

## **ETI AND LTI UPDATE AND PARLIAMENTARY COMMITTEE SESSION 11<sup>th</sup> October 2016 AT PARLIAMENT**

### **1. POLICY CHANGES TO THE EMPLOYMENT TAX INCENTIVE**

- Briefing to the standing committee on finance on 2<sup>nd</sup> batch of the taxation laws amendment bill.
- Presented by Catherine MacLeod & Cecil Morden from National Treasury.

#### **a. BACKGROUND OF THE ETI**

- SA introduced the ETI in 2013 to draw additional young workers into employment and to provide young workers with work experience.
- ETI shares the cost of hiring between employers and government.
- ETI is one element of government's suite of employment policies. It is not meant to address all causes of the unemployment challenge.
- ETI complements existing programmes, like FET colleges and SETA's, expanded public works programme & community works programme and jobs funds.

#### **b. REVIEW OF THE ETI**

- The ETI will expire on 31 December 2016 unless there are legislative amendments.
- The incentive needed to be reviewed before the end of 2016 to assess its effectiveness and whether potential amendments would be required.
- Process of reviewing incentive has been dependent on data:
  - o Lags in data collection delayed process somewhat;
  - o NEDLAC consultations began in July, which meant that amendments could not be included in the July TLAB (as indicated in press release);
  - o Report on NEDLAC deliberations in final stages of sign-off
- Two options have been put forward in the draft legislation:
  - o Extension for 2 years;
  - o Cap of R20 million.
- Key research questions:
  - o Data in terms of jobs supported and created, cost and value of the claims;
  - o The sector/s and amounts where the ETI was claimed and whether that included vulnerable and Special Economic Zones;
  - o The firms, including SMEs formal businesses and manufacturing sectors, which received the incentive and their characteristics;
  - o Age group and the nature of the jobs supported;
  - o Evidence of any job displacement or job retention;
  - o General effectiveness and experience of the scheme and qualitative aspects.
- Evidence presented included:
  - o Quantitative analysis of the data;
  - o Qualitative reports.

#### **c. CURRENT DESIGN**

- Qualifying workers
  - o 18-29 years old;
  - o Earn higher than stipulated minimum wages, up to a maximum of R6000 per month;
  - o Qualify for 24 months per employer
- Qualifying employers
  - o Registered for PAYE, tax compliant;
  - o Formal, private sector (not government and SOEs)
- Value of incentive
  - o Formula based on monthly income
  - o Up to a maximum of R1000 per worker per month

- How it is claimed?
  - o Offset against monthly PAYE payable to SARS by employers
  - o Refund mechanism for any employers with insufficient PAYE payable
- Special Economic Zones – age limitation will not apply.

#### **d. RECAP OF THE PROBLEM THE ETI WAS TRYING TO ADDRESS**

- In SA labour market, being unemployed reduces chances of getting job
  - o 26.7% unemployment rate
  - o Of the unemployed in Q3: 2014 only 13% found jobs in Q4: 2014
- Young people are particularly at risk
  - o Among the young, 5 in 1 are discouraged or not economically active. This is compared 3 in 10 adults
  - o 53.7% unemployment rate for 15 to 24 year olds.
- This has a severe impact on our ability to reduce poverty and inequality.
- There are various reasons, but the most common explanations are:
  - o Perceptions of difficult labour relations and regulations make firms reluctant to hire untested workers.
  - o Inexperienced workers require training which firms are ill-equipped to provide
- Requires a multi-pronged approach to resolving unemployment
- The ETI tried to reduce the risks and costs associated with hiring younger workers, who tend to be inexperienced.
- Not likely to resolve all the problems in the labour market, but intended to increase likelihood that employers would employ more people.

#### **e. KEY FEATURES OF THE ETI**

- The ETI aims to stipulate employment of 18-29 year olds in the formal sector by reducing the risks and costs associated with hiring younger workers, who tend to be inexperienced.
  - o It targeted formal sector employers, by using a tax incentive. The Quarterly Labour Force Survey shows that the formal sector accounts for three quarters of young people's jobs.
  - o It sought to encourage new jobs, by only being eligible to workers who were hired after 1 October 2013, and by limiting the incentive to two years, by which time the worker will have received more skills.
  - o It sought to lower the cost of hiring an additional worker as an offset to the costs and risks described above
  - o It sought to prevent abuse by legislating that claims had to be linked to minimum wages and imposing heavy penalties on transgressors.
  - o It sought to avoid subsidizing higher earning young workers by lowering the amount that could be claimed beyond a certain point.
  - o It sought to prevent displacement of older workers by imposing heavy penalties for those who replaced older workers to access the incentive and possible disqualification by the Min of Finance.
- It sought to extend the incentive to all workers under special economic zones.

#### **f. PERFORMANCE OF THE ETI**

- Performance assessment based on 2014/2015 tax year
  - o Long data lags
  - o PAYE annual returns are filed in May, three months after end of tax year
- Take up of the incentive exceeded initial estimates
  - o Total revenue foregone (1 Jan 2013 – 31 March 2016): R6.06 billion. The initial estimates: R1 billion per tax year.
  - o Claimed by 45 751 unique employers
  - o Number of workers claimed for were also higher
- National Treasury's descriptive report indicates
  - o ETI claimed for 645 973 workers/individuals in 2014/2015
  - o That is 17% of workers between ages of 18-29 (PAYE registered)
  - o 57% of the said workers were not registered for PAYE the year before
  - o Strongest for workers that earn between R2000-R4000 pm

	2013/2014	2014/2015
Duration of ETI incentive	2 months	12 months
Number of firms claiming	13 399	32 368
Number of ETI supported jobs	134 923	686 402
ETI supported jobs as % of total jobs	1.02%	5.10%
Number of individuals in ETI supported jobs	134 196	645 973

#### g. CLAIMS BY SECTOR

- Sectors with the highest value of claims & number of jobs are:
  - o Financial and business services; Wholesale and retail; Agriculture
- Manufacturing has the largest number of employers claiming
- Claims by small firms (<50 employees) are high in:
  - o Manufacturing (64% of claiming firms)
  - o Financial and business services (70% of claiming firms)

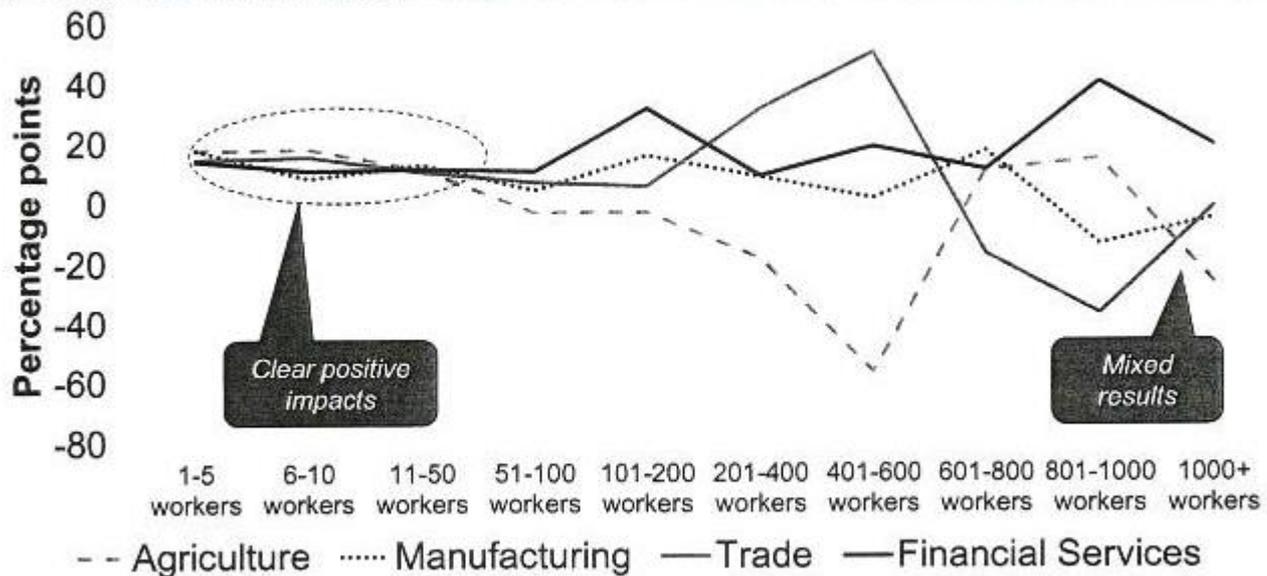
Industry	ETI claim (R mn)	# firms claiming ETI	% sector claiming ETI	% of jobs eligible for ETI	# supported jobs	% ETI supported jobs by ETI	Avg claim per firm (R)
Fin & bus services	807	7 111	11%	24%	244 503	26%	113 450
Trade	712	5 532	18%	38%	157 600	28%	128 703
Manufacturing	298	7 448	16%	19%	83 852	21%	40 077
Agriculture	259	3 041	18%	35%	96 667	26%	85 209
Tourism	148	2 246	26%	39%	38 549	28%	65 804
Non-gov Comm Serv	101	3 201	10%	20%	25 525	13%	31 401
Construction	60	1 728	13%	23%	19 297	19%	34 872
Transport	39	1 014	13%	13%	11 589	18%	38 350
Mining	19	392	18%	6%	5 491	19%	47 320
Utilities	10	317	11%	9%	2 534	21%	31 235
Unknown or errors	3	318	3%	16%	625	7%	10 243
<b>Total</b>	<b>2 460</b>	<b>32 368</b>	<b>13%</b>	<b>22%</b>	<b>686 418</b>	<b>23%</b>	<b>75 879</b>

#### h. KNOWN IMPACTS OF THE ETI FROM RESEARCH (I)

- Econometric research by Prof. N. Rankin (Stellenbosch University) & A. Chatterjee (NT) commissioned by Treasury shows:
  - o Significant positive impacts on employment growth of between 2.4 and 15.9 percentage points – depending on methodology
  - o Positive employment impacts most pronounced for smaller employers
  - o Finding robust for different estimation techniques
  - o Emerging evidence that wages for ETI-supported jobs are slightly higher than jobs in firms that don't claim ETI
  - o No findings of significant negative effects (i.e. displacement, wage suppression)
- Published research by Prof. V. Ranchhod and Arden Finn (UCT)
  - o Use the QLFS to estimate impact on 2014
  - o Did not find significant results of ETI on economy-wide employment levels
  - o Prof. H. Borat suggested that the QLFS might not be correct data set to test impact

## i. IMPACT BY SECTOR AND FIRM SIZE

Positive result indicates average increase in growth rate of employment for claiming firms (relative to non claiming). Negative results do not necessarily imply negative growth rates.



Four largest sectors in terms of ETI claims. Percentage point impact on growth rate of ETI eligible group. First differences estimate.

## j. KNOWN IMPACTS OF THE ETI FROM RESEARCH (II)

- Preliminary independent research using tax data
  - o Ms. A. Ebrahim, Prof. M. Leibbrandt & Prof. V. Ranchhod (SALDRU UCT) find that youth employment impacts are highest in employers with less than 200 workers but does not find an economy-wide impact on employment
  - o Ms. I. Makgetla (Yale) finds no evidence of an increase in hiring across firms.
- Qualitative review by Ms. Carmel Marock (Singizi Consulting), commissioned by Business
  - o Focus groups with 35 firms and 3 business associations
  - o Employers review it as an effective job creation tool
  - o Helped companies to retain jobs in the economic downturn
  - o Large businesses where able to retain workers after 24 months, though some workers left due to attractive alternative offers due to experience gained in first job
  - o Promotes tax compliance
- Survey of employers by National Treasury indicates
  - o 238 out of 720 (complete) respondents claimed the ETI
  - o Perceived to deliver on objectives, namely increase young employment & work experience
    - 56% say ETI positively impacted hiring – rises to 69% when firm claims ETI and the learnership
  - o Impact is lower where claims are automated or targeted employees form existing work force

## k. KNOWN IMPACTS OF THE ETI RESEARCH (III)

- Overview of existing evidence by Prof. H. Bhorat (DPRU, UCT)
  - o ETI compares favourably to the cost per job supported through other government programmes
  - o No evidence of wide-spread significant negative effects
  - o Displacement of older workers is "quantitatively small" – and only at the margin (i.e. employment of 30-35 year olds was still positive)
  - o Wage abuse or negative churn did not materialize
  - o Labour brokers did not benefit disproportionately

- Main recommendations:
  - o Continue with the ETI policy
  - o Cautiously positive – data limited to first year of implementation

## I. NT ANALYSIS OF DISTRIBUTION OF CLAIMS

- Analysis based on 2014/2015 tax data
- Impacts at upper end driven by small sample sizes

Limit	Total number of firms claiming at or above the limit	Total ETI claims in rands by firms claiming at or above limit	Total cumulative ETI claims in jobs by firms claiming at or above the limit	Simple average claim per job by firms claiming at or above the limit	Average of every claiming firm's average claim per job
R 20 million	8	R 448 232 140	92 767	R 4 832	R 4 603
R 10 million	19	R 597 591 959	139 375	R 4 288	R 3 899
R 5 million	41	R 757 467 250	181 582	R 4 171	R 4 009
R 3 million	87	R 929 763 278	229 606	R 4 049	R 4 072
R 2 million	129	R 1 033 673 277	256 466	R 4 030	R 4 142
R 1 million	271	R 1 236 521 357	315 958	R 3 914	R 4 112

### m. TLAB PROPOSAL 1: EXTEND THE ETI

- Current act includes sunset date of 31 December 2016
  - o National Treasury recognized that this is a new policy tool in the SA context
  - o National Treasury committed to review evidence of the policy impact before the sunset
  - o The evidence presented to date indicates emerging consensus of modest positive effects of the ETI programme.
  - o Negative effects did not materialize
- Proposal: Extend ETI for two more years
  - o Data for 2015/16 and 2016/17 will only become available with lags over this period
  - o Administrative arrangement: the proposed sunset date of 28 Feb 2019 aligns the ETI with the tax year (rather than the calendar year)
  - o No adjustments to value of incentive
  - o Includes clean-up and maintenance of definitional sections, and administrative sections.

### n. TLAB PROPOSAL 2: INSERT CAP ON MONETARY VALUE PER EMPLOYER

- Improve targeting of incentive – want to target employers where impacts are greatest
  - o Impacts in smaller firms is greater than in larger firms
- Want to limit the “redundancy cost” of the incentive
  - o Firms claim the incentive for activities they would have undertaken in absence of the programme – always present in incentive programmes.
  - o The ETI is administratively simple, so high claims are possible
  - o Represents a loss to the fiscus
- Fiscal space is more limited now than 3 years ago
  - o Take-up exceeded initial expectations
- Proposed cap: R20 million per employer per tax year
  - o Presents limits to claims – not an exclusion of employers
- Policy question: Balance between effectiveness and efficiency
  - o Employers with large claims also support large number of jobs
  - o Do not want to impede the positive impacts of the programme with a cap that is too low
  - o Do not want to risk fiscal losses with a cap that is too high
  - o Process of public comments intended to understand the impact of the proposed cap

### o. PROCESS OF STAKEHOLDER ENGAGEMENT

- Government engaged with social partners through NEDLAC, as input to the review process

- Government presented the broad policy proposals to NEDLAC partners
- Report on NEDLAC deliberations in final stages of sign-off
  - o Indicates scope of discussions and policy preferences

**p. VIEWS FROM SURVEY RESPONDENTS ABOUT ETI IMPACT**

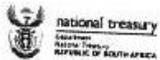
*"This is the system that will enhance the level of critical and scarce skills development and **better the employment opportunities for the young generation.**" – Health and safety trainer, Mining industry, Gauteng.*

***It reduces unemployment** under the younger generation that doesn't have a degree and it increases their opportunity of learning and growth and experience. – Tax practitioner*

*"Understanding the impacts of ETI has to be viewed against the timing of introduction when very onerous labor law provisions were introduced and employers had to adapt their businesses, these **labour law changes** ultimately discouraged hiring due to cost impacts." (Did not provide sector data)*

*"Allows us to **grow people into the business** at an affordable cost. We are able to be more aggressive in recruitment" – Owner, small employer (10-19 workers), retail, KZN.*

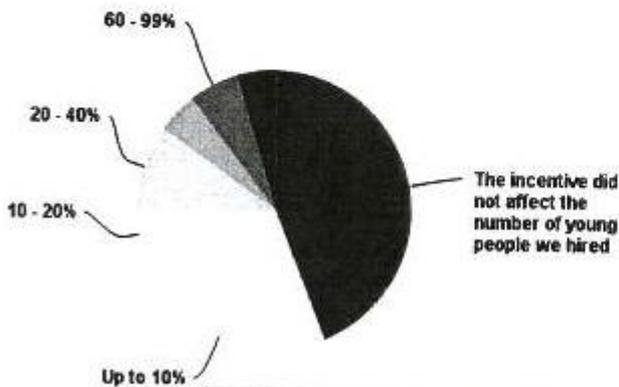
*"Due to the tax incentive, we have been able to maintain the level of wages, but increase the number of people we train. We were able to **afford to appoint more staff and give more people training**, without it negatively impacting our business." – Tax practitioner*



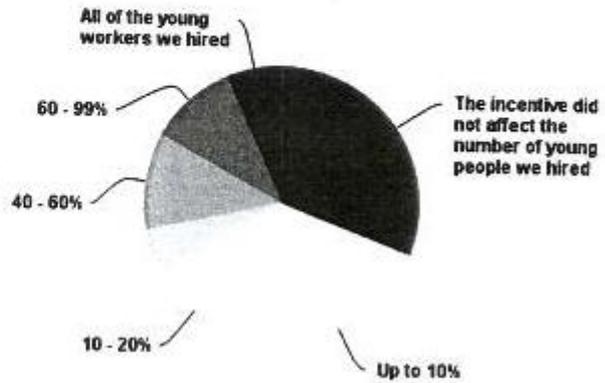
**q. FEEDBACK FROM NT SURVEY OF EMPLOYERS**

- Does the incentive affect hiring?

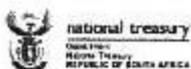
**Claimed ETI... 56% say yes**



**Claimed ETI and learnership... 69% say yes**



Proportion of young workers due to incentive	Mid point	Number	Weighted
None		0	97
Up to 10%	0.05	68	3.4
10 - 20%	0.15	26	3.9
20 - 40%	0.3	19	5.7
40 - 60%	0.5	26	13
60 - 99%	0.8	25	20
All of the young workers we hired	1	17	17
Total		278	
Weighted "Additionality"			22.66%



## **r. GENERAL COMMENTS IN MEETING**

- R1000 cannot be deemed as a living cost, the bar must be raised to at least R4000.
- Questions were raised in terms of the impact of the proposed cap.
- Questions were raised in terms of the abuse of ETI and whether there are any interventions.
- There is a concern in terms of the different views of Prof. Rankin and Prof. Ranchhod.
- Regarding labour brokers, not much was mentioned except for the comment that was made that COSATU will, once public hearings are held, object to ETI.
- Questions were raised on why NT is only focusing on certain age groups.
- Most questions were left unanswered by Treasury, but the chairman indicated that it is not a problem as everyone needs more time.
- Going forward, the following was discussed:
  - o The committee needs more information;
  - o The committee is to a certain degree convinced by Treasury, but it is work in progress and the grey areas need to be looked at;
  - o The committee does not want a situation where an employer employs 100 employees at R1000 pm;
  - o The committee supports ETI but with qualifications that members have put forward;
  - o The committee is very impressed with the report thus far, but it is not fair towards Parliament to make a decision now;
  - o It is strongly recommended to go ahead with public hearings and the process of these hearings will start today (11 October 2016).

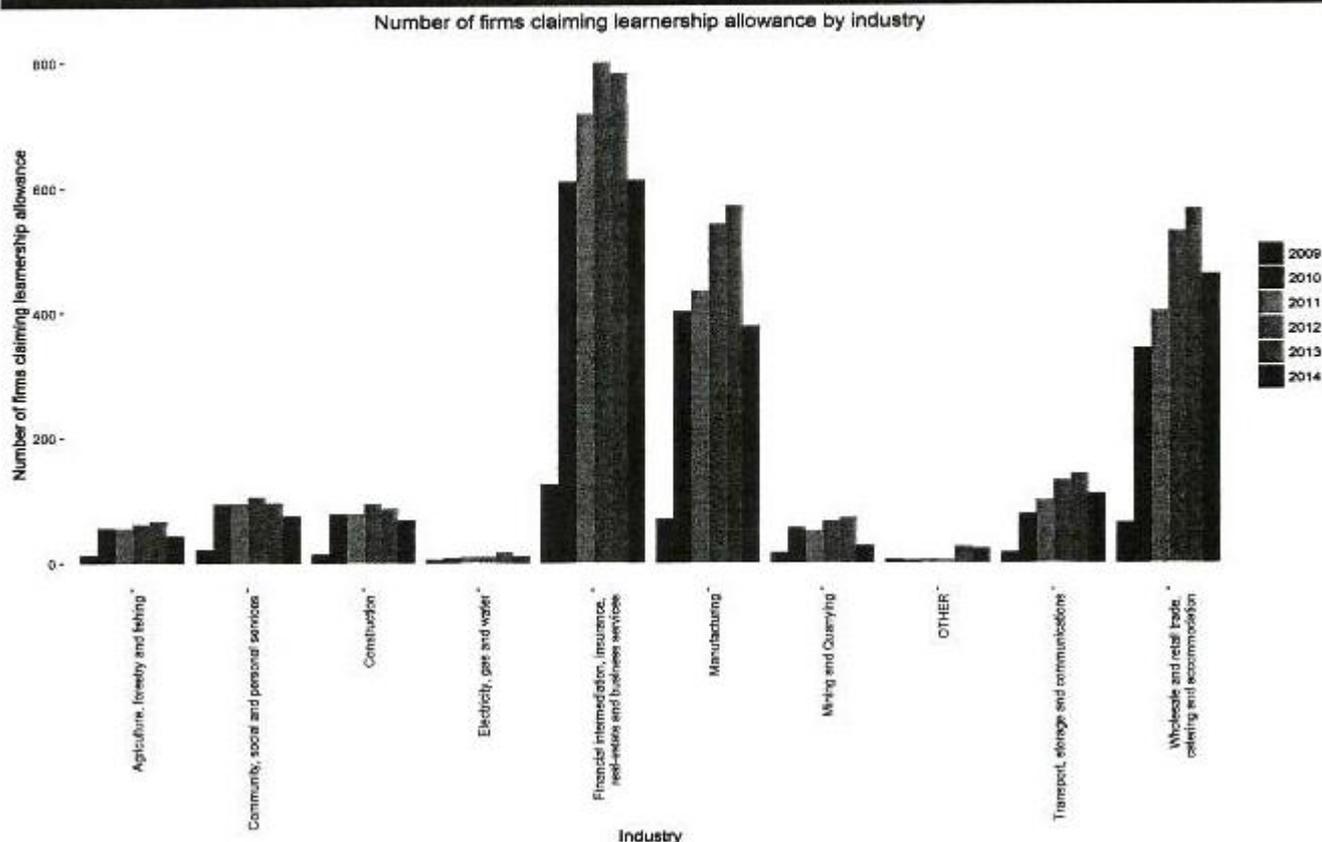
## **2. LEARNERSHIP TAX INCENTIVE REVIEW**

### **a. PURPOSE**

- Sunset clause for the LTI was on 1 October 2016
- National Treasury conducted a review to determine whether the LTI should continue, and if so, in what form
- Review aimed to understand if the LTI has been successful in meeting its objectives:
  - o Developed skill, reduced cost of training for employers, and assisted with job creation?
  - o Correctly targeted? Has it encouraged training in appropriate skills that match the workplace requirements employers are looking for, as well as skills that will be important for jobs in the future?
- Avenues for the review:
  - o Review of existing literature, including international experience
  - o Online survey on employment tax incentive and LTI
  - o Stakeholders submissions
  - o SARS tax administrative data analyzed

**b. UPTAKE OF LTI BY SECTOR – SARS ADMINISTRATIVE DATA**

# Uptake of Learnership Tax Incentive by Sector – SARS administrative data



**c. SUMMARY STATS ON LTI BASED ON SARS DATA**

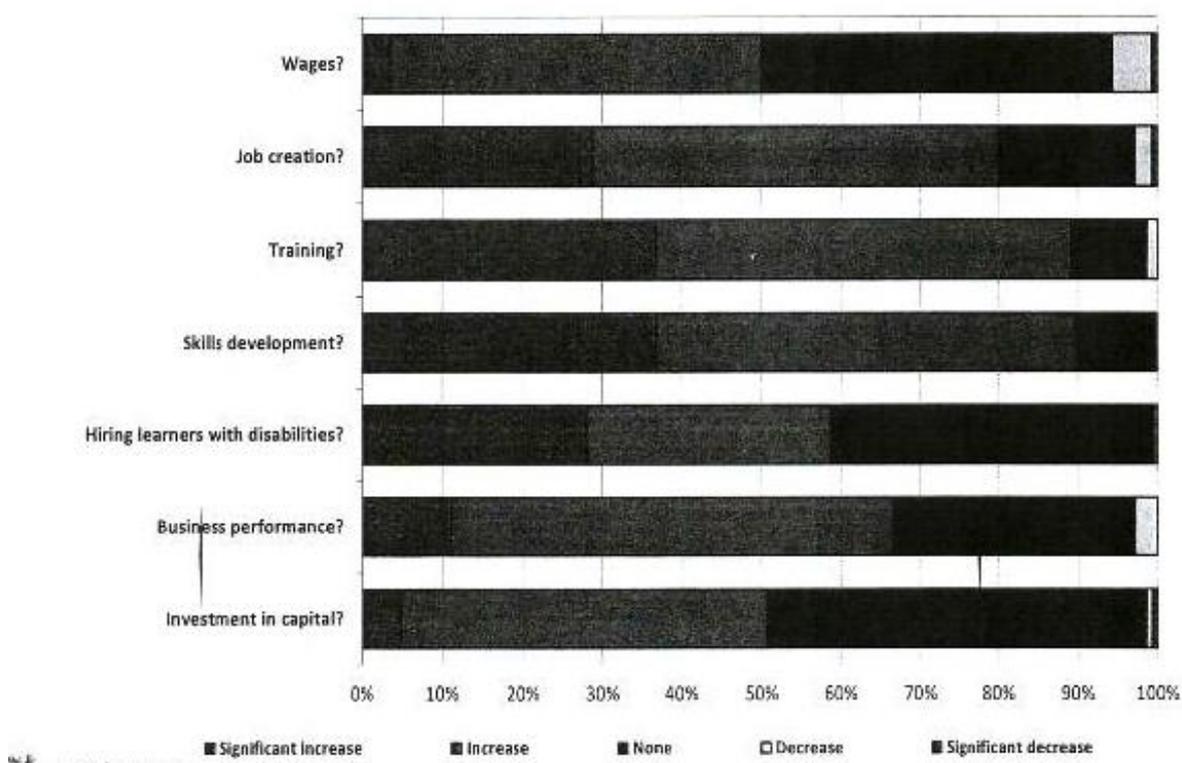
- Over the last 5 years an average of just over 700 finance sector firms per year claimed the LTI
- Manufacturing and wholesale and retail trade firms are the next biggest users of the LTI
- Between 2009 and 2014 the total value of claims attributable to the finance sector was R4.9 billion, accounting for 36.3% of total claims (R13.4 billion). Wholesale and retail, and manufacturing are the other big claiming sectors, together accounting for 35.5% of total claims
- Estimated number of learnership agreements / learners supported through the LTI = value of claims divided by R30 000
- Note that one of the reasons for the decline in the number in the Table below in 2013 and 2014 are due to incomplete data. The tax expenditure data are available with a considerable lag.

		2009	2010	2011	2012	2013	2014	Total
Number of firms	Registered (current year)	345	1,722	1,947	2,342	2,414	1,808	10,578
	Completed	4	13	63	443	935	636	2,094
Value of claims (R mil)	Registered (current year)	255.0	2,389.1	2,689.4	3,489.8	2,708.3	1,900.1	13,431.6
	Completed	0.7	26.6	126.8	862.9	1,765.1	688.9	3,471.1
Estimated number of learners								
	Registered (current year)	8,499	79,636	89,645	116,327	90,276	63,337	447,721

**d. NT ONLINE SURVEY – ETI AND LTI**

- May 2016 survey – aim to gather information from businesses on whether they have used the LTI, experiences of they have, and gauge if LTI achieving has achieved stated objectives.
- Sent on-line to business organizations and professional umbrella organizations, 1018 responses received, 720 complete
- Survey provided useful info on respondent's views of whether the LTI is working or not
- Opportunity for respondents to comment on how the LTI and administration thereof can be improved

**e. EFFECT OF LTI IN MEETING ITS OBJECTIVES – RESPONDENT'S VIEWS**



**f. SUMMARY OF WRITTEN SURVEY RESPONSES**

**Training & Skills**

- LTI makes skills investment cost effective
- Without LTI, senior staff more attractive
- Business model would probably change without LTI
- LTI increases willingness of employer to train
- Incentive aids company to train own technicians
- Some training courses are for limited value
- Make learnerships more relevant to business needs

**SETAs**

- Sort out the SETAs – not helpful in getting employees registered
- Admin process too cumbersome
- Would invest more if there was more SETA support
- Consider governing institutes to register learnerships
- SETA inefficiencies delay claiming exit allowance
- Difficulties in training providers formalizing qualifying programmes
- Administration has to be an online process
- Introduce strict performance criteria for SETAs

**Other suggestions**

- Reduce the administrative and organizational burden
- More marketing of the benefits of LTI
- Align to new nomenclature of the QCTO
- Deduction to be claimed in advance
- Convert the tax incentive to a grant

**Additionality ? – training of some professionals (e.g. CAs) will happen irrespective of LTI**

**Even if well-designed, LTI can only achieve its objectives if it can be efficiently administered**

### **g. MORE APPROPRIATE TARGETING OF THE LEARNERSHIP TAX INCENTIVE NECESSARY**

- Current design of the LTI does not focus on a particular qualification level or agreement type. All sectors are equally targeted
- Economic situation and skills development priorities have shifted:
  - o Government support should be targeted at workers that are most vulnerable to unemployment due to lack of relevant qualifications.
  - o Important that the LTI complements overall skills strategy of DHET. "Demand for occupational qualifications greatest at NQF levels 1 – 6" – DHET.
- Aligned with DHET policy priorities, our recommendations seek to encourage employers to train learners in those skill categories where demand is the highest
- More focused targeting of the LTI by prioritizing agreements with learners who have basic to intermediate skills levels and qualifications (NQF levels 1 – 6 related agreements to receive larger education)
- In line with achieving the NDP goal of producing 30 000 artisans annually by 2030.

### **h. PROCESS OF ENGAGING STAKEHOLDER**

- Public informed of the intention to review the LTI – Budget 2016 (Feb)
- Online survey of LTI to gather feedback on users' views on its efficacy and suggestions for improvement – May 2016
- All other submissions received from stakeholders taken into account
- LTI reviewed document and draft TLAB (2<sup>nd</sup> batch) released for public information – September 2016

### **i. RECOMMENDATION 1 – CONTINUATION BEYOND SUNSET DATE**

- The sunset date for the LTI should be extended from 1 October 2016 to 31 March 2022
- Given the outcome of the review process, there is sufficient evidence to support the continuation of the LTI beyond its current sunset date
- However, the review also highlighted challenges in the current system linked to the administration of the incentive; the need of more appropriate targeting of the incentive; and tools to promote the provision of better data for future policy analysis of the LTI are essential.

### **j. RECOMMENDATION 2 – EXTENSION**

- In addition to SETAs, allow other governing institutions that are accredited by SAQA to register learnerships in their respective fields of specialty
- SETAs are a key link in the LTI system in terms of administration
- However, SETAs have various problems that have a significant impact on the uptake of LTI
- Reducing the administrative burden on SETAs by broadening the number of accredited bodies through which learnerships can be registered which could alleviate a large portion of the bureaucratic delays currently experienced in the system
- The scope can be widened by including professional bodies accredited by SAQA and the Quality Council for Trades & Occupations (QCTO) in each sector to take some burden from the SETAs. Link to QCTO to place greater emphasis on training quality – key concern for many employers.

### **k. RECOMMENDATION 3 – TARGETING**

- Prioritize learnership agreements with learners that have basic to intermediate skills levels and qualifications
- HSRC studies note that the LTI provides a majority of high levels skills qualifications mostly concentrated in the financial sector
- Feedback on additionality relating to finance sector – would train even without LTI
- Current design of the incentive does not exclude any qualification level. The LTI should be designed to afford those with more basic to intermediate skills levels an opportunity to attain a qualification together with the experience in order to increase their chances of finding employment.

- This recommendation proposes narrowing the incentive by reducing the value of the deduction on respect of learners with qualifications between NQF levels 7 – 10.

**I. RECOMMENDATION 4 – DATA MANAGEMENT**

- Make completion of SARS IT180 form compulsory for firms claiming the LTI and for SARS to share the data with NT
- While SARS administrative data provides more info relating to the firms that claim the LTI, info relating to the learners themselves is not available at a sufficient level of detail
- Need greater data at individual level to trace the person entering the learnership up to the point where that individual hopefully finds employment
- This would enable a more effective assessment of the LTI in future

**m. MAIN PROPOSALS IN DRAFT TLAB 2016 (SECOND BATCH)**

- National Treasury proposes the continuation of the LTI until 31 March 2022
- All registered learnerships will still qualify for the incentive, however, our proposed targeting prioritizes learners with basic to intermediate qualifications by providing higher value claims.

**Learnership Tax Incentive Targeting Proposal**

	<b>Qualification</b>	<b>Proposed</b>	<b>Current</b>
Person without disability	NQF 1 - 6	<b>40,000</b>	30,000
	NQF 7 - 10	<b>20,000</b>	30,000
Person with disability	NQF 1 - 6	<b>60,000</b>	50,000
	NQF 7 - 10	<b>50,000</b>	50,000