....	76
8.3.9	Tax incentives for regional development .....	77
8.3.10	Local / Regional Tax Incentives.....	77
8.4	CONCLUSION.....	77
CHAPTER 9.....		79
CONCLUSION.....		79

9.1	INTRODUCTION .....	79
9.2	SUMMARY OF FINDINGS AND ANSWERS TO RESEARCH OBJECTIVES.....	80
9.3	CONCLUSION.....	81
	LIST OF REFERENCES.....	83

## LIST OF FIGURES

Figure 1: Unemployment rates per age group in South Africa as at September 2010 .....	2
Figure 2: Unemployment rates by age and education in South Africa as at September 2010.....	3
Figure 3: Employment and foreign investment in Shenzhen, 1979-2006.....	57

## LIST OF TABLES

Table 1: Abbreviations used in this document .....	9
Table 2: Employment growth in the Indian export processing zones from 1996 to 2002	44
Table 3: The performance of Export Oriented Units and employment generated in India during the period April 2008 to March 2009 .....	46
Table 4: The effect of some of the new generation SEZ's on direct employment, investment and exports in India .....	50
Table 5: Comparison of the tax incentives available to support job creation in South Africa, Brazil, Russia, India and China.....	66

# **TAX INCENTIVES THAT SUPPORT JOB CREATION IN SOUTH AFRICA – A COMPARATIVE STUDY AMONGST BRICS**

## **CHAPTER 1**

### **INTRODUCTION**

#### **1.1 BACKGROUND**

In 2008, South Africa joined the global financial crisis and faced its first recession in 17 years (National Treasury, 2011:13). The country's economy slowed down rapidly and the rate of unemployment which was relatively high before the financial crisis worsened. While global economic growth picked up in 2010, job creation remained slow (National Treasury, 2010b:37-39).

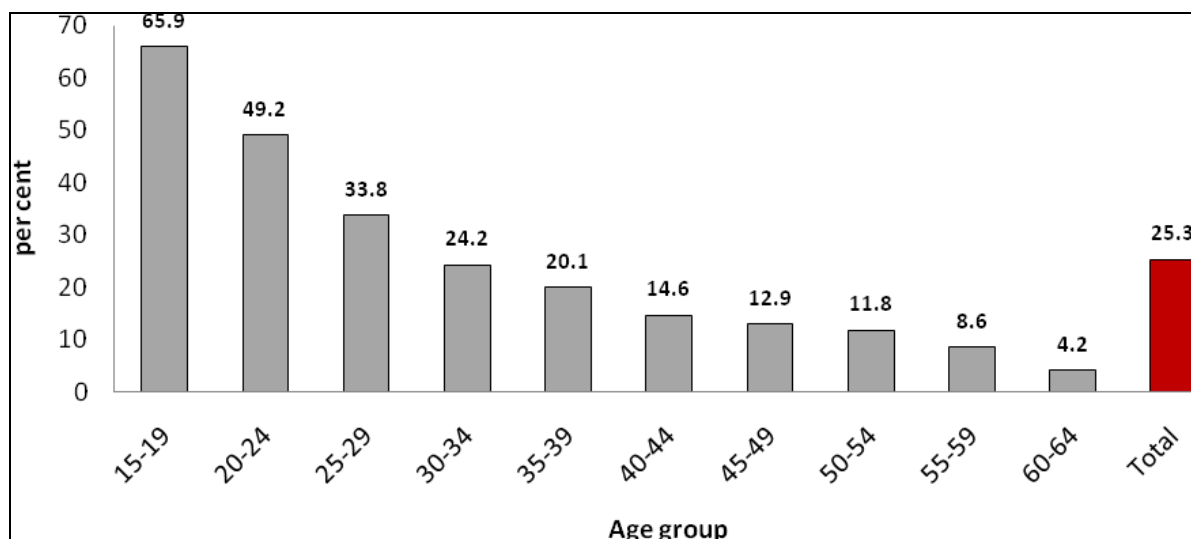
South Africa's unemployment rate is amongst the highest in the world and accounts for approximately two per cent of global unemployment (National Treasury, 2011:13). From a population of approximately 50 million South Africans only 13.1 million people are employed. The percentage of working-age people employed in South Africa is approximately 41 per cent compared to 65 per cent in Brazil, 55 per cent in India and 71 per cent in China (National Treasury, 2011:11). In order to compare with the emerging markets average of 56 per cent, South Africa will need to employ an additional five million people (National Treasury, 2011:12). Another significant concern is the unemployment rate of South African working-age youth. Only 12.5 per cent of South Africans between the ages of 15 and 24 years old have a job compared to the emerging markets average of 36 per cent (National Treasury, 2011:11).

South Africa's youth were significantly affected by the economic crisis. They accounted for approximately 40 per cent of the job losses in South Africa between December 2008 and December 2010 (National Treasury, 2011:13). Young unemployed people lack the

necessary skills and work experience required by most employers (Burns, Edwards & Pauw, 2010:18-19; National Treasury: 2011:5). Approximately two-thirds of young people have never worked. Those who have had some work experience are more than three times likely to find a job than those with no work experience (National Treasury, 2011:5-7). Employers are reluctant to hire unskilled and inexperienced workers as they cannot effectively assess the workers capabilities. Furthermore, the costs associated with hiring and firing workers in South Africa is high, thus many unskilled people find it difficult to gain employment (Burns *et al.*, 2010:18-19; National Treasury, 2011:16).

Figure 1 below illustrates the unemployment rates per age group in South Africa as at September 2010.

**Figure 1: Unemployment rates per age group in South Africa as at September 2010**

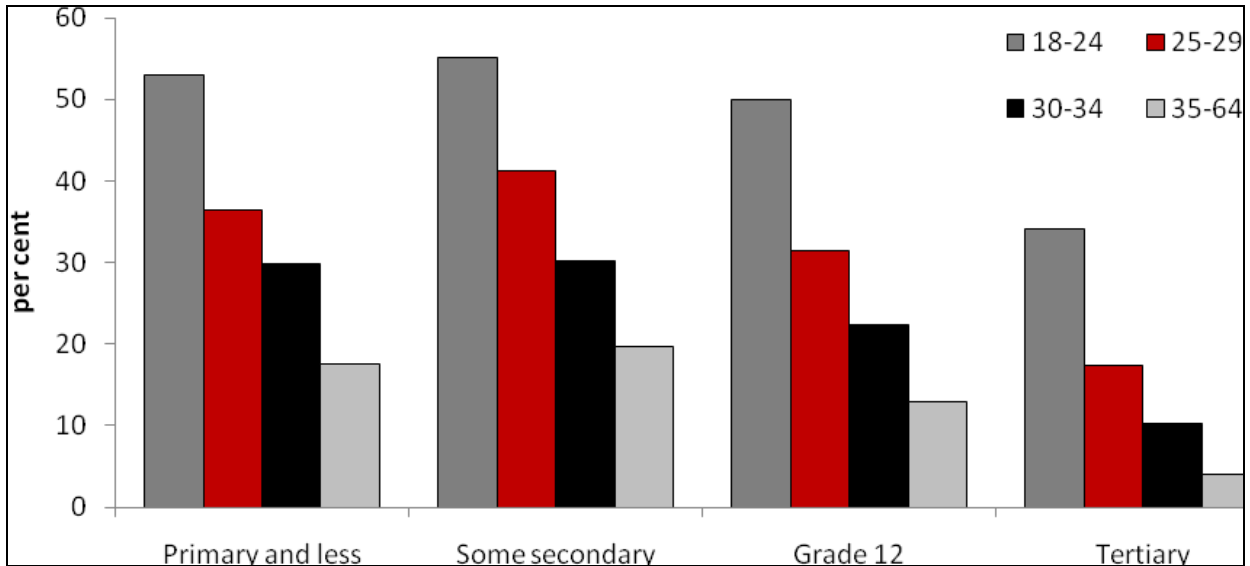


Source: Statistics South Africa Quarterly Labour force Survey, September 2010 (National Treasury, 2011:13)

Figure 1 illustrates that the unemployment rate of young people in South Africa is the highest. As at September 2010, 65.9 per cent of people between the ages of 15 to 19 years were unemployed and 49.2 per cent of people between the ages of 20 to 24 years were unemployed. This compares to an unemployment rate of 24.2 per cent of those between the ages of 30 to 34 years.

Figure 2 below illustrates unemployment rates by age and education in South Africa.

**Figure 2: Unemployment rates by age and education in South Africa as at September 2010**



Source: Statistics South Africa Quarterly Labour Force Survey, September 2010 (National Treasury, 2011:15).

Figure 2 illustrates that even though young people in South Africa are more educated than those over the age of 25 years, young people still experience difficulty in finding a job (National Treasury, 2011:14). The level of education, quality of qualifications and the appropriateness of the qualification in the specific workplace remain concerns for employers. Thus, employers do not consider education as a reliable indication of a workers capabilities and regard skills and work experience as more important (Burns *et al.*, 2010:18; National Treasury, 2011:15-16).

Unemployment hinders a country’s economic growth and creates a burden on the government to provide social assistance. Furthermore, unemployment is associated with socio-economic problems such as “poverty, crime, violence, a loss of morale, social degradation and political disengagement” (National Treasury, 2011:9). Job creation is important for the overall economic growth of our country and will help alleviate the problems of poverty and inequality (National Treasury, 2010b:47; National Treasury, 2011:11).



Previous research supports the fact that unemployment in South Africa is a significant concern that needs to be addressed (Burns *et al.*, 2010; National Treasury, 2011; Ndedi, 2009; Thwala, 2008).

## **1.2 PROBLEM STATEMENT**

A comprehensive set of policies is needed to expand long-term job growth in South Africa (National Treasury, 2010b:37). These policies should focus on increasing the country's economic growth, enhancing the economy's labour absorption capacity, providing a supportive environment for small business development, improving education and skills development, reducing the cost of labour, providing more flexible labour market policies and promoting effective job search especially for the youth (Burns *et al.*, 2010:16-19; ILO, OECD, IMF & World Bank, 2012:9-12).

Tax policies may also assist in generating employment (ILO *et al.*, 2012:9). These policies include changing the structure of taxation from labour and capital towards consumption, immovable property and environmental externalities (ILO *et al.*, 2012:10), a decrease in payroll taxes and social security contributions for newly employed workers or low-paid workers (Easson & Zolt, 2002:22; ILO *et al.*, 2012:11), tax holidays, additional deductions for training expenses or tax credits for employing new employees (Easson & Zolt, 2002:31).

An extensive search of the Sabinet, Ebscohost and Science Direct databases indicate that no studies focusing on tax incentives that are available to support job creation in South Africa have been conducted to date.

## **1.3 PURPOSE STATEMENT**

In this study the tax incentives that are available to businesses in South Africa will be researched to establish what tax incentives are currently available to support job creation. The tax incentives available in South Africa will be compared to the tax incentives currently available in Brazil, Russia, India and China to support the creation of jobs. This will be done in order to identify whether South Africa is on par with other developing countries and

to identify possible new tax incentives that the South African government could introduce to stimulate job creation in South Africa.

Brazil, Russia, India and China (BRIC) were chosen as comparatives in this study for the following reasons:

- Brazil, Russia, India, China and South Africa are all developing countries with emerging market economies (ILO *et al.*, 2012:18).
- Brazil, India and China are generating employment and contributing extensively to lowering the levels of poverty (National Treasury, 2010:2).
- The economies of BRIC are significant to the global economy. The collective economies of these four countries are expanding rapidly and driving the global economy. It is projected that BRIC's will account for 37 per cent of the global growth in the period 2011 to 2016 (Grant Thornton, 2012:2).
- In December 2010, South Africa was invited to join the BRIC countries. This resulted in a change of the acronym BRIC to BRICS (Brazil, Russia, India, China and South Africa). Although South Africa's economy, population size and geographical size are much smaller than the BRIC's, the union could bring about increased foreign direct investment (FDI) by investors (Pheeha & Troskie, 2011:28). Thus, it would be beneficial to examine how South Africa's tax incentives compare with those provided by the BRIC's in order to be competitive.

Lastly, since these countries are very important developing countries with rapid growing economies it would be beneficial for South Africa to examine what tax incentives are currently available in these countries and how effective the incentives are in generating employment, so that South Africa may learn from the experience of these powerful countries.

#### **1.4 RESEARCH OBJECTIVES**

The objectives of the study are to:

- identify and analyse the existing tax incentives that support job creation in South Africa;

- identify and briefly explain the tax incentives that support job creation in Brazil, Russia, India and China, and determine through a review of existing literature how successful such incentives were in stimulating job creation in these countries;
- evaluate whether the tax incentives currently available to support job creation in South Africa are on par with what is available for businesses in Brazil, Russia, India and China through a review of existing literature; and
- highlight the tax incentives that support job creation in Brazil, Russia, India and China that are not currently available in South Africa that could possibly be introduced in South Africa, in order for South Africa to expand on the tax incentives currently available to stimulate job creation.

## **1.5 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY**

The South African government has introduced numerous measures, including tax incentives, to help stimulate job creation (Gordhan, 2010; Gordhan, 2011; National Planning Commission, 2011). This study aims to identify the tax incentives that are available in South Africa to support the creation of jobs and to compare these incentives with the tax incentives available in Brazil, Russia, India and China to support the creation of jobs. This will be done in order to identify new tax incentives that the South African government could possibly introduce in South Africa to help stimulate job creation.

Furthermore, this dissertation could be used as a point of reference for the South African National Treasury and South African Revenue Service (SARS) to introduce additional tax incentives that support job creation and therefore assist government to reach its goal of creating five million new jobs by 2020 as stated in the new growth path (National Planning Commission, 2011).

The delimitations and assumptions relating to this study are stated below.

## 1.6 DELIMITATIONS

The proposed study has several delimitations. Firstly, it will be limited to tax incentives that are available in South Africa, Brazil, Russia, India and China.

Secondly, since the study focuses on tax incentives, only the tax incentives provided by the South African National Treasury and SARS and the specific countries tax authorities will be discussed. The study will not focus on other incentives such as grants, subsidies and low-cost financing provided by other government institutions such as the Department of Trade and Industry (DTI) in South Africa. It is suggested that the non-tax incentives provided by the government and their effectiveness on job creation be researched in future studies.

The study will be limited to tax incentives introduced with the objective of creating more jobs. If an incentive is provided with a dual purpose, only the part dealing with job creation will be discussed in detail. The study will not focus on tax incentives available to small businesses and manufacturing entities, even though these entities play an important role in stimulating job creation. Tax incentives provided to small businesses and manufacturing entities are very wide and require a separate comprehensive study. The current study will also not focus on tax incentives provided for research and development as this topic has been researched extensively in South Africa.

The literature in this study will be limited to literature freely available in English. The study will be limited to the tax incentives provided by the revenue authorities which exist at the time of the study being conducted. Previous incentives which were provided by the respective authorities but that have now expired will not be discussed in detail.

Finally, the study will focus on the effectiveness of the tax incentives in creating jobs and will not consider the overall economic effect and other pertinent factors that the tax incentives may have in a specific country.

## 1.7 ASSUMPTIONS

This study makes the assumption that the tax incentives provided by the relevant governments directly influence the number of jobs created. Thus, when analysing the effectiveness of the tax incentives in creating jobs, we assume that the tax incentives are directly related to the number of jobs created even though there may be other factors that influenced the number of jobs created.

## 1.8 DEFINITION OF KEY TERMS

This study involves a number of key terms, namely “job creation”, “tax incentives”, “unemployment”, and “youth”. The definitions of these key terms are considered below:

*Job Creation:* The study employs the Cambridge Online Dictionary’s (Cambridge University Press, 2012) definition of job creation. Job creation is defined as “the process of providing new jobs, especially for people who are unemployed.”

*Tax incentives:* The study employs the definition by Wentzel (2010:36). Tax incentives are defined as “fiscal measures such as tax deductions, exclusions or exemptions introduced by government to reduce the tax liability of a company when it invests in a particular project.”

*Unemployment:* The study employs Statistics South Africa’s (Statistics South Africa, 2004:16) official definition of unemployment. Unemployment is defined as “the number of people without a job, who want to work, are available to work and are actively looking for a job.”

*Youth:* The study employs the International Labour Organisations definition of youth which restricts youth to include people between the ages of 15 and 24 years (National Treasury, 2011: 13).

The table below lists the abbreviations used in this document together with the meaning for the reader's ease of reference.

**Table 1: Abbreviations used in this document**

<b>Abbreviation</b>	<b>Meaning</b>
ADA	The Agency for the Development of the Amazon
ADENE	The Agency for the development of Northeast
AFRMM	Merchant Marine Fee (Brazil)
BRIC	Brazil, Russia, India, China
BRICS	Brazil, Russia, India, China, South Africa
Crore	A unit in the Southern Asian numbering system equal to ten million. ₹23 crore equals to 230 million rupees
DTI	Department of Trade and Industry
EOU	Export Oriented Unit
EPZ	Export Processing Zone
HTP	Hardware Technology Park
FTZ	Free Trade Zone
GDP	Gross Domestic Product
ICMS	Sales Tax (Brazil)
IDZ	Industrial Development Zone
IOF	Tax on Financial Transactions (Brazil)
IPI	Excise Tax (Brazil)
IRPJ	Corporate Income Tax (Brazil)
IT	Information Technology
ITES	Information Technology Enabled Services
MFTZ	Manaus Free Trade Zone
PIS / COFINS	Tax on Gross Revenue (Brazil)
R	South African Rand
SADC	Southern African Development Community
SARS	South African Revenue Service
SETA	Sector Education and Training Authority
SEZ	Special Economic Zone
STP	Software Technology Park
SUDAM	The Superintendence of Amazonas Development
SUDENE	The Superintendence of Northeast Development
US\$	United States of America Dollars
₹	Indian Rupee

The study is divided into nine chapters. This chapter discussed the background and need for the study, set out the delimitations and assumptions that apply to the study and defined

the key terms used in the study. Chapter 2 provides an introduction to tax incentives and lists the advantages and disadvantages of providing tax incentives. The literature on tax incentives that are available in South Africa, Brazil, Russia, India and China to support job creation are reviewed in Chapters 3 to 7. In Chapter 8 the tax incentives that are available in South Africa to support job creation are compared with the tax incentives that are available in Brazil, Russia, India and China to support job creation. Chapter 9 provides a summary of the purpose and findings of this study.

## **CHAPTER 2**

### **LITERATURE REVIEW**

#### **2.1 INTRODUCTION**

This chapter begins with an introduction of tax incentives as an instrument for job creation and lists the advantages and disadvantages of providing tax incentives. In the next chapters, the tax incentives that are available to support the creation of jobs in South Africa, Brazil, Russia, India and China and their effectiveness in creating jobs will be discussed.

#### **2.2 TAX INCENTIVES AS AN INSTRUMENT FOR JOB CREATION**

Tax incentives have been used in developing countries for many years (Bolnick, 2004). Governments often provide tax incentives to distort investment decisions in order to encourage investments that would not normally have been made if tax incentives were not provided. These encouraged investments include investments that will assist the government in achieving an increase in employment, technology transfers and regional development (Easson & Zolt, 2002:2).

Tax incentives have become a much more significant factor in influencing investment decisions than in the past years. Their importance could be attributed to the provision of more generous tax incentives, increased tax sensitivity due to the reduction of non-tax barriers such as trade liberalization, transformation of the business environment which allows production to occur in several different countries and the desire of a country or enterprise to become internationally competitive (Easson & Zolt, 2002:2).

In Africa, many of the Southern African Development Community (SADC) countries provide tax incentives to encourage exports, economic diversification and job creation (Bolnick, 2004:7.19). While tax incentives have been successful in creating thousands of



jobs in countries such as Mauritius and Lesotho (Bolnick, 2004:7.17) they have not been able to generate significant amounts of investment or jobs in many of the other SADC countries (Bolnick, 2004:7.18). Tax incentives cannot compensate for deficiencies in the tax system, poor infrastructure and the economic and political problems of a country (Easson & Zolt, 2002: 4).

Tax incentives may take the form of tax holidays, reduced tax rates, tax deductions, tax allowances, accelerated depreciation and investment tax credits. Each incentive has its own advantages and disadvantages and there is no preferred incentive (Easson & Zolt, 2002:2).

Tax incentives that are normally provided to promote job creation include:

- a reduction in payroll taxes and social security contributions for the employment of a specific category of workers or for the employment of workers in areas with high unemployment (Easson & Zolt, 2002:22);
- tax holidays (Easson & Zolt, 2002:30);
- additional deductions for training expenses (Easson & Zolt, 2002:30); and
- tax credits for employing additional workers (Easson & Zolt, 2002:30).

The main advantages and disadvantages of providing tax incentives are discussed below.

### **2.3 ADVANTAGES OF TAX INCENTIVES**

There are many advantages of providing tax incentives. These include:

- Tax incentives may reduce the tax on net profits resulting in a higher net rate of return for investors. This may lead to an increase of investments by investors (Bolnick, 2004:3.1).
- Tax incentives are a practical and flexible instrument for influencing other policy objectives. These may include promoting investment, job creation, skills development and regional development (Bolnick, 2004:3.2; Easson & Zolt, 2002:10).
- Tax incentives may symbolise government's commitment to encouraging investment and markets the country as an attractive investment destination (Bolnick, 2004:3.2).

- Tax incentives may assist in attracting foreign direct investment and its resultant benefits by lowering the effective tax rate on investments. These benefits include an increase in capital transfers, employment creation, technology transfers and regional development (Bolnick, 2004:3.2; Easson & Zolt, 2002:10).
- They may be an effective instrument in attracting investment when more than one country competes for the same investment and where the investment would not have been made in the country if those incentives were not provided (Bolnick, 2004:3.2; Easson & Zolt, 2002:9).
- Tax incentives may compensate for deficiencies in the investment environment such as unreliable or high cost infrastructure, macroeconomic instability and a weak legal system which make investment in the area unattractive (Bolnick, 2004:3.2).
- New investments as a result of tax incentives may enhance tax revenues directly from taxes paid by the investor or indirectly through increased tax revenues received from employees, suppliers and consumers (Bolnick, 2004:3.2; Easson & Zolt, 2002:10).
- Experience shows that tax incentives have worked. Malaysia, Ireland, Costa Rica and Mauritius are examples of highly successful small countries that have used tax incentives effectively to increase investment and growth (Bolnick, 2004).

## **2.4 DISADVANTAGES OF TAX INCENTIVES**

The disadvantages of providing tax incentives are listed below:

- Tax incentives may result in a loss of revenue to the economy. The loss of revenue may be substantial where the incentive did not significantly affect the investment decision. A further loss of revenue may occur where tax incentives provided to attract a particular investment is more generous than necessary. A loss of revenue may also occur when enterprises that enjoy tax incentives take resources and profits away from enterprises that pay their full taxes (Bolnick, 2004:3.7; Easson & Zolt, 2002:10-11).
- Other fiscal adjustments are needed to compensate for the budget gap resulting from the provision of tax incentives. In order to mend the budget gap, the government may decrease its expenditure, reduce the provision of goods and services to the public;

increase the tax burden on other activities and persons or resort to financing. All of these measures may have a negative effect on the country's economy (Bolnick, 2004:3.10).

- Tax incentives may provide enterprises and individuals with an opportunity to engage in tax avoidance and evasion (Bolnick, 2004:3.7; Easson & Zolt, 2002:10-12).
- Tax incentives may complicate tax administration in many ways. Firstly, preferential tax incentives require the application of different rules to different taxpayers. Secondly, it requires highly skilled administrative personnel to prevent and control the abuse of loopholes. Lastly, highly skilled personnel are diverted from performing important duties such as collecting tax revenues towards designing incentives, screening applicants and monitoring performance (Bolnick, 2004:3.10; Easson & Zolt, 2002:12).
- The economic costs of incentives are complex and difficult to monitor. This may result in government pursuing measures that are uneconomical and inconsistent with the countries developmental goals (Bolnick, 2004:3.16).
- Tax incentives are not a significant factor in determining the feasibility of most investments. Thus, the revenue lost from providing tax incentives could be used to improve the investment environment which may lead to increased economic growth and job creation (Bolnick, 2004:3.17; Easson & Zolt, 2002:9).
- Experience shows that tax incentives are usually ineffective. Many developing countries have failed to promote investment through the provision of tax incentives. Countries that were successful in attracting investment provide various other benefits in addition to tax incentives. Mauritius, Costa Rica, Ireland and Malaysia used tax incentives together with stable economic and political conditions, an educated workforce, good infrastructure, an export friendly environment, a well developed legal system and effective investment promotion systems. These conditions assisted in attracting a significant amount of investment (Bolnick, 2004:3.17).

## **2.5 CONCLUSION**

Tax incentives may be effective in stimulating investment, especially where projects are feasible in many different locations and where non-tax factors are similar (Bolnick,

2004:2.9). However, investments may have a negative effect on a country's economy if the incentives results in a substantial loss of revenue to the economy and where essential public goods and services are substituted in order to provide tax incentives (Bolnick, 2004:2.9).

Although tax incentives may assist in attracting investment, there are many other factors that influence an investor's decision to invest in a particular project. Tax incentives are not a major consideration for most investment decisions (Easson & Zolt, 2002:9).

Tax incentives should be designed based on a country's local conditions and objectives. The incentives should be frequently analysed in order to ensure that informed decisions are made (Bolnick, 2004:8.4). Governments should be cautious of providing generous tax incentives that have little effect on investment and job creation and a negative effect on revenue, tax administration and a country's economic development (Bolnick, 2004:3-3.18; Easson & Zolt:1-13). Furthermore, tax incentives cannot compensate for the economical, political and infrastructure deficiencies of an investment environment and will have very limited impact in a poor investment environment (Bolnick, 2004).

The tax incentives that are available to support job creation in South Africa and their effectiveness in creating jobs will be reviewed in the next chapter.

## CHAPTER 3

### TAX INCENTIVES THAT SUPPORT JOB CREATION IN SOUTH AFRICA

#### 3.1 INTRODUCTION

The South African government has on many occasions recognised the importance of job creation and expressed its willingness to help create new jobs (Gordhan, 2010:2; Gordhan, 2011:1; National Planning Commission, 2012:1).

In the 2010 Budget Speech the Minister of Finance, Mr Pravin Gordhan, emphasised the importance of job creation particularly the importance of promoting youth employment. Mr Gordhan announced several measures to increase employment including promoting labour-absorbing industries and services, encouraging entrepreneurship and the development of small businesses, strengthening the implementation of the expanded public works programme and investment in further education and skills development (Gordhan, 2010:8).

In the 2011 Budget Speech, Mr Gordhan once again emphasised government's commitment to job creation (Gordhan, 2011:1). A youth employment subsidy in the form of a tax credit was proposed, the learnership tax incentive was renewed for a further five years, changes were made to turnover tax to support the small business environment, and consideration was given to extending the industrial development zone tax incentive to more labour-intensive projects (Gordhan, 2011: 31).

In the 2012 Budget Speech, Mr Gordhan announced a proposal for the establishment of special economic zones in South Africa (SARS, 2012b:7). Further relief was granted to small business corporations and micro businesses (SARS, 2012b:6). Adjustments were made to the learnership tax incentive (SARS, 2012b:19) and industrial policy incentive to ease administrative burdens (SARS, 2012b:23).

The National Development Plan, which details the new growth path of our country, highlights its two main challenges as unemployment and the poor quality of education available to black South Africans. These two factors were given the highest priority (National Planning Commission, 2011:2-3). The new growth path aims to create five million new jobs by 2020 and 11 million jobs by 2030. It aims to achieve this by creating an environment that supports employment and rapid economic growth, promoting labour-absorbing industries and increasing exports and competitiveness amongst other things (National Planning Commission, 2011:10).

The tax incentives that are provided by SARS in order to support job creation will now be considered.

## **3.2 SECTION 12H – LEARNERSHIP ALLOWANCE**

### **3.2.1 Background**

The learnership tax incentive was introduced in 2002, in order to promote job creation by reducing the cost of hiring and training employees through learnership's and to encourage skills development (SARS, 2008:1). Section 12H of the Income Tax Act (South Africa,1962) provides a deduction in addition to the actual salaries, wages, training and any other allowable expenses, to employers who enter into a registered learnership agreements with employees (SARS, 2008:1, Wentzel, 2010:92). Allowances may be claimed for learnership agreements entered into before 31 October 2016 (South Africa, 1962).

A learnership is a structured work-based approach to learning skills and developing competencies with the objective of gaining a recognized occupational qualification (Kruss, Wildschut, Janse van Rensburg, Visser, Haupt & Roodt, and 2012:3). A learnership agreement is defined as an agreement entered into between a learner, an employer and an accredited training provider for a specified period of time. In terms of the agreement, the employer must enter into a contract of employment with the learner and provide the learner with specified work experience and training while the learner must work for the employee and attend the specified education and training provided by the training

provider. The agreement must be registered with the Sector Education and Training Authority (SETA) (SARS, 2008:2; Wentzel, 2010, 92-93).

Section 12H of the Income Tax Act (South Africa, 1962) allows an employer to deduct, subject to certain conditions, an annual tax deduction of up to a maximum of R30 000 per employee as long as the employee is registered under a learnership agreement. It also allows a once-off completion allowance amounting to R30 000 upon successful completion of the learnership. If the learnership duration is greater than 24 full months, the completion allowance is R30 000 multiplied by the number of consecutive 12 month periods covered by the agreement. The learnership deduction is increased to R50 000 per employee if the employee is a disabled person (SARS, 2011:3-10, Wentzel, 2010: 93).

### **3.2.2 Effectiveness**

No information could be found on the effectiveness of the learnership tax incentive in creating jobs in South Africa. Therefore, the effectiveness of learnership's in creating jobs in South Africa was investigated.

Training programmes assist with skills development, enhancing productivity and improving employability. It also serves as a basis for young people to enter the workforce. Training programmes are widely used all over the world. In developing economies, training programmes assist with employment prospects between approximately six and 57 per cent (National Treasury, 2011:20).

A study conducted by the Human Sciences Research Council (Kruss *et al.*, 2012:22) suggests that learnership's are relatively successful in creating employment in South Africa. It was found that 86 per cent of learners that completed a learnership were able to find a job and that ninety per cent of these learners were permanently employed (Kruss *et al.*, 2012:26). Furthermore, the benefits for young learners that completed a learnership were substantial as they transformed from being highly unemployable to highly employable (Kruss *et al.*, 2012:23).

Majority of the learners found jobs immediately after completing a learnership. Many of them were employed in the formal sector by large private firms or by the public sector and just more than half of the learners were employed by their existing employers where they carried out their training (Kruss *et al.*, 2012:26). Thus, the learnership tax incentive may have the potential to increase employment in South Africa.

### **3.3 SECTION 12I – INDUSTRIAL POLICY PROJECTS**

#### **3.3.1 Background**

The industrial policy project tax incentive was introduced in 2009 in support of government's industrial policy strategy. It replaced the industrial development allowance that expired in 2005 (Wentzel, 2010:67). The industrial policy project incentive is aimed at encouraging investment in manufacturing assets in order to improve the productivity of the manufacturing sector and to promote training in order to improve labour productivity and skills development (Department of Trade and Industry, 2011:34).

The projects that will qualify under this section are Greenfield and Brownfield projects in the manufacturing sector. Greenfield projects are new industrial projects that utilise only new and unused manufacturing assets while Brownfield projects relate to expansions or upgrades of existing industrial projects (Department of Trade and Industry, 2011: 34).

According to section 12I (7) (a) of the Income Tax Act (South Africa, 1962), the taxpayer must invest a minimum of R200 million for Greenfield projects or the greater of R30 million or 25 per cent of the value of existing manufacturing assets for Brownfield projects. In addition, the project must upgrade an industry by utilising new technology that results in improved energy efficiency and by providing skills development. The thresholds for expenditure on manufacturing assets ensure that only projects that may substantially benefit the economy may qualify for this incentive (Wentzel, 2010:68).

Section 12I of the Income Tax Act (South Africa, 1962) provides for additional investment and training tax allowances for approved industrial policy projects. An additional training allowance equal to the cost of training provided to employees may be deducted from the



taxpayers' taxable income. The additional training allowance may not exceed R36 000 per employee with a maximum of R20 million per project. The allowance is increased to R30 million per project if a project achieves preferred status.

According to section 12I (8) of the Income Tax Act (South Africa, 1962) a project will achieve preferred status if it will significantly contribute to the industrial policy programme in South Africa. A project will contribute to the programme by upgrading an industry, creating direct employment within South Africa, providing skills development within South Africa, acquiring goods and services from SMME's, provide general business linkages within South Africa and in the case of Greenfield projects if the project is located within an Industrial Development Zone (Department of Trade and Industry, 2011:35).

Approval for this incentive must be obtained before investment in the manufacturing assets and applications must be submitted by 31 December 2014. Government has a budget of R20 billion committed to these projects (Wentzel, 2010:70).

### **3.3.2 Effectiveness**

As at March 2012, 13 projects with a total investment of R21.7 billion were approved. It is estimated that these projects will create 1 618 direct jobs and 25 448 indirect jobs. It is also estimated that the projects will support small, medium and micro enterprise procurement with approximately R3.7 billion. These projects will benefit with R4.5 million of additional tax allowances (Department of Trade and Industry, 2012a).

## **3.4 INDUSTRIAL DEVELOPMENT ZONES**

### **3.4.1 Background**

Industrial Development Zones (IDZ's) were introduced in 2002/2003 in order to promote international competitiveness in South Africa's manufacturing sector and to increase exports of South African goods (Wentzel, 2010:65). An industrial development zone is a designated industrial area linked to an international air or sea port, which may contain one or more custom controlled areas, customized for manufacturing and storage of goods

(SARS, 2012a). The objectives of these zones include promoting economic development, increasing investment, enhancing skills and creating employment within these zones (SARS, 2012a). Tax incentives are provided to businesses operating within these zones in order to attract foreign and local investment to these zones (SARS, 2012a).

IDZ's have the benefit of adding value within the zone and provide investors with the freedom to access the global market. Manufacturers operating within an industrial development zone are able to import raw materials, machinery and assets to be used in the production of goods, into the zone free of customs duty and VAT. They are also entitled to the normal deductions and allowances available to South African companies in terms of the Income Tax Act. Thus, manufacturers operating within these zones enjoy a lower cost of production (Wentzel, 2010:65-66).

There are currently four designated IDZ's in South Africa. These include Coega (Eastern Cape), Richards Bay (Kwazulu-Natal), East London (Eastern Cape) and the OR Tambo International Airport (Gauteng). The OR Tambo International Airport IDZ is not operational and is waiting for its operational permit (Bisseker, 2012).

### **3.4.2 Effectiveness**

Since 2002, Coega has created 27 412 jobs and generated investments of R9.65 billion (Esterhuizen, 2012). Coega also assisted with enhancing skills development within the zone and over 80 per cent of all trainees that completed training programmes were able to find employment. In addition to tax incentives, Coega provides various other human capital solutions including human resource management, recruitment services, training services, youth development, employment relations services and business development (Coega, 2012).

The East London IDZ and Richard Bay IDZ were not as successful as Coega in creating jobs and generating investment. East London created 5 524 jobs and generated investments worth R1.5 billion, while Richards Bay created 300 jobs and generated investments of R650 million (Esterhuizen, 2012).

According to the DTI, government has invested approximately R7 billion across the three IDZ's. These zones attracted a total of 40 companies and generated investments of R11.8 billion (Bisseker, 2012). A total of 33 236 direct jobs, including temporary construction jobs were generated (Bisseker, 2012; Esterhuizen, 2012).

However, many of the investments generated into the IDZ's were from companies that relocated into the zones, taking existing jobs with them. In the East London IDZ only three out of the 14 investments were new investments, and at the Coega IDZ, only four out of 10 of the investments were new. Rob Davies, the Minister of Trade and Industry, did not think that the IDZ's achieved its full potential (Bisseker, 2012).

Industrial Development Zones in South Africa contain a number of weaknesses. These include insufficient planning, inadequate co-ordination amongst government agencies and investors, inadequate governance arrangements, a lack of competitive tax and other incentives within the zones and a preference towards capital and energy intensive industries instead of labour absorbing industries, amongst others. Coega lost a significant US\$ 2.7 billion in potential investment, due to the zone unable to accommodate heavy users of electricity. Richards Bay faced environmental challenges on the land on which the IDZ was situated. Only a portion of the IDZ land was suited for IDZ development and the zone only received its operating permit in 2009. The OR Tambo IDZ is also facing challenges with the land designated for the zone and the IDZ has not yet received its operating permit. SARS was insufficiently consulted on tax incentives promised by the DTI. Furthermore, the tax incentives provided by South African IDZ's are not competitive with the tax incentives provided by international IDZ's and investors are not impressed with the incentives that South African IDZ's have to offer (Bisseker, 2012).

### **3.5 SPECIAL ECONOMIC ZONES**

#### **3.5.1 Background**

In the 2012 Budget Speech, the Minister of Finance proposed the establishment of Special Economic Zones (SEZ's) in South Africa (SARS, 2012b:7). The programme is intended to assist government in reaching its objectives in terms of industrial development, regional

development, job creation and increased FDI (Cisse, 2012; Department of Trade and Industry, 2012b).

Special economic zones are geographically designated areas of a country selected for specific economic activities, that are supported with more liberal commercial and economic policies than the rest of the country, aimed at attracting increased foreign investment (Cisse, 2012; Department of Trade and Industry, 2012b). SEZ's have become a popular instrument for attracting increased investment and industrial development in developing countries that seek economic growth (Cisse, 2012).

The proposed SEZ's will expand on and address the challenges experienced with IDZ's (Cisse, 2012; SARS, 2012b:7). A dedicated legislative framework for SEZ's called the Special Economic Zone Policy and Bill is being established. The SEZ Bill aims to ensure that SEZ's effectively achieve its objectives and will also enable the government to effectively regulate SEZ's and IDZ's. The existing IDZ's will be incorporated as part of SEZ's as a type of SEZ (Department of Trade and Industry, 2012b).

The locations of the special economic zones are being explored and feasibility studies will commence once high-potential zones have been identified. The regions being explored include areas within North West, Limpopo and Free State. SEZ's in South Africa do not have to be associated with a sea port or international airport as in the case with IDZ's (Jones, 2012).

It is likely that businesses operating within these zones will enjoy reduced corporate income tax rates and additional tax deductions for the employment of low income-earning individuals (SARS, 2012b:7). Operators of special economic zones may be entitled to an income tax exemption (SARS, 2012b:7).

### **3.5.2 Effectiveness**

Since special economic zones have not yet come into effect in South Africa, the effectiveness of the incentive on job creation cannot be determined. However, as businesses operating in SEZ's may enjoy reduced corporate income tax rates and

operators of SEZ's may be entitled to a tax exemption, it may be beneficial to examine the success of South Africa's expired tax holiday scheme which provided manufacturing companies with an income tax exemption.

In 1996, the South African government introduced a tax holiday scheme to assist it in attaining its industrial development objectives. The tax holiday was intended to promote international competitiveness and increase economic growth and development. The tax holiday expired 3 years later on 30 September 1999. The tax incentive provided manufacturing companies with an exemption from income tax for up to six consecutive years, depending on whether the company met certain criteria. These criteria included labour absorption, regional location and industrial priority. At the time of withdrawal of the tax holiday, a total of 174 projects were making use of the incentive with a total investment value of R6.6 billion. These projects created 15 000 job opportunities. The government decided not to extend the tax holiday in 1999 as the corporate tax rate for all companies was reduced from 35 per cent to 30 per cent (Wentzel, 2010: 79).

### **3.6 CONCLUSION**

The tax incentives that are available to support job creation in South Africa are either linked to skills development or industrial projects. The effectiveness of these incentives, with the exception of the learnership tax deduction (no information on this incentive is available as yet); on job creation has not been significant in comparison to the five million jobs required as per the new growth path.

The section 12I industrial policy project incentive is expected to create 1 618 direct jobs and 25 448 indirect jobs. IDZ's contain a lot of weaknesses and have not achieved its full potential. The three operational IDZ's created only 33 236 jobs since 2002. Furthermore, a number of jobs created in these zones were temporary jobs and existing jobs from businesses that relocated to these zones. The Coega IDZ was the most successful IDZ in South Africa creating the most number of jobs. Coega provided many other benefits to businesses located in the zone such as human resource management, recruitment services, training services, youth development, employment relations services and

business development. Thus, tax incentives should be used in conjunction with other benefits in order to achieve maximum results.

The effectiveness of the learnership tax allowance could not be determined due to a lack of available literature. It is important that SARS analyse the effectiveness of this incentive so that proper decisions can be made.

In the next chapter, the tax incentives that are available to support job creation in Brazil and their effectiveness in creating jobs will be reviewed.

## CHAPTER 4

### TAX INCENTIVES THAT SUPPORT JOB CREATION IN BRAZIL

#### 4.1 INTRODUCTION

Brazil is the fifth largest country in the world (KPMG, 2011:14) with the sixth largest economy (World Bank, 2012:1). Its economy is driven by well developed agricultural, mining, manufacturing and service sectors (KPMG, 2011:15). Brazil was the first Latin American country and one of the first countries in the world to overcome the global financial crisis. It emerged from the crisis stronger and more attractive (PWC, 2010:33). In 2011, Brazil created over two million jobs and improved social inequalities in the country (Forte, 2012).

Brazil is divided into 26 states and a federal district. The states are further divided into municipalities. Each state is governed by its own constitution and state legislation (KPMG, 2011:20). Brazil's tax system allows taxes to be levied by the federal, state and municipal governments. Income tax is levied at the federal level while indirect taxes such as value added tax is levied at both the state and federal level (Byrne, 2002:11). The main principles of the Brazilian tax system are defined by the Federal Tax Code of 1996 and by the Federal Constitution of 1998 (KPMG, 2011:56).

Federal tax incentives are aimed at achieving national policy objectives such as enhancing exports and promoting certain industries while state and local tax incentives are directed towards specific objectives such as increasing local employment. State and local tax incentives usually comprise of an exemption or deferral of indirect taxes, such as value added tax and property taxes, that they are entitled to levy (KPMG, 2011:68). State and local tax incentives provided to investors may vary as incentives are provided to investors based on the importance of the investment to the state (PWC, 2010:43).

A discussion of tax incentives identified to increase employment opportunities in Brazil follows.

## **4.2 SUPERINTENDENCE OF AMAZONAS DEVELOPMENT (SUDAM) AND SUPERINTENDANCE OF NORTHEAST DEVELOPMENT (SUDENE)**

### **4.2.1 Background**

In 1959, the Superintendence of the Development of the Northeast Region (SUDENE) was established. Sudene was created as an agency to promote regional development and to reduce inequalities in terms of income and employment in the Northeast region. In 1966, the Superintendence of Amazonas Development (SUDAM) was established to promote regional development in the Northern Amazon region (Farret, 2001:9). SUDENE and SUDAM were extinguished in May 2001 due to suspicions of corruption. The Agency for the Development of Northeast (Adene) and the Agency for the Development of the Amazon region (ADA) were established in their place. However, ADENE and ADA did not have a real existence as they were not provided with the necessary financial and human resources to perform their duties (Gomes, 2000). In 2007, SUDAM and SUDENE were recreated as agencies that are administratively and financially independent from the government (KPMG, 2011:69).

Businesses that operate within the Amazon and Northeast regions of Brazil may be eligible for certain tax incentives. Under SUDAM and SUDENE, businesses may receive up to 75 per cent reduction in income tax due on operating profit provided that the businesses carry on approved projects. Projects that qualify for the incentives include the implementation, expansion, diversification and improvement of projects that will improve economic regional development. The income tax reductions may not be distributed to the shareholders of the businesses. It must be held as a capital reserve to be used for capital increases or used to set off against existing losses. The incentive may be provided for a maximum period of ten years and is due to expire in December 2013 (PWC, 2010:44-45).

Businesses that maintain enterprises that significantly assist with the economic development of the Northeast region and Northeast Amazon region may be entitled to a gradual reduction of income tax from 25 per cent to 12.5 per cent. This incentive will also expire in December 2013 (PWC, 2010:45).



Businesses may also be entitled to an exemption from Merchant Marine Fee (AFRMM) and Tax on Financial Transactions (IOF) subject to certain conditions (PWC, 2010:45). AFRMM is an import cost based on amounts paid for international ocean freight, the proceeds which will be used for the renewal of the Brazilian merchant marine (PWC, 2010:72). IOF is a federal tax levied mainly on certain foreign exchange transactions, insurance policies, loans or credit operations and securities transactions (PWC, 2010:167). Certain businesses may also be entitled to Sales Tax incentives depending on the nature of the project (PWC, 2010:45).

Eligibility for the incentives depends on SUDAM / SUDENE's approval of the project. The agencies will evaluate the project to determine whether the project is technically and economically feasible and whether the project is suitable within the overall economic development of the region (KPMG, 2011:69; PWC, 2010:44).

#### **4.2.2 Effectiveness**

Income inequality and regional inequality are significant concerns of the Brazilian government. The Northeast region is the poorest region while the Southwest region is the wealthiest region. The SUDAM and SUDENE tax incentives have assisted with the development of the Northeast and Amazon regions by bringing in more business, a higher industrial output and the creation of employment (Ferreira, 2004).

However, it is argued that if no incentives were provided by the Northeast region the resources could have been invested in other regions of Brazil. Thus, the jobs that were created through investments in the Northeast could have been created in those other regions. Furthermore, a loss of jobs may occur where large innovative companies set up businesses in the less developed regions in order to take advantage of the tax incentives, creating pressure on regular businesses which eventually close down (Ferreira, 2004).

Nonetheless, despite the numerous incentives provided by SUDENE, the Northeast region did not experience a faster economic growth compared to the rest of the country (Ferreira, 2004).

## **4.3 MANAUS FREE TRADE ZONE**

### **4.3.1 Background**

In 1967, the Manaus Free Trade Zone (MFTZ) was established in the Amazon in the city of Manaus. MFTZ was established with the objective of creating an industrial, commercial and farming centre in the Amazon region, to integrate the Amazon economy with the rest of the country and to assist with job creation. The main attraction of MFTZ was tax incentives. In 1968, the incentives were extended to all the Western Amazon states of Brazil (Ferreira, 2004).

The zone comprises of three poles, (1) the commercial pole, (2) the industrial pole and (3) the agricultural pole (KPMG, 2011:70). The federal government introduced several tax incentives in order to promote economic development within this region. Tax incentives are provided to businesses located within this region. These incentives include a 75 per cent reduction of corporate income tax (IRPJ) for a period of ten years, a reduction of import duties, an exemption from excise taxes (IPI), deferment / reduction / exemption of sales tax (ICMS) on the importation of certain products used for specific purposes, a presumed ICMS tax credit as well as reductions and suspensions of taxes on gross revenue (PIS / COFINS) (Ferreira, 2004; KPMG, 2011:70 & PWC, 2010:46).

The MFTZ is administered by an agency called Suframa (Ferreira, 2004). The tax incentives of the free trade zone will expire in the year 2023 (PWC, 2010:34).

### **4.3.2 Effectiveness**

MFTZ is probably the most important tax incentive programme in Brazil. It assisted in creating a significant amount of jobs, exports and industrial development. The zone has attracted a large number of industrial businesses and is currently the main location for electronic equipment factories in Brazil (Ferreira, 2004). In 2010, there were approximately 430 companies located in the Industrial Pole of Manaus. These companies generated revenues of approximately US\$ 35.152 billion between 1 January 2010 to 31 December

2010. The industrial pole also assisted with the creation of 103 562 direct jobs and 440 000 indirect jobs (Suframa, 2012).

The costs associated with MFTZ are high and direct job creation very low. However, in contrast to SUDENE, if no tax incentives and exemptions were provided by MFTZ, it is possible that almost none of the businesses and jobs located in the free trade zone would remain in the zone. Without tax incentives there would be no economic rationality for locating industrial firms in the zone. The location of the zone and lack of infrastructure make the zone unattractive. Thus, it could be more beneficial if businesses were set up in other existing regions of Brazil instead of MFTZ (Ferreira, 2004).

#### **4.4 BRASIL MAIOR (GREATER BRAZIL)**

##### **4.4.1 Background**

On 3 August 2011, the Brazilian government issued a new industrial policy called *Brasil Maior*, which means “Greater Brazil” in English. *Brasil Maior* is intended to stimulate the competitiveness of the national industry by promoting exports, technological innovation and domestic production (Deloitte, 2011). The policy provides incentives, financing and tax relief for industries that have the potential to improve the countries international competitiveness (Brasil, 2011). The main tax incentives offered by *Brasil Maior* that may assist in job creation follow.

##### **4.4.2 Labour-intensive industries**

From 1 December 2011, the social security tax, for certain labour-intensive industries, was temporarily suspended and replaced with a tax on gross revenues. The industries that will benefit from this incentive include manufacturers of clothing, footwear, textiles, auto parts, capital goods, plastics, furniture, electrical materials, buses, shipping industry, airplane industry, hotels, call centres, software sectors and microchip design (Jones, 2012:3).

The incentive is aimed at creating more jobs by reducing the cost of production (Administrator, 2012; Taxand, 2012). The employee social security tax is currently 20 per

cent of the total payroll costs and is considered to be a significant cost for businesses. The social security tax was replaced with one per cent tax on gross revenues for industries and two per cent tax on gross revenues for service sectors. These sectors will have to pay an additional 1.5 per cent COFINS on the importation of the above mentioned products (Deloitte, 2011; Taxand, 2012; Towers Watson, 2011).

The tax incentive will apply from 1 December 2011 to 31 December 2012 (Deloitte, 2011). It is estimated that companies may save between \$45 billion and \$50 billion in social security taxes over the 13 month period (Towers Watson, 2011).

#### **4.4.3 Regional incentives**

From 3 August 2011, businesses that are engaged in installation, expansion or modernisation projects approved by Sudam or Sudene may be entitled to a reduction of corporate income tax (IRPJ). The incentive is provided to the businesses that are engaged in the manufacturing of machinery, equipment, instruments and devices based on digital technology that are related to the Digital Inclusion Programme. The businesses may claim an income tax reduction for a period of ten years (Deloitte, 2011).

#### **4.4.4 Effectiveness**

As these incentives are fairly new, no literature on the effectiveness of these incentives could be found. It is recommended that the effectiveness of this incentive on job creation be researched in future studies.

### **4.5 STATE / LOCAL TAX INCENTIVES**

#### **4.5.1 Background**

As mentioned above, the individual states of Brazil have the freedom and authority to provide a variety of tax incentives on taxes which they are entitled to levy (Nelson, 2002:139). Tax incentives are mainly provided by the state in order to attract new

investments and increase employment within the state (Porsse, Haddad & Ribeiro, 2005:2). State tax incentives are generally designed as an exemption, reduction or deferral of indirect taxes (KPMG, 2011:68). A reduction in sales tax has the advantage of providing goods at a lower cost (Nelson, 2002:142).

In the 1990's, this system led to taxation war amongst states as they competed with each other to provide the best incentives in order to attract foreign direct investment, jobs, economic growth and other related benefits. Dell Computer and Ford are examples of multinational companies that compared the financial incentives provided by different states of Brazil in deciding where to invest. Both companies were provided with more than just a reduction in sales tax. In 1997/1998, Dell Computer investigated five different states in Brazil in order to determine where to invest. Dell chose to invest in the state of Rio Grande do Sul. Dell's decision was based on the competitive incentives provided by Rio Grande do Sul as well as its positive relationship with POLO, an independent private agency that promoted foreign investment in Rio Grande do Sul. Dell is currently operating successfully in Rio Grande do Sul and has expanded its operations significantly since its initial investment. It has become a leader in the Brazilian market and is exporting from Rio Grande do Sul to the Mercosul market (Nelson, 2002).

At the same time Ford Motors was provided with favourable tax incentives by the state of Rio Grande do Sul. However, in 1997 when Olivio Dutra became the new state government, Olivio argued that the tax incentives provided to Dell and Ford was too generous and attempted to renegotiate the incentives provided. Ford was not pleased with the new incentives and began to investigate other areas where it could invest. Ford decided to invest in the state of Bahia where it received more favourable incentives. The residents of Rio Grande do Sul were angry at Olivio's decision since the loss of investment resulted in a loss of jobs in the state. Therefore in order to retain Dell Computer's investment in Rio Grande do Sul, Olivio provided Dell with the original financial incentives. The cost of each job created in the case of Ford is approximately five times more the cost of a job, in terms of tax and fiscal incentives, in a General Motor plant in Tennessee. Thus, the tax competition amongst the states in Brazil resulted in a significant loss of revenue for the country (Ferreira, 2004; Nelson, 2002).

## **4.5.2 Effectiveness**

Local tax incentives have been recognised for their effectiveness in creating jobs and income. However the loss of tax revenue may be high resulting in the inefficient allocation of public goods (Porsse *et al.*, 2005:2). The provision of local tax incentives could be detrimental to a country's economic interests as states will compete against each other in order to gain investments without considering the country's interests (Nelson, 2002:141-142).

The above case of Ford Motors and Dell Computer illustrate how competitive states may become in order to attract new investment. It also illustrates the significance that local tax incentives play in attracting investment to the state. As discussed above states often provide overly generous incentives to attract investment from multinational companies at the expense of the country (Nelson, 2002:139-153).

In a study conducted by Porsse *et al.* (2005: 1-18) on the economic effects of regional tax incentives, it was found that an increase in demand generated by new investments in a state produces positive results in terms of job creation in that state. However, the consequent effects on Gross Domestic Product (GDP) and employment on the rest of the states of Brazil are negative but small in comparison to the effect on the state that implemented such policy. The average effect results in a positive effect on job creation and a negative effect on GDP for the Brazilian economy as a whole.

## **4.6 YOUTH EMPLOYMENT INCENTIVES**

### **4.6.1 Background**

The Brazilian government provides tax incentives to assist with youth employment (International Youth Foundation, 2008:2; Jacinto, C: 2008:11; Nes, EF: 2012). However, no literature on the details of these tax incentives could be found. It is recommended that the tax incentives provided by the government to support youth employment and its effectiveness on job creation be researched in future studies.

#### 4.6.2 Effectiveness

The effectiveness of this incentive could not be determined due to a lack of literature available. It is recommended that the effectiveness of youth incentives to support job creation in Brazil be researched in future studies.

#### 4.7 CONCLUSION

The tax incentives available to support job creation in Brazil include reducing payroll taxes for labour absorbing industries, promoting youth employment, the provision of local tax incentives for investment and employment and tax incentives for the development of under-developed regions.

MFTZ was probably the most successful tax incentive provided by the Brazilian government resulting in the most number of jobs created. The zone also assisted with increasing exports and industrial development. However, the costs associated with MFTZ are high.

The tax incentives provided by Sudam and Sudene have assisted with generating employment in the Northeast and Amazon regions of Brazil. However it is argued that the jobs created in these regions could have been created in other regions of Brazil if no tax incentives were provided.

Local tax incentives are an important factor in attracting investments and generating employment in a state. However, as stated above the states often provide overly generous tax incentives which may result in a significant loss of revenue to the country.

The effectiveness of the *Brasil Maior* could not be determined due to a lack of available literature. The next chapter will focus on the tax incentives that are available to support job creation in Russia.

## CHAPTER 5

### TAX INCENTIVES THAT SUPPORT JOB CREATION IN RUSSIA

#### 5.1 INTRODUCTION

Russia is the world's largest country by land area, occupying most of Eastern Europe and Northern Asia (PKF, 2011:11). It has the eighth largest population in the world comprising of highly educated people (PKF, 2011:12). In 2011, Russia was the ninth largest economy in the world (World Bank, 2012:1). The country is key producer and exporter of mineral resources, oil and gas and electric power (PKF, 2011:14).

Russia's tax system is regulated by the Tax Code of the Russian Federation. The code allows taxes to be levied at the federal, regional and local levels with majority of the taxes levied at federal level (PKF, 2011:49). In the past, there were very few tax incentives available in Russia (Deloitte, 2012b:27). However, more incentives have been introduced as part of the government's objective to transform the country's economy from a resource based economy to an innovation based economy. Thus, most of the incentives are aimed at promoting innovation and the transformation of industries (Deloitte, 2012b: 6).

#### 5.2 SPECIAL ECONOMIC ZONES

##### 5.2.1 Background

Russia's first economic zones were established in the 1990's. These zones were ineffective due to numerous reasons discussed below. In 2005, the Russian government enacted Federal Law Number 116 to govern the creation and functioning of SEZ's in Russia. This new law improved the situation of SEZ's significantly (Russia's Special Economic Zones, 2012; Laurier, 2008). The Ministry of Economic Development is the main strategic body responsible for planning and legal regulation of SEZ's and the JSC Special Economic Zones is responsible for managing investor relations (Sheviakova, 2010:1).



After the legislation was enacted in August 2005, all SEZ's and free economic zones established before its enactment came to an end except for two economic zones, Kaliningrad and Magadan (Komolov, 2005:83). These two zones still exist but are governed by separate laws and are entitled to different incentives (Deloitte, 2012b:27).

SEZ's were established by the government in order to transform the country's economy from a resource based economy to an innovation based economy (Kalmykova, 2012; Rybakov, 2009). SEZ's are aimed at attracting FDI and advanced technologies, creating new jobs, increasing exports, replacing imports and experimenting with new labour and business policies (Anon, Not dated). Federal Law 116 allows for the establishment of four types of SEZ's. These include technology and innovation zones, Industrial production zones, tourist and recreational zones and port zones (KPMG, 2011:33). The federal law also provides for the type of activities that may be carried out in each of the different types of SEZ's (KPMG, 2012b:15).

Businesses that operate within SEZ's are entitled to a number of benefits. These benefits include tax incentives, a free customs zone, public financing of infrastructure, acquisition of land or leasing of property at reduced rates and a "one stop shop" consisting of a number of government agencies located in one centre in order to simplify relations between investors and government agencies (Russia's Special Economic Zones, 2012 ; JSC SEZ, Not dated:4). The free customs zone allows technology-intensive enterprises to import goods into the zone free of customs duties and taxes and without tariff regulation (JSC SEZ, not dated: 5).

Federal Law 117 of 2005, which is an extension of Federal Law 116, provides a number of tax incentives to businesses that operate within SEZ's (Malakha, 2006:43-44). Tax incentives provided to SEZ's includes (Deloitte, 2011: 27, JSC SEZ, Not dated: 5; Rybakov, 2009):

- A reduction in corporate profit tax depending on the type of the zone and the regional authority;
- Exemption from corporate property tax and transport tax for five to ten years depending on the region;
- Exemption from land tax;

- Accelerated depreciation for manufacturing and tourist zones;
- Reduction of salary related taxes for innovation zones;
- Unlimited time for utilising tax losses; and
- A guarantee against changes in unfavourable tax law.

### 5.2.2 Effectiveness

Russia's first SEZ's were established in the 1990's in order to stimulate the development of four sectors. These sectors include (1) manufacturing and high-technology industries, (2) transport infrastructure, (3) tourism and (4) health. The zones were ineffective and did not achieve its objectives due to numerous reasons. SEZ's did not have a specific legal framework and were governed by subordinate legislation. The lack of a legal framework did not provide for the protection of foreign investments. There was constant conflict between the regions and the federal government for providing greater benefits and there was insufficient control over the zones. Over time, the zones developed into offshore zones, meaning that companies registered themselves in the SEZ territories and enjoyed the benefits of SEZ's but carried on their business activities outside the zones (Sheviakova, 2010:1; Russia's Special Economic zones, 2012).

The special economic zone that operated in Ingushetia from 1994 to 1997 cost the federal budget US\$ one billion without bringing any benefits to the region. The Kaliningrad SEZ was established for the wrong reasons and promoted import substitution instead of export competitiveness (Vladislav, 2012).

Federal Law 116 and Federal Law 117 were established in 2005. These laws significantly assisted with transforming the situation of SEZ's in Russia (Laurier, 2008). As at January 2012, there were 25 special economic zones carrying on 307 projects. More SEZ's are being planned. The total private investment generated from SEZ's was approximately US\$ 12 billion while the Russian government spent approximately US\$ one billion to develop these zones (Kalmykova, 2012). Between 2005 and 2010 over 6 000 new jobs were created in all SEZ's (JSC SEZ, Not dated: 16).

However, SEZ's in Russia still remain unattractive to investors (Sheviakova, 2010:2). Firstly, they are too small in size to accommodate large projects. Secondly, the benefits provided to SEZ's including tax incentives are not competitive with the benefits provided by other countries. For example in the country Belarus, near to Russia, land is sold at a discount, there are no profit, property or land taxes for ten to twenty years and the social security tax is only nine per cent compared to 30 per cent in Russia. Third, there is a lack of proper infrastructure which is supposed to be financed by the state. Fourth, the registration process is timely and complicated. Lastly, the zones are not located in proper geographical locations. Most SEZ's in Russia are located in the more developed areas of the country while global experience proves that SEZ's may assist in advancing under-developed regions. Furthermore, SEZ's in Russia cannot be set up near the coastline to take advantage of airports, seaports and highways due to the poor transport infrastructure (Vladislav, 2012; Sheviakova, 2010:3).

### **5.3 REDUCED SOCIAL CONTRIBUTION RATES**

#### **5.3.1 Background**

Businesses that are engaged in software development, media activities, engineering activities (Deloitte, 2011c:5) and agriculture (KPMG, 2012b:28) and that meet certain requirements may be entitled to reduced rates of social security contributions: Businesses operating in technological-innovative special economic zones, certain businesses applying the simplified tax system and businesses that employ disabled persons may also be entitled to reduced social security contributions (KPMG, 2012b:28).

Social security contributions comprise of mandatory contributions by an employee to the Russian pension fund, social insurance fund, medical insurance fund and insurance against occupational accidents and diseases. The social insurance contribution amounts to approximately 30 per cent of an employee's annual remuneration where the employees remuneration does not exceed US\$16 000. Where the employee's remuneration exceeds US\$16 000 the employee must contribute an additional 10 per cent of the amount exceeding US\$16 000 to the Russian pension fund (KPMG, 2012b:28).

The social security contributions may be reduced to:

- 14 per cent on annual remuneration for businesses engaged in software development not exceeding US\$16 000 and exemption for remuneration exceeding US\$16 000 (Deloitte, 2011c:5);
- 26 per cent on annual remuneration for businesses engaged in media activities not exceeding US\$16 000 and exemption for remuneration exceeding US\$16 000 (Deloitte, 2011c:5);
- 30 per cent of annual remuneration for businesses engaged in engineering activities not exceeding US\$16 000 and exemption for remuneration exceeding US\$16 000 (Deloitte, 2011c:5); and
- 14 per cent on annual remuneration for businesses carrying on business in technological-innovative SEZ's not exceeding US\$16 000 and exemption for remuneration exceeding US\$16 000 (Deloitte, 2011c:3).

### **5.3.2 Effectiveness**

No literature on the effectiveness of this incentive to support the creation of jobs could be found. It is recommended that the effectiveness of this incentive be researched in future studies.

## **5.4 REGIONAL TAX INCENTIVES**

### **5.4.1 Background**

Regional tax incentives are provided by most regions in Russia. Tax incentives are provided to businesses that carry on business operations considered a priority in the region and that invest in certain minimum amounts. These businesses may be entitled to a 4.5 per cent reduction in profit tax and a reduction or exemption of property tax (Deloitte, 2011c:3).

## **5.4.2 Effectiveness**

Regional tax incentives and the public services are important factors considered by investors in determining the location of investment. Thus, almost all regions provide tax incentives and public services in order to compete for investments. The competition amongst the regions may result in a substantial loss of revenue by the region and country (World Bank, not dated).

No literature on the effectiveness of the incentive on job creation could be found. It is recommended that the effectiveness of the incentive to support job creation be researched in future studies.

## **5.5 TAX INCENTIVES FOR THE EMPLOYMENT OF DISABLED PERSONS**

### **5.5.1 Background**

Businesses that employ disabled persons and that meet certain requirements may be entitled to reduced social security contributions (KPMG, 2012b:28).

### **5.5.2 Effectiveness**

No literature on the details of this incentive and its effectiveness on job creation could be found. It is recommended that the details of this incentive and its effectiveness on job creation be researched in future studies.

## **5.6 CONCLUSION**

There are not many tax incentives available to support job creation in Russia. Tax incentives are mainly provided to transform the country's economy from a resource based economy to an innovation based economy. The tax incentives that may assist in job creation include special economic zones, reductions in social security tax and regional tax incentives. SEZ's have not had a significant impact on job creation. Only 6 000 new jobs

were created in all SEZ's between 2005 and 2010. Furthermore, SEZ's in Russia remain unattractive even though the zones were reformed in 2005. The effectiveness of reduced social security contributions provided to businesses engaged in software development, media activities and engineering activities and regional tax incentives could not be determined.

In the next chapter, the tax incentives that support job creation in India will be discussed.

## CHAPTER 6

### TAX INCENTIVES THAT SUPPORT JOB CREATION IN INDIA

#### 6.1 INTRODUCTION

India has a large population of over one billion people and a labour force of approximately 478.3 million people at 2010 (Ernst & Young, 2011:10-13). In 2011, India was the tenth largest economy in the world (World Bank, 2012:1) and the second largest emerging economy after China (Ernst & Young, 2011:16). India's GDP has been growing at an average of 8.6 per cent over the last five years (Ernst & Young, 2011:16). Its economy is driven by an internationally competitive service sector, the manufacturing sector and the agricultural sector. In recent years, the service sector has been the most important sector demonstrating rapid growth (Deloitte, 2012a:1).

According to the United Nations Conference on Trade and Development's World Investments Prospects Survey 2010-2012, India was rated the second most attractive destination for FDI in the world, after China (Ernst & Young, 2011:17). As mentioned in Chapter 2, FDI may assist in enhancing a country's economic development, innovation and job creation (Easson & Zolt, 2002:10).

In India, taxes may be levied by the central and state governments (Deloitte, 2012a:10). The tax laws of India are currently governed by the Income Tax Act, 1961 and the Wealth-Tax Act, 1957. The Direct Tax Code, 2010 is expected to replace the Income Tax Act, 1961 from 1 April 2013. The Direct Tax Code aims to reduce tax rates to bring more people and companies under the tax net and to replace profit-linked incentives available to companies with investment-linked incentives (The Economic Times, 2012). Since the Direct Tax Code will only be implemented in 2013, the study will examine the tax incentives available under the Income Tax Act, 1961.

Tax incentives are provided by the government of India to encourage investment in specific industries, promote regional development and increase exports. Tax incentives may take the form of tax holidays, additional tax deductions and accelerated depreciation

(Deloitte, 2012a:3). The tax incentives that are provided by the government of India to increase employment are discussed below.

## **6.2 EXPORT PROCESSING ZONES**

### **6.2.1 Background**

India's export processing zones (EPZ) are aimed at encouraging export oriented industries, enhancing the country's export competitiveness, attracting FDI and generating employment (Aggarwal, 2004:2). India was one of the first countries in Asia that developed EPZ's in order to promote exportation. Asia's first EPZ was set up in Kandla, India in 1965 (Mukherjee, Not dated: 1; SEZ India, 2012). However, since then little has been done to strengthen EPZ's in India (Shah, 2009:1).

In the 1960's, the government of India promoted EPZ's by providing businesses located in the zones with certain benefits such as tax holidays and free infrastructural services. However, the zones did not experience rapid economic growth. The inefficiency of the zones could be attributed to a number of factors including the absence of an EPZ policy, unclear objectives of the zones, limited power by the zone authorities and poor infrastructure. In the early 1990's, EPZ's in India went through a reform to provide better facilities, greater incentives and improved governance to create a more attractive investment environment and increase the performance of the zones (Aggarwal, 2004: 4-6).

Section 10A of the Income Tax Act (India, 1961), provides EPZ's with a deduction of 100 per cent of the profits and gains from the export of articles or things or computer software for a period of ten consecutive years commencing from the year in which the undertaking starts manufacturing or commences its business activities up until 31 March 2012 (KPMG, 2010:66).

### **6.2.2 Effectiveness**

EPZ's in India had a very limited impact in creating employment and enhancing exports. The zones employed only 0.01 per cent of the labour force and accounted for less than



four per cent of exports. Furthermore, only 20 per cent of the total investment generated by EPZ's was from foreign direct investment (Mukherjee, Not dated:11). Some of the factors that contributed to the inefficiency of these zones include the imposition of strict policies, strict labour laws, lengthy procedures and the absence of a single window clearance, poor infrastructure, location disadvantages and the small size of EPZ's (Mukherjee, Not dated:11).

Table 2 below reflects the employment growth in the Indian export processing zones from 1966 to 2002. More recent data could not be found.

**Table 2: Employment growth in the Indian export processing zones from 1966 to 2002**

Year	Total employment (number)	Average zone employment (number)	Average annual employment growth between the two years (%)
1966	70	70	0
1970	450	450	50.2
1975	1 450	725	41.9
1980	6 000	3 000	34.2
1985	16 200	4 050	22.6
1990	35 205	5 868	16.9
1995	61 431	10 239	11.9
2000	81 371	11 624	6.2
2002	88 977	12 711	5.2

Source: Ministry of Commerce (Aggarwal, A, 2004:13)

Table 2 reflects a continuous increase in the employment level from 70 workers in 1966 to 88 977 workers in 2002. The average employment per zone also increased from 70 workers in 1966 to 12 711 workers in 2002. However, the average annual growth rate in employment decreased from 1970 to 2002, despite the addition of five new operational EPZ's (Aggarwal, 2004:13). The decrease of the annual growth rate in employment could be attributed to the lack of competitiveness of India's EPZ's and the country's dependence on the Soviet Union (USSR) markets for exports in the 1990's. Other reasons include the high costs of operating in the zones due to the poor investment climate, poor infrastructure and poor quality of governance of the zones (Aggarwal, 2004:16-17).

A survey conducted by the Indian Council for Research on International Economic Relations (Aggarwal, 2004:22), revealed that fiscal incentives and subsidies are a major attraction of EPZ's. Thus, the provision of attractive incentives could help generate investments within EPZ's (Aggarwal, 2004:23). However, according to the survey managers of EPZ's reported that incentives were inefficiently managed. They had to wait a long time to receive incentives, the policies were complex, information was unavailable, they did not receive adequate support and corruption was common (Aggarwal, 2004:25).

In addressing the weaknesses encountered by EPZ's, the government of India introduced the Special Economic Zone Policy in April 2000 (Government of India: Department of Commerce, 2012:81; Mukherjee, Not dated: 2; SEZ India, 2012). The Special Economic Zone Act, 2005 allowed existing EPZ's to convert to SEZ's and for EPZ's to enjoy all the reductions and benefits under the SEZ Act (Lakshmanan, 2009:13). Thus, several EPZ's were converted to SEZ's (Aggarwal, 2004:1). Special economic zones in India will be discussed in detail later in this chapter.

### **6.3 ELECTRONIC HARDWARE TECHNOLOGY PARK / SOFTWARE TECHNOLOGY PARK**

#### **6.3.1 Background**

Export Oriented Units (EOU) was introduced in India in 1981. EOU's are similar to SEZ's but enjoy greater flexibility in terms of acquisition of raw materials and ports of exports, better local facilities, larger land areas and availability of skilled workers. EOU's are mainly concentrated in textiles, food processing, electronics, chemicals, plastics, granites and minerals (Government of India: Department of Commerce, 2012:89-90). Section 10B of the Income Tax Act, 1961 (India, 2012) provides EOU's with an exemption of the profits and gains derived from the export of articles, things and computer software for a period of ten consecutive years up until 31 March 2012.

Entities engaged in the business of developing and exporting computer software and which are 100 per cent export oriented unit may register their entity as a Software Technology Park (STP) (Khona, 2000). Section 10A of the Income Tax Act (India, 1961)

allows the profits and gains derived from the export of articles, things and computer software by an entity set up in a Free Trade Zone (FTZ) or Software Technology Park area or Hardware Technology Park (HTP) area, to be fully exempt for a period of ten consecutive years up until 31 March 2012. STP's are also allowed to import certain products duty free. The central government, state government, public or private sector enterprises or any combination thereof may set up a STP (Khona, 2000).

### 6.3.2 Effectiveness

As at 31 March 2011, 2 446 units were in operation under the EOU scheme. The value of exports from EOU's during 2010 to 2011 was approximately ₹76 031.13 crore compared to ₹84 135.66 crore in 2009-2010 (Government of India: Department of Commerce, 2012:90). Information of the number of people employed by EOU's during 2010 to 2011 could not be found.

The performance of EOU's and employment generated during the period April 2008 to March 2009 are summarised in Table 3 below:

**Table 3: The performance of Export Oriented Units and employment generated in India during the period April 2008 to March 2009**

SEZ	Exports (₹ crores)	Imports (₹ crores)	Net Foreign Exchange (₹ crores)	Investment (₹ crores)	Employment
NSEZ	10 608.82	2 531.47	8 077.35	2 274.45	43 714
SEEPZ –SEZ	18 539.12	7 309.11	11 230.01	5 227.93	41 858
MSEZ	14 044.65	4 709.98	9 334.67	23 949.19	54 204
CSEZ	17 697.20	5 808.35	11 888.85	8 416.22	86 333
VSEZ	7 908.36	3 642.66	4 265.70	1 013.20	19 731
FSEZ	3 086.39	1 070.13	2016.26	1 275.38	9 946
KASEZ	98 582.38	86 472.58	12 109.80	3 410.40	24 514
ISEZ	1 031.29	162.89	868.40	189.71	3 305
Total	171 498.21	111 707.17	59 791.04	45 756.48	283 605

Source: Dev. Commissioner, All SEZ's based on annual performance Report submitted by EOU's ([www.eouindia.gov.in/fact\\_figure.htm](http://www.eouindia.gov.in/fact_figure.htm)).

As indicated in Table 3, a significant amount of exports, investment and jobs were created during the period April 2008 to March 2009. A total of 283 605 jobs were created.

In the last two decades India's information technology (IT) and information technology enabled services (ITES) industries have become globally competitive. These industries have assisted significantly in enhancing the country's economic growth, increasing FDI and generating employment. In 2010-2011, the IT software and services industry generated approximately 240 000 jobs, resulting in a total direct employment of 2.5 million people from these sectors. The indirect employment generated by the software industries was approximately 8.3 million people (STPI, 2011:4).

In addition exports from the STP's increased from ₹205 505 crore in 2009-2010 to ₹215 264 crore in 2010-2011. The number of new STP units registered in 2010-2011 was 294 compared to 521 registered during 2009-2010. The decrease in the number of new parks registered may be due to the expected expiration of section 10A of the Income Tax Act on 31 March 2011 (STPI, 2011:4). Section 10A of the Income Tax Act was extended for another year and expired on 31 March 2012. As at 31 March 2011 6 554 software technology park units were operating of which 5 565 were actually exporting (STPI, 2011:6).

## **6.4 SPECIAL ECONOMIC ZONES**

### **6.4.1 Background**

The SEZ policy was introduced by the government of India in April 2000, in order to promote SEZ's as an instrument for economic growth. The SEZ policy intends to overcome the weaknesses experienced by export processing zones. SEZ's are supported with well-developed infrastructure, attractive incentives and minimum regulations (Mukharjee, Not dated: 2; SEZ India, 2012).

SEZ's are currently regulated by The Special Economic Zones Act, 2005 supported by the SEZ rules. The main objectives of the SEZ Act are to promote economic development, increase exports, increase employment, infrastructure development and to generate

additional domestic and foreign investment (Government of India: Department of Commerce, 2012:81; SEZ India, 2012).

The government of India provides a number of benefits to SEZ units and SEZ developers, in order to promote SEZ's (Shah, 2009:2).

The main tax incentives provided to SEZ units include (SEZ India, 2012; Shah, 2009:2):

- Exemption from import duties of goods imported for the development, operation and maintenance of SEZ units;
- Tax exemption on export profit equal to 100 per cent for the first five years, 50 per cent for the next five years and 50 per cent of the re-invested export profit for the following five years;
- Exemption from central sales tax and service tax; and
- Exemption from state sales tax and other levies determined by the respective state governments.

The main tax incentives offered to SEZ developers include (SEZ India, 2012):

- Exemption from customs and excise duties;
- Income tax exemption of business profits for 10 years out of 15 years; and
- Exemption from central sales tax and service tax.

The Direct Tax Code will substitute the profit-linked incentives provided to SEZ's with investment-linked incentives. Thus, once the Direct Tax code comes into effect the tax incentives listed above will expire and only capital expenditure incurred will be allowed as deductible expenditure. However, the Direct Tax Code allows for the grandfathering of profit-linked incentives to continue for SEZ developers notified on or before 31 March 2012 and SEZ units that commence operations on or before 31 March 2014 (KPMG, 2010:11).

#### **6.4.2 Effectiveness**

The government of India has actively supported the development of SEZ's. They developed an SEZ policy, reviewed the policy frequently, and ensured that sufficient

facilities are provided to the SEZ developers and SEZ units. These conditions resulted in many entities seeking to develop businesses in the special economic zones (Mukharjee, Not dated: 15).

On the announcement of the SEZ policy, a number of export processing zones were converted into special economic zones. Furthermore, since the enactment of the SEZ Act in February 2006, 583 formal approvals have been granted for setting up SEZ's, out of which 380 SEZ's have been notified and are in various stages of operation (Government of India: Department of Commerce, 2012: 82-83).

As at 21 February 2012, the three main sectors of SEZ's formerly approved were the IT, electronic software, electronic hardware and semiconductor sector followed by the biotech sector and engineering sectors. The IT, electronic software, electronic hardware and semiconductor sector is the most significant sector accounting for approximately 61 per cent of the total formal approvals (Government of India: Department of Commerce, 2012: 84).

SEZ's assisted significantly in enhancing India's economic growth and increasing the country's international competitiveness. SEZ's have also assisted in increasing exports, investments and employment (Mukharjee, Not dated:8). Between February 2006 and September 2011, SEZ's provided direct employment to over 680 604 people, attracted investments of ₹231 159 crore, and promoted exports worth ₹998 492 crore. At 30 September 2011, SEZ's in India provided direct employment to more than 815 308 people (Government of India: Department of Commerce, 2012:88). SEZ's are expected to attract investments worth US\$ 30 billion and generate employment to approximately two million people (Mukharjee, Not dated: 16).

The success of some of the most significant new generation SEZ's in generating employment, investment and exports are summarised in Table 4 below.

**Table 4: The effect of some of the new generation SEZ's on direct employment, investment and exports in India**

SEZ	Sector	Direct employment generated (people)	Investment generated ( ₹ crore)	Exports ( ₹ crore)
Nokia SEZ	Telecom Equipment	15 043 (projected: 20 000)	2 718.108 of which 833.51 is FDI	44 749.59 (2006/07– 2010/11)
Mahindra City SEZ	Apparels and fashion accessories, IT and Hardware, Auto ancillary	17 523 (projected: 57 236)	1 652.70 of which 191.27 is FDI	8 869.92 (2006/07-2010/11)
Apache SEZ Development India Private Ltd	Footwear	6 362 (projected: 20 000)	375.88 of which 130.54 is FDI	600.20 (2006/07-2010/11)
Mundra Port and SEZ	Multi Product	2 284 (projected: 211 812)	23 586.40 of which 216.72 is FDI	5 014.63 (2007/08-2010/11)
Moser Baer SEZ	Non-conventional energy	884 (projected: 1 000)	1 374.87	1 371.33 (2007/08-2010/11)
Wipro Limited, Arandha Pradesh	IT	9 018 (projected: 7 000)	312.84	3 419.11 (2007/08-2010/11)
Divi's Laboratories Limited	Pharma	1 434 (projected: 1500)	550	1 967.51 (2007/08-2010/11)
Flextronics SEZ	Electronic Hardware	1 600 (projected:1000)	773.86 of which 427 is FDI	277.52 (2007/08-2010/11)
ETL Infrastructure Services Ltd	IT	47 315 (projected: 1 000)	397.65 of which 91.14 is FDI	7 065.71 (2007/08-2010/11)
Wipro Limited, Karnataka	IT	9 582	640.73	8 055.10 (2007/08-2010/11)
Biocon Limited	Biotech	2 068 (projected: 2325)	1 111.03	1 531.31 (2006/07-2010/11)
Serum Bio-Pharm Park	Pharma	608 (projected: 1 622)	656.31	1 959.97 (2007/08-2010/11)
Manyata Embassy Business Park	IT/ITES	12 595	1 440	5 531.28 (2007/08-2010/11)
Chandigarh Administration	IT	4 600 (projected: 4 500)	390.80	752.21 (2008/09-2010/11)
Hyderabad Gems Limited	Gems and Jewellery	6 912 (projected: 10 098)	214.60	3 353.03 (2008/09-2010/11)

SEZ	Sector	Direct employment generated (people)	Investment generated ( ₹ crore)	Exports ( ₹ crore)
Maharashtra Airport Development Corporation Ltd	Multi-Product	615 (projected: 30 500)	1 077.10	29.19 (2008/08-2010/11)
Reliance Jamnagar Infrastructure Ltd	Multi Product	928	37 395.50 of which 70 is FDI	177 707.70 (2008/09-2010/11)
Suzion Infrastructure Ltd	Hi-tech engineering products and related services	388 (projected 365)	603.50	2 868.16 (2008/09-2010/11)

Source: Government of India: Department of Commerce (2012:86-88).

As illustrated in Table 4, SEZ's in India attracted a significant amount of investment, generated a substantial amount of employment and increased exports. The SEZ's listed in Table 4 generated employment for over 139 760 people and projected employment of 369 958.

However, SEZ does also have a negative socio-economic effect on the country. The provision of overly generous tax incentives resulted in a loss of revenue to the country, particularly when existing firms moved their factories into special economic zones in order to take advantage of the tax incentives provided. It is believed that within the next ten years, an investment of ₹100 000 crores will result in a revenue loss of ₹150 000 crores. The removal of labour laws in SEZ's may result in unfair labour practices and poor quality of employment for workers employed within SEZ's. Furthermore, large corporate companies were taking advantage of acquiring subsidized SEZ land at the expense of agricultural farmers, resulting in further social inequalities and unemployment (Mukharjee, not dated: 16-20).

SEZ's have become less attractive since the introduction of minimum alternate tax; dividend distribution tax and the substitution of profit-linked incentives with investment-linked incentives. The introductions of these taxes lead to a decrease in exports from SEZ's. The government of India is looking at developing a new set of guidelines in order to enhance the productivity of SEZ's (The Economic Times, 2012b).



## **6.5 DEDUCTION IN RESPECT OF EMPLOYMENT OF NEW WORKMEN**

### **6.5.1 Background**

Section 80 JJ AA of The Income Tax Act (India, 1961), effective from 1 April 1999, provides a tax deduction to the industrial sector for additional jobs that it creates during a year. A deduction may be claimed if the increase in the number of workmen during the year exceeds 10 per cent of the number of workmen on the last day of the preceding year of assessment. Eligible companies may claim a 30 per cent additional deduction of the amount paid as wages to newly recruited regular workmen in excess of 100 workers. A regular workman excludes as casual workman, a workman that is employed through contract labour or any other workman that is employed for less than 300 days during the year. Companies are allowed to claim a deduction for three consecutive assessment years commencing from the year of assessment that the employment is provided (India, 2012).

### **6.5.2 Effectiveness**

No literature on the effectiveness of this incentive could be found. It is recommended that the effectiveness of section 80 JJ AA of The Income Tax Act (India, 1961) on job creation be researched in future studies.

## **6.6 DEDUCTION OF EXPENDITURE INCURRED ON SKILL DEVELOPMENT PROJECT**

### **6.6.1 Background**

Section 35CCD of the Income Tax Act (India, 1961) was introduced in 2012 with an effective date of 1 April 2013 (Anon, 2012). The section provides a tax deduction equal to one and a half times the expenditure incurred on specific skill development projects, excluding the cost of any land and buildings. Expenditure that is claimed under this section may not be claimed under any other section of the Income Tax Act, 1961.

## 6.6.2 Effectiveness

Since the incentive is not yet effective, no literature on the effectiveness of this incentive is available. It is recommended that the effectiveness of the section 35CCD of The Income Tax Act (India, 1961) on job creation be researched in future studies.

## 6.7 CONCLUSION

The government of India provides numerous tax incentives to support the creation of jobs. These include deductions for the employment of new workmen, deductions for expenditure incurred on skills development and tax incentives for export processing zones, export oriented units, software technology parks, hardware technology parks and special economic zones.

From these incentives, special economic zones, export oriented units and hardware and software technology parks were successful in creating jobs. However, the incentives for export oriented units, hardware technology parks and software technology parks have expired from 31 March 2012. The tax incentives currently available to SEZ's will also expire and will be replaced with investment linked incentives once the Direct Tax Code is implemented.

The success of SEZ's in India could be attributable to governments' proactive support for the development of SEZ's as well as the tax incentives provided to SEZ's. As mentioned above, the decrease in the number of SEZ's may be attributable to the introduction of minimum alternate tax, dividend distribution tax and the substitution of profit-linked incentives with investment-linked incentives. The success of EOU's, hardware technology parks and software technology parks may be attributed to India's powerful service sector and the provision of tax incentives. As mentioned above, the tax incentives provided under section 10A and 10B were expected to expire in March 2011. Thus, there was a decrease in the number of EOU's registered.

Export processing zones in India were not very successful in generating a significant amount of jobs. The effectiveness of tax deductions for employing additional workmen and

tax deductions for expenditure incurred on skills development could not be determined due to a lack of literature available.

The tax incentives that are available to support job creation in China will be discussed in the next chapter.

## CHAPTER 7

# TAX INCENTIVES THAT SUPPORT JOB CREATION IN CHINA

### 7.1 INTRODUCTION

China is the world's third largest country, in terms of land mass, after Russia and Canada. It has the largest population in the world with over 1.3 billion people. In 2010, China became the second largest economy in the world, moving ahead of Japan. Its average GDP between 2006 and 2010 was 11.22 per cent. The manufacturing sector is the most important sector in China followed by the service sector (KPMG, 2012:9-21).

Tax Incentives are provided at both state and local levels. The government of China provides tax incentives to promote investment in certain projects. These projects include high-tech enterprises, agriculture, forestry, major infrastructure projects, certain environmental projects and certain transfers of technology (Deloitte, 2011b:3).

The tax incentives currently provided by the Chinese government to create jobs in China are discussed below.

### 7.2 SPECIAL ECONOMIC ZONES

#### 7.2.1 Background

Special economic zones were established in China in the early 1980's to introduce economic reform after a devastating decade of Cultural Revolution. Shenzhen was the first SEZ set up in China followed by Zhuhai, Shantou, Xiamen, Shanghai Pudong New area, Hainan and Tianjin Binhai New Area (Zeng, 2011:9). There are currently seven SEZ's in China (Guo & Feng, 2007:3).

SEZ's were established to attract FDI, generate employment, increase exports, and advance new technology (Zeng, 2011:4-5; Yeung, Lee & Kee, 2009:223). In addition, one

important objective of the first SEZ's in China was to experiment with new policies and new enterprises for a market-oriented economy. Prior to 1978, China's economy was centrally co-ordinated (Zeng, 2011:8).

The new Corporate Income Tax Law, which became effective on 1 January 2008, withdrew the tax incentives provided to SEZ's. However, the new Corporate Income Tax Law provides for the grandfathering of tax incentives to foreign investment enterprises. Foreign investment enterprises established before the promulgation of the Corporate Income Tax Law that enjoyed a lower income tax rate are entitled to a gradual increase in tax rate to 25 per cent over a period of five years commencing from 2008. Unused tax holidays of foreign investment enterprises established before the promulgation of the Corporate Income Tax Law may be enjoyed until their expiry. However, if an enterprise has not enjoyed any tax holidays due to tax losses, the tax holiday will be deemed to commence from 2008 (PWC, 2008:54).

The main tax benefits that were available to SEZ's under the Income Tax Law on Enterprises with Foreign Investment and Foreign Enterprises and its Implementation Rules include (Ernst & Young, Not dated):

- A corporate income tax rate of 15% (compared to the normal 25%);
- A full tax exemption in the first two years; and
- Tax at the rate of 12.5% for the next three years.

### **7.2.2 Effectiveness**

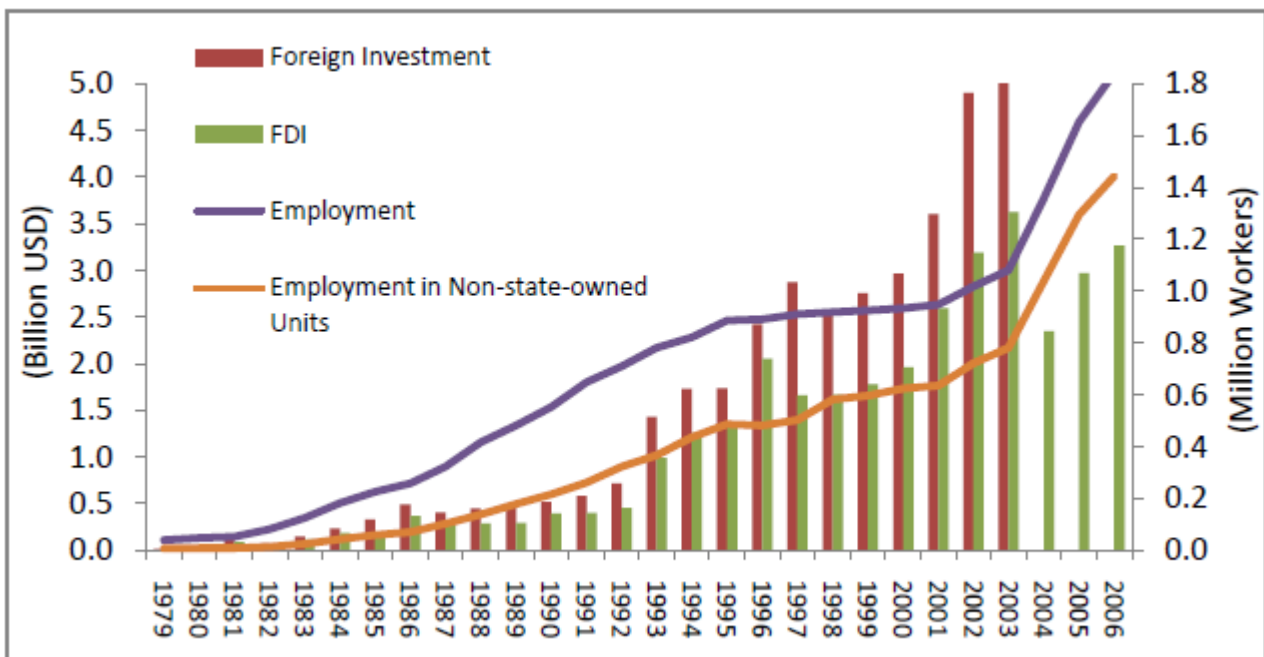
Special Economic Zones have contributed significantly in advancing economic reform in China and is largely responsible for developing the countries international competitiveness. SEZ's have contributed significantly to enhancing China's GDP, increasing exports, generating employment and attracting of foreign investment and new technologies (Guo & Feng, 2007:1-2; McCallum, 2011:6-8, Zeng, 2011:12-13).

The Shenzhen SEZ was particularly successful and has transformed over the past few decades from being a small fishing village to a major industrial and financial centre. Shenzhen attracted a significant amount of human and capital resources which assisted in

promoting a rapid economic growth, increased employment and reduction in poverty (Guo & Feng, 2007:1-5). In 2006, the first five SEZ's generated a total of 15 million jobs which accounted for approximately two per cent of the national employment (Zeng, 2011:13).

Figure 3 below illustrates the relationship between foreign direct investment and employment generated in Shenzhen from 1979 to 2006.

**Figure 3: Employment and foreign investment in Shenzhen, 1979-2006**



Source: Shenzhen Statistics Bureau, various years (McCallum, 2011:20-210).

Figure 3 illustrates that an increase in foreign direct investment is directly associated with a rapid increase in employment generated by the non-state sector. The non-state sector is mainly represented by foreign enterprises.

The success of China's SEZ's may be attributable to:

- Government's commitment to reform the country and a high-level of pragmatism. The government was determined to make changes and provided a supportive environment for economic experimentation within the SEZ. SEZ's are allowed to experiment freely towards a market-oriented economy (Guo & Feng, 2007:3; Zeng, 2011:15-16).

- SEZ's are provided with various incentives to encourage investment within the zones. These include the provision of low cost land, tax incentives, export tax exemption, duty free imports of raw materials and goods to be used for exportation, rapid custom clearance and favourable policies to attract skilled labour amongst others (Guo & Feng, 2007:4; Zeng, 2011:16).
- SEZ's are provided with political and economical independence. They are able to develop their own municipal laws and regulations and are entitled to govern and administer the zones. This entitled them to formulate new policies and methods that they considered necessary to improve economic development (Guo & Feng, 2007:8; Zeng, 2011:16).
- SEZ's are provided with strong support and proactive participation from government. These include the decentralization of power, an efficient regulatory and administration system, investment in infrastructure and the provision of various business services amongst others (Guo & Feng, 2007:8-10; Zeng, 2011:17)
- SEZ's are successful at attracting FDI due to the provision of various incentives and benefits provided to businesses operating within these zones. An increase in FDI may result in an increase in investment, the attraction of technologies and skills, increasing employment and the development of a local manufacturing capacity (Guo & Feng, 2007:11; Zeng, 2011:17-18).
- SEZ's have the advantage of a diverse population consisting of immigrants from across the country and overseas. This assists in creating an innovative and entrepreneurial culture within the zones (Guo & Feng, 2007:8-9; Zeng, 2011:22).
- They have clear objectives and benchmarks in terms of GDP growth, exports, FDI generation and employment revenues. There is also strong competition amongst the zones to attract new enterprises and reach their goals (Zeng, 2011:22).
- SEZ's consists of large geographical areas located in the coastal region linked to the international market. SEZ areas have easy access to major infrastructure such as airports, ports and railways. Furthermore they are specially set up next to economic hubs or neighbouring countries (Guo & Feng, 2007:3-4; Zeng, 2011:23).

## 7.3 ENTERPRISE ZONES AND INDUSTRIAL FREE ZONES

### 7.3.1 Background

China's trade zones are classified into special economic zones, enterprise zones and industrial free zones. The enterprise zones comprise of economic and technology development zone, high-tech industrial development zone and border economic cooperation zone. Industrial zones comprise of export processing zones, bounded zones and industrial parks (McCallum, 2011:18). The objectives of these zones include an increase in foreign direct investment, exports and research and development (Ernst & Young, Not Dated).

Each trade zone has its own package of tax and other incentives. Goods imported into industrial zones to produce goods for exports are free from customs duty and import taxes subject to approval by the customs authorities (KPMG, 2012:48). In addition, the import licence and quota system do not apply to goods imported into these zones (KPMG, 2012:51).

Export processing zones were entitled to a tax holiday of 50 per cent of the normal applicable tax rate for foreign invested enterprises producing goods mainly for export. However, this incentive was withdrawn when the new Corporate Income Tax Law was enacted (Deloitte, 2007:3). As at 2011 there were 16 Free Trade Zones and over 60 Export Processing Zones in China (KPMG, 2012:48).

The tax holidays granted to new technology and high-tech enterprises located in new technology and high technology development areas was also withdrawn under the new Corporate Income Tax Law. The new law allows for the grandfathering of certain tax incentives for state encouraged new technology and high-tech enterprises in the five special economic zone areas and Shanghai Pudong New area (Deloitte, 2007:3).

However, the new Corporate Income Tax Law expands the eligibility of tax incentives for high-tech enterprises in high-tech development zones to enterprises located throughout



the country. Tax incentives provided to high-tech enterprises are aimed at innovation and therefore will not be considered in this study (Deloitte, 2007:3).

### **7.3.2 Effectiveness**

Since the introduction of trade zones in the 1980's, the amount of FDI, imports and exports has increased substantially. The effect of FDI on employment was also substantial. The number of jobs generated by foreign-invested enterprises in all industrial enterprises tripled between 1995 and 2005. Between the years 2000 and 2005 China's total employment in industrial enterprises increased from 89.24 million to 105.20 million and the foreign-invested enterprises contributed to 56 per cent of this growth (McCallum, 2011:7).

Upon entering into the World Trade Organisation, the advantages available to Industrial Zones diminished (Zeng, 2011:12).

## **7.4 SELF-EMPLOYED GRADUATES**

### **7.4.1 Background**

Graduates, who start their own businesses within three years after leaving school, may be entitled to a tax deduction. Each individual enterprise is entitled to a maximum of 8 000 Yuan, (approximately R10 489), in annual deductions from sales tax, personal income tax, urban maintenance tax, construction tax and education surcharge (Lehman, Lee & Xu, 2010; Li, 2011; Xinhua, 2010).

The incentive was introduced by the government to increase employment and encourage entrepreneurship in order to create employment. Graduates that would like to claim the deduction must hold an unemployment registration certificate and apply for the incentive between 1 January 2011 to 31 December 2013 (Lehman *et al.*, 2010; Li, 2011; Xinhua, 2010).

## **7.4.2 Effectiveness**

No literature on the effectiveness of this incentive could be found. It is recommended that the effectiveness of this tax incentive on job creation be researched in future studies.

## **7.5 RE-EMPLOYMENT OF LAID-OFF WORKERS**

### **7.5.1 Background**

Enterprises involved in specific commercial and trading activities that recruit certain unemployed individuals are entitled to receive tax deductions. The enterprises are allowed an annual deduction of 4 000 Yuan from business tax, urban maintenance tax, construction tax, education surcharge and corporate income tax for each unemployed individual recruited (China Briefing, 2010; The Ministry of Finance and the State Administration of Taxation, 2010).

The unemployed individuals recruited must hold an unemployment registration certificate and be (China Briefing, 2010):

- a laid-off worker from a state-owned enterprise; or
- a laid-off worker as a result of state-owned enterprise bankruptcy; or
- a laid-off worker from collective enterprises established by SOE's; or
- other types of urban residents that are unemployed for more than one year and receive minimum standard subsidies.

Enterprises that would like to claim the deduction must apply for the incentive between 1 January 2011 and 31 December 2013. Enterprises are entitled to deductions for up to three years from the date of approval (China Briefing, 2010; The Ministry of Finance and the State Administration of Taxation, 2010).

## **7.5.2 Effectiveness**

The tax incentive was introduced in 2003 to promote the re-employment of laid off workers and has been amended and extended numerous times. By the end of 2008, enterprises claimed deductions amounting to 15.7 billion Yuan relating to the re-employment of approximately 6.8 million laid-off workers (Chen & Tian, 2011:41; General Office of the State Administration of Taxation, 2012; Xinhua, 2009).

## **7.6 DISABLED WORKERS**

### **7.6.1 Background**

Enterprises that employ disabled persons are entitled to a deduction amounting to 100 per cent of the salary expenses paid to disabled employees in addition to the actual salary expenses paid to disabled employees (EU SME Centre, 2012:9; Hong Kong Trade Development Council, 2009).

An enterprise that would like to claim this deduction must (Hong Kong Trade Development Council, 2009):

- enter into a legal labour contract or service agreement with the disabled employee for at least one year;
- provide an actual job in the enterprise for each disabled worker;
- pay monthly premiums for each disabled person, for basic old-age insurance, basic medical insurance, unemployment insurance and work-related injury insurance in accordance with the national policy provisions;
- make periodic wage payments to each disabled employee through a bank or other financial institution of not less than the minimum wage applicable to the locality of the enterprise; and
- be equipped with basic facilities for providing employment to disabled persons.

In addition, the Chinese government has promised to offer an additional tax incentive to enterprises that offer at least 25 per cent of their jobs to disabled person in order to promote the employment of disabled workers (Xinhua, 2011).

### **7.6.2 Effectiveness**

No literature on the effectiveness of this incentive could be found. It is recommended that the effectiveness of this tax incentive on job creation be researched in future studies.

## **7.7 CONCLUSION**

The government of China provides numerous tax incentives to support the creation of jobs. These include tax deductions for the employment of laid-off workers, tax deductions for youth employment, tax deductions for employing disabled persons and tax incentives to special economic zones, enterprise zones and industrial free trade zones.

The tax deductions for re-employment of laid-off workers assisted with the employment of a significant amount of laid-off and unemployed workers. The tax deductions for youth employment and for employing disabled persons could not be determined due to a lack of available literature.

The special economic zones, enterprise zones and industrial free trade zones have also assisted in generating significant amounts of jobs. The numbers of jobs created by tax incentives in China far exceed the numbers of jobs created by the other BRIC countries. Thus, South Africa should investigate the feasibility of implementing similar tax incentives to increase employment in South Africa.

## **7.8 SUMMARY**

The tax incentives that are available to support job creation in South Africa, Brazil, Russia, India and China were identified in chapters 3 to 7. These incentives include:

- tax deductions for the employing new workmen;

- tax deductions for employing disabled persons;
- tax deductions and allowances for skills development;
- reductions in payroll taxes;
- regional tax incentives;
- tax incentives for youth employment; and
- tax incentives for special economic zones, export processing zones, industrial development zones and enterprise zones.

The incentives were evaluated based on their effectiveness in creating jobs. The tax incentives that were most successful in generating employment include tax deductions for the re-employment of laid off workers, tax incentives provided to special economic zones and tax incentives provided to enterprise zones. China's special economic zones, industrial zones and enterprise zones were the most successful in generating substantial amounts of employment.

The effectiveness of many tax incentives identified in this study could not be determined due to a lack of literature available. It is recommended that the effectiveness of these incentives be investigated in future studies.

In the next chapter the tax incentives that are available to support job creation in South Africa will be compared with the tax incentives that are available to support job creation in Brazil, Russia, India and China to determine whether the tax incentives that support job creation in South Africa are on par with what is available in the other countries.

## CHAPTER 8

# COMPARISON OF TAX INCENTIVES THAT ARE AVAILABLE TO SUPPORT JOB CREATION IN SOUTH AFRICA, BRAZIL, RUSSIA, INDIA AND CHINA

### 8.1 INTRODUCTION

The purpose of this study is to perform a comparison of the tax incentives available to support job creation in South Africa with the tax incentives available to support job creation in the BRIC countries. This will be done to evaluate whether the tax incentives that are available to support job creation in South Africa are on par with what are available to support job creation in Brazil, Russia, India and China. The tax incentives that are available in Brazil, Russia, India and China for job creation that are not available in South Africa will be examined to determine whether the South African government may consider implementing such incentives.

The tax incentives available to support job creation in South Africa, Brazil, Russia, India and China and their effectiveness in creating jobs were discussed in the previous five chapters. In this chapter a comparison will be done to compare the tax incentives available in South Africa, Brazil, Russia, India and China that support job creation. In doing a comparison, the tax incentives available will be set out in table format.

The tax incentives that are common amongst South Africa, Brazil, Russia, India and China will be evaluated to determine whether the tax incentives available in South Africa are on par with those available to businesses in the other countries.

Where South Africa does not have an incentive which is currently available in Brazil, Russia, India or China the incentive will be evaluated based on its effectiveness in creating jobs in that specific country to determine whether South Africa should consider implementing the incentive.

## 8.2 COMPARISON OF THE TAX INCENTIVES AVAILABLE TO SUPPORT JOB CREATION IN SOUTH AFRICA, BRAZIL, RUSSIA, INDIA AND CHINA

A comparison of the tax incentives that are available to support job creation in South Africa, Brazil, Russia, India and China are set out below.

**Table 5: Comparison of the tax incentives available to support job creation in South Africa, Brazil, Russia, India and China**

Incentive	South Africa	Brazil	Russia	India	China
Tax incentives for employing additional workmen	None identified	None identified	None identified	An additional deduction amounting to 30 per cent of the amount paid as wages to newly recruited regular workmen in excess of 100 workmen	An annual deduction from certain taxes amounting to 4 000 Yuan for each unemployed individual recruited.
Tax incentives for youth employment	None identified	An incentive for youth employment exists but no literature on the details of this incentive could be found.	None identified	None identified	A tax deduction for graduates who start their own business. Each individual enterprise is entitled to a maximum of 8 000 Yuan in annual deductions from certain taxes.

Incentive	South Africa	Brazil	Russia	India	China
<b>Tax incentives for skills development</b>	<p>An annual tax allowance of up to a maximum of R30 000 per employee registered under a learnership agreement. A once-off completion allowance amounting to R30 000 multiplied by the number of consecutive 12 month periods covered by the agreement upon successful completion of the learnership.</p> <p>Additional investment and training tax allowances for approved industrial policy projects. The additional training allowance may equal to a maximum of R36 000 per employee over six years with a maximum of R20 million per project. If a project achieves preferred status, the total additional training allowance is increased to R30 million per project.</p>	None identified	None identified	Additional tax deduction amounting to one and a half times the expenditure incurred on certain skill development projects	None identified



<b>Incentive</b>	<b>South Africa</b>	<b>Brazil</b>	<b>Russia</b>	<b>India</b>	<b>China</b>
<b>Tax incentives for employing disabled workers</b>	The annual learnership tax allowance and completion allowance stated above is increased to R50 000 if the employee under the registered learnership is a disabled person	None identified	Reduced social security contributions for businesses that employ disabled employees and that meet certain requirements	None identified	Additional deduction amounting to 100 per cent of the salary expenses paid to the disabled employee
<b>Reduction of payroll taxes</b>	None identified	The social security tax for certain labour-intensive industries is temporarily replaced with a one per cent tax on gross revenues for the industrial sector and a two percent tax on gross revenues for the service sector.	Reduced social security contributions for businesses engaged in software development (14.5 per cent), businesses engaged in media activities (26 per cent) and businesses engaged in engineering activities (30 per cent)	None identified	None identified
<b>Industrial Development Zones / Export Processing Zones</b>	Raw materials and assets to be used in production may be imported into the zone free of customs duty and VAT.	None Identified	None identified	Tax exemption of profits and gains derived from the export of articles, things and computer software by an EPZ up until 1 March 2012.	Goods imported into industrial zones to produce goods for exports are not subject to customs duty and import taxes subject to approval by the customs authorities.

Incentive	South Africa	Brazil	Russia	India	China
Export Oriented Units/ Hardware Technology Parks / Software Technology Parks / New Tech and High-Tech Enterprises / Enterprise Zones	None identified	None identified	None identified	Tax exemption of profits and gains derived from the export of articles, things and computer software by a Software Technology Park and Hardware Technology Park operating in an EOU up until 1 March 2012. STP's are allowed to import certain products duty free.	Grandfathering of certain tax incentives for state encouraged new technology and high-tech enterprises operating in the five special economic zone areas and Shanghai Pudong New area. Expansion of tax incentives for high-tech enterprises located throughout the country (no longer restricted to high-tech enterprises in high-tech development zones)

Incentive	South Africa	Brazil	Russia	India	China
<b>Special Economic Zones / Free Trade Zones</b>	Proposed incentive	<p>A 75 per cent reduction of corporate income tax for a period of ten years. A reduction of import duties. An exemption from excise taxes. Deferment or reduction or exemption of sales tax on the importation of certain products. A presumed sales tax credit. Reductions and suspensions of taxes on gross revenue.</p>	<p>A free customs zone for technology-intensive enterprises. A reduction in corporate profit tax depending on the type of zone and the regional authority. An exemption from corporate property tax and transport tax for five to ten years depending on the region. An exemption from land tax. Accelerated depreciation for manufacturing and tourist zones. A reduction in salary related taxes to residents of innovation SEZ's. Unlimited time for utilising tax losses and a guarantee against changes in unfavourable tax law.</p>	<p>Grandfathering of tax incentives for SEZ units and SEZ developers. SEZ units are entitled to tax holidays, duty free imports, exemptions from central sales tax, service tax and certain local taxes. SEZ developers are entitled to tax holidays, an exemption from customs duties, excise duties, central sales tax and service tax.</p>	<p>The tax incentives provided to SEZ's expired in January 2008 when the new Corporate Income Tax Law became effective. However, the Corporate Income Tax Law allows for the grandfathering of tax holidays to foreign investment enterprises. The tax holiday provided for a full tax exemption in the first two years, 12.5 per cent tax rate for the next three years and thereafter a tax rate of 15 per cent compared to the normal tax rate of 25 per cent.</p>

Incentive	South Africa	Brazil	Russia	India	China
<b>Tax incentives for regional development</b>	None identified	An income tax reduction for certain businesses operating in the designated under-developed regions. A further tax reduction for businesses that maintain enterprises which significantly assist with the economic development of the under-developed regions. Exemption from merchant marine fee, tax on financial transactions and certain local taxes. Temporary tax incentives per <i>Brasil Maior</i>	None Identified	None identified	None identified
<b>State / Local / Regional Tax Incentives</b>	None identified	Individual states have the freedom and authority to provide a variety of incentives on taxes which they are entitled to levy. These normally take the form of an exemption, reduction or deferral of indirect taxes.	Almost all of the regions in Russia provide tax incentives in order to attract investment. These may include a 4.5 per cent reduction in profit tax, and a reduction of property tax or exemption from property tax.	None identified	None identified

## **8.3 SUMMARY OF COMPARATIVE STUDY**

### **8.3.1 Tax incentives for employing additional workmen**

India and China are the only countries that provide tax incentives to businesses that hire additional workmen. India's tax incentive is aimed at employing additional workers while China's tax incentive is aimed at the re-employment of laid-off or unemployed workers.

The effectiveness of India's tax incentive could not be determined due to a lack of literature available. It is recommended that the effectiveness of this incentive on job creation be investigated in future studies and by South African government.

The tax incentive provided by China assisted in creating a significant amount of jobs. Tax incentives amounting to 15.7 billion Yuan were claimed for the re-employment of approximately 6.8 million laid-off workers. This resulted in a cost of approximately 2 309 Yuan or R2 979 per job created (15.7 billion Yuan divided by 6.8 million workers).

It is recommended that the South African consider the feasibility of implementing a tax incentive similar to China's tax incentive for the re-employment of laid-off workers or unemployed workers.

### **8.3.2 Tax incentives for youth employment**

Brazil and China are the only countries that provide tax incentives for youth employment. The learnership tax allowance provided by South Africa may also assist in youth employment. However, the allowance is intended to promote skills development and is therefore discussed later in this chapter.

No information could be found on tax incentives provided by Brazil to support youth employment. It is recommended that the details and effectiveness of these incentives be investigated in future studies and by the South African government.

China provides a tax deduction to graduates who start their own businesses. Thus, the incentive has the advantage of creating employment for the graduate as well as other unemployed people that the graduate will hire in his business. However, the incentive does not provide a solution for young educated people who would like to gain skills and work in the formal sector. The effectiveness of China's youth employment incentive could not be determined due to a lack of literature available. It is recommended that the effectiveness of this incentive on job creation be investigated in future studies and by the South African government.

Since youth unemployment is a major concern in South Africa, the South African government should consider finding out more about the effect of these incentives and other options to help create jobs for the youth.

### **8.3.3 Tax incentives for skills development**

South Africa and India are the only two countries that provide tax incentives for skills development. This is an important policy for job creation as young and unskilled workers experience difficulty in finding jobs. There are currently two tax incentives available in South Africa to promote skills development. These include the learnership tax allowance and the industrial policy project training tax allowance. India provides a tax deduction amounting to one and a half times the amount incurred on any skills development project.

The industrial project allowance is expected to generate 1 618 direct jobs and 25 448 indirect jobs. This amounts to just over 27 000 jobs. This amount is insignificant compared to the 5 million jobs that the government aims to create according to the new growth path.

The effectiveness of South Africa's learnership tax incentive and India's tax deduction for skills development could not be determined due to a lack of literature available. The South African government should monitor and evaluate the effectiveness of the learnership tax allowance to determine whether the incentive is effective in generating skills and creating new jobs. It is recommended that the effectiveness of India's tax incentive on job creation be investigated in future studies and by the South African government.

It is evident that the South African government is committed towards promoting skills development in South Africa. South Africa provides the most tax incentives to promote skills development than any other country in this study. The South African government is commended for its efforts in this regard.

#### **8.3.4 Tax incentives for employing disabled workers**

South Africa, Russia and China provide tax incentives to employers that employ disabled employees. The tax incentives provided by South Africa are only available to disabled persons employed under a registered learnership agreement.

The effectiveness of the tax incentives provided by South Africa, Russia and China could not be determined due to a lack of literature available. The South African government should investigate whether unemployment amongst disabled workers is a major concern in South Africa and whether the learnership tax incentive has assisted with creating jobs for disabled people or if additional incentives are needed.

It is recommended that the effectiveness of both incentives on job creation be investigated in future studies and by South African government.

#### **8.3.5 Reductions of payroll taxes**

Brazil and Russia are the only two countries identified in this study that provide certain businesses with a reduction of payroll taxes. In Brazil the social security tax is temporarily replaced with a one per cent tax on gross revenues for certain industrial sectors and a two per cent tax on gross revenues for certain service sectors. In Russia, businesses that are engaged in software development, media activities and engineering activities may qualify for reduced rates of social security contributions. The social security contribution rates are reduced to 14.5 per cent for businesses engaged in software development, 26 per cent for businesses engaged in media activities and 30 per cent for businesses engaged in engineering activities.

The effectiveness of these incentives could not be determined due to a lack of literature available. However, since these incentives will reduce the payroll costs for employers, it may encourage employers to employ more people. It is recommended that South African government investigate the effectiveness of these incentives on job creation and the feasibility of implementing a similar incentive of this nature in South Africa. However, the policy should focus on long-term employment creation, thus the incentive should be provided over a longer-term instead of temporarily as in the case of Brazil.

### **8.3.6 Industrial Development Zones and Export Processing Zones**

Tax incentives for industrial development zones and export processing zones are more common amongst the BRICS. India, China and South Africa provide tax incentives to businesses operating within these zones.

The tax incentives provided by South Africa and China to businesses operating within industrial zones are similar. Both of these countries allow businesses to import goods used in production in the industrial zones free of customs duty and VAT. Businesses that operated within industrial zones in China were provided with tax holidays. However, the tax holidays have been withdrawn under the new Corporate Income Tax Law. India provides export processing zones with a tax exemption of profits and gains derived from exports up until 1 March 2012.

South Africa and India had very limited success in generating investment and employment within the zones. However, China achieved remarkable success in increasing exports, FDI and employment. As mentioned in Chapter 3, South Africa's IDZ's contain a number of weaknesses. It is recommended that the South African government performs a comprehensive study of IDZ's in South Africa in order to identify all the weaknesses of these zones and develop methods that will improve the attractiveness of these zones. It is recommended that the government compare the benefits provided by China's industrial zones with the benefits provided by South Africa's IDZ's as China's industrial zones have proved to be very effective.



### **8.3.7 Enterprise Zones / Export Oriented Units / New Tech and High-Tech Enterprises / Hardware Technology Parks / Software Technology Parks**

In India, tax incentives are provided to export oriented units, hardware technology parks and software technology parks until 1 March 2012.

Under the new Corporate Income Tax Law, the Chinese government allows for the grandfathering of tax incentives to new technology and high-tech enterprises, located in specific areas. In addition, the tax incentives for high-tech enterprises were expanded to high-tech enterprises located throughout the country.

Both countries attained a significant increase in exports, employment and FDI. It is recommended that the South African government consider the feasibility of implementing enterprise zones in South Africa in order to assist with job creation.

### **8.3.8 Special Economic Zones and Free Trade Zones**

Tax incentives provided to special economic zones and free trade zones are the most common incentive amongst the BRICS to support the creation of jobs. Brazil, Russia, India and China have already implemented special economic zones or free trade zones, while South Africa has proposed implementing special economic zones in the future.

The incentives provided by each country differs, however most countries offer some form of tax holiday together with the exemption of certain taxes and other non-tax benefits. Brazil, Russia, India and China achieved remarkable success in generating FDI and employment. China's SEZ were most successful in attracting investment and creating jobs however the tax incentives available to Chinese SEZ's will soon be replaced with investment linked incentives when the new Direct Tax Code is implemented.

It is important to note that the success of China's SEZ's were attributable to a number of factors and not only by the provision of tax incentives. Thus, it is recommended that the South African government carefully design and set up SEZ's so that it may achieve similar success enjoyed by China. It is recommended that the South African government perform

a comprehensive study to determine how South Africa may implement successful SEZ's by learning from the experience of other successful countries.

### **8.3.9 Tax incentives for regional development**

Brazil is the only country in this study that used tax incentives for regional development with the objective of creating new jobs. The incentives provided did not contribute to a significant increase in economic growth or employment. Therefore, it is not recommended that South Africa implement a tax policy of this nature.

### **8.3.10 Local / Regional Tax Incentives**

Brazil and Russia are the only two countries identified in this study that provide local tax incentives for job creation. The incentives provided by Brazil were successful in generating investment and jobs, however the provision of overly generous tax incentives could result in a negative effect on the country's economy. The effectiveness of regional tax incentives provided by the various regions of Russia could not be determined due to a lack of literature available. However, since most taxes in South Africa are levied at national level, local tax incentives may not be effective in creating jobs in South Africa.

## **8.4 CONCLUSION**

Through the comparative study performed in this chapter, it is clear that the South African government is committed to creating jobs. Tax incentives provided by the South African government to support job creation include:

- learnership tax allowance;
- industrial policy project allowance; and
- industrial development zones.

The South African government may expand the provision of tax incentives by referring to the tax incentives provided by Brazil, Russia, India and China, for example:

- tax incentives and other incentives for special economic zones or free trade zones provided by Brazil, Russia, India and China;
- tax incentives for businesses operating in enterprise zones provided by India and China;
- reforming the industrial development zone by learning from the example of China;
- reductions in payroll taxes for labour absorbing sectors provided by Brazil and Russia;
- tax incentives for employing additional workmen provided by India and China;
- tax incentives that support youth employment provided by Brazil and China; and
- expanding tax incentives for the employment of disabled persons provided by China and Russia.

## CHAPTER 9

### CONCLUSION

#### 9.1 INTRODUCTION

South Africa's unemployment rate is amongst the highest in the world and accounts for approximately two per cent of global unemployment. Unemployment inhibits a country's economic development and is associated with various socio-economic problems such as poverty, crime, violence and inequality.

The South African government recognises that unemployment in South Africa is a significant concern and is committed to creating new jobs. The new growth path aims to create five million new jobs by 2020 and 11 million new jobs by 2030.

Tax incentives have assisted in generating significant amounts of employment in countries such as Mauritius and Lesotho; however, it has not been able to generate significant amounts of investment or jobs in many of the other Southern African countries. Thus, tax incentives should be designed based on a countries local conditions and objectives. Furthermore, tax incentives cannot compensate for the deficiencies of a country's tax system, poor infrastructure and economic and political problems and will have very limited impact in a poor investment environment.

The purpose of this study was to compare the tax incentives available in South Africa to support job creation with those available in Brazil, Russia, India and China.

A comparative study of the tax incentives available to support job creation amongst the BRICS was done to:

- evaluate whether the tax incentives currently available to support job creation in South Africa are on par with what is available for businesses in Brazil, Russia, India and China; and

- evaluate whether the tax incentives that support job creation in Brazil, Russia, India and China that are not currently available in South Africa could be introduced in South Africa, so that South Africa could improve on its tax incentives to stimulate job creation, and thereby create more jobs.

Only tax incentives with the objective of creating jobs were evaluated in this study.

## **9.2 SUMMARY OF FINDINGS AND ANSWERS TO RESEARCH OBJECTIVES**

The South African government provides a number of tax incentives to support job creation in South Africa. These include the section 12H learnership tax allowance, section 12I industrial policy project training allowance and tax incentives to businesses operating in industrial development zones. In addition, the government has proposed tax incentives for businesses operating within special economic zones. Thus, it is clear that the South African government is committed to identifying various policies to assist with reducing unemployment in South Africa.

Tax incentives provided by Brazil, Russia, India and China include deductions for employing new workers, deductions for the employment of laid-off workers, deductions for employing disabled persons, tax incentives for youth employment, reductions in payroll taxes, tax incentives for regional development, local tax incentives and tax incentives provided to businesses operating in export processing zones, industrial development zones, enterprise zones and special economic zones.

Based on the comparative study performed, the tax incentives available to support job creation in South Africa are in some instances on par with the tax incentives available to support job creation in BRIC. Businesses operating within South Africa's IDZ's enjoy similar tax incentives as businesses that operate within China's industrial zones. However, the industrial zones of China previously provided businesses that operated within the zones with a tax holiday. Furthermore, the industrial zones of China have been established for many more years and have achieved more success than South Africa's IDZ's.

It is evident that the South African government is committed towards skills development. The South African government currently provides two tax incentives to promote skills development in South Africa. These incentives include the learnership tax allowance and industrial policy project training tax allowance. The only other country that provides tax incentives for skills development is India. Hence, the tax incentives provided by South Africa for skills development exceed the tax incentives provided by BRIC. In addition, only South Africa, Russia and China provide tax incentives for the employment of disabled workers.

However, as indicated in chapter 8, certain incentives were identified that are available in Brazil, Russia, India and China that are not available in South Africa, for example:

- tax incentives and other incentives for special economic zones or free trade zones provided in Brazil, Russia, India and China;
- tax incentives for businesses operating in enterprise zones provided in India and China;
- reductions in payroll taxes for labour absorbing sectors provided in Brazil and Russia;
- tax incentives for employing additional workmen provided in India and China; and
- tax incentives that support youth employment provided by Brazil and China.

The South African government should further investigate the effectiveness of these tax incentives and their suitability in the South African context and consider implementing similar tax incentives to expand its efforts of reducing unemployment in South Africa.

In addition, it is recommended that the South African government consider reforming the industrial development zone policy in order to increase the attractiveness of the zone to promote investment and generate additional jobs.

### **9.3 CONCLUSION**

It is evident that the South African government is committed to identifying policies that assist with the creation of new jobs in South Africa. A number of tax incentives were introduced by the government to assist in job creation. The industrial development zones

have created a total of 33 236 jobs and industrial policy projects are expected to create 1 618 direct jobs and 25 448 indirect jobs. The government should be commended for its efforts to reduce unemployment in South Africa. Nonetheless, it is essential that the government investigates further possible options including the tax incentives as set out in this study.

The tax incentives provided by South Africa should be monitored in order to ensure that the incentives are successful in achieving their objectives and that the incentives do not have a negative effect on the country's economy. It is also important that the South African government continues to evaluate the effectiveness of the tax incentives listed in this study and that the government does not only consider the effectiveness of tax incentives in creating jobs but also consider the overall economic effect that these incentives will have in South Africa.

Although tax incentives may assist in increasing employment, they should not be viewed as the main instrument for solving unemployment in South Africa. The government should consider other policies that focus on promoting economic growth, promoting a labour absorbing economy, labour market policies, improving education and skills development in order to effectively reduce unemployment in South Africa.

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