PKF Taxation Services Limited

Expanding Counties' Tax Base & Sources of Revenue

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Areas to be covered

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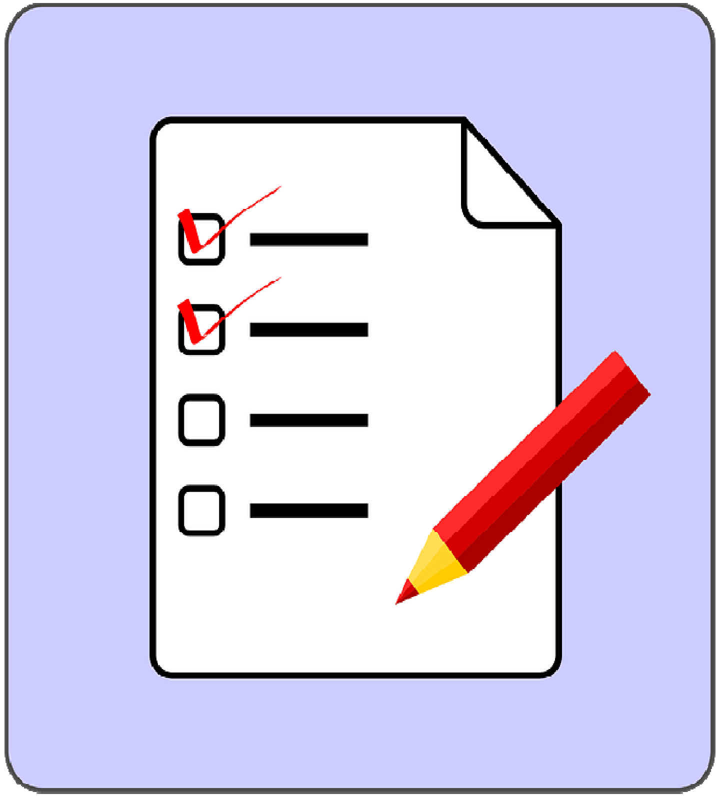
- Background
- County financing and revenue
- Alternative sources of revenue
- Recommendations
- A county case study



County Taxation: Background

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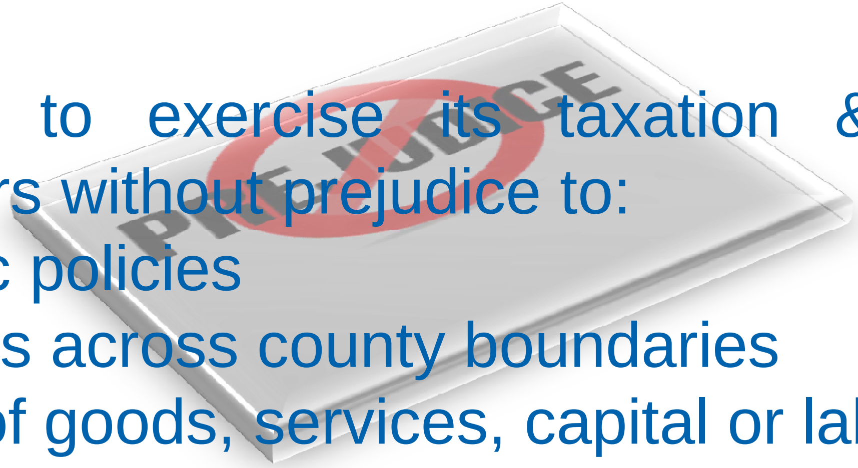
General Rules for Counties

Article 209(5) Constitution



County Government to exercise its taxation & other revenue-raising powers without prejudice to:

- national economic policies
- economic activities across county boundaries
- national mobility of goods, services, capital or labour

County Taxation: Background
Art. 209 (1), (2), (3) & (4) Constitution

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By the National Government

- Income Tax
- VAT
- Customs Duties + Other duties on imports & exports of goods
- Excise Duty
- Other taxes & duties as authorised by Act of Parliament
- Service Charges

By the County Government

- Property Rates
- Entertainment Taxes
- Other taxes & duties as authorised by Act of Parliament
- Service Charges

County taxation: A background

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Devolved Functions at March 2013:

- Agriculture,
- Control of all kind of pollution,
- Cultural activities,
- County transport,
- Animal control,
- Trade development and regulation,

County Taxation: A background

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- County planning and development,
- Preprimary education-village polytechnics-homecraft centres-childcare facilities,
- Natural conservation,
- Public works and services,
- Firefighting services and disaster management,
- Control of drugs and pornography, and
- Participation of community .

County taxation: A background

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- The Constitution provides for a phased transfer of functions from national to county governments within 3 years after the 2013 elections depending on the capacity that the counties have.
- The counties currently receive a minimum of 15% of the National revenue while in South Africa, local governments receive 25%-30% of the national revenue.
- This amount may prove to be inadequate for counties to perform both decentralized government and local government functions as envisaged by the Constitution.

County financing: The Reality

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- In the financial year 2013/2014, counties cumulatively budgeted for Kshs. 277.4 billion to finance their expenditure. This comprised of Kshs. 210 billion grant from the National Government, and Kshs 67.4 billion to be generated from local revenue sources.

- This means that own revenue for the financial year 2013/2014 accounted for 25%. This goes to show that counties rely heavily on resources from the national government and that they cannot sustain their operation if the only source of revenue was from their own revenue.

County financing: The Reality

- For the 1st quarter of the year 2013/14. Nairobi City County raised the highest amount of local revenue at **KShs. 1.3 billion**, followed by Narok County and Mombasa County which raised **KShs. 754.2 million** and **KShs. 207.5 million** respectively.

- Lamu, Garissa and Tana River collected the lowest revenues at **KShs. 5.1 million**, **KShs. 7.2 million** and **KShs. 8.2 million** respectively.

County financing : The Reality

- West Pokot County generated the highest proportion of revenue in the first quarter against its annual revenue target at 32.5 per cent followed by Busia and Baringo at 27.5 per cent and 23.1 per cent respectively.

- Some counties encourage lump sum payment of revenue by giving competitive rates to those who make one time payments. This way they reduce leakage and maximize collection in the first quarter.

County financing: The Reality

In a recent study carried out it emerged that:

- 37% of the counties sampled relied on single business permits as their core sources of local revenues;
- 32% relied on user-fees and charges
- 31% of them relying on property rates. This is partly because the rate of urbanization within counties is low.

County financing: The Reality

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- Counties often miss its revenue potential within their administrative boundaries mainly because of:

➢ overdynamic and unproductive political processes,

➢ lack of reliable and updated data,

➢ low institutional capacity.

- It is believed that existing local revenues from property taxes are collected from 70% of potential property tax payers, and only 40% of the total amount of its potential values. In other words, the property taxes collected only 28% of its penetrable potential.

Alternatives for financing Counties

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- **Joint Authorities and Joint Committees**: these can be set up as provided for under Article 189 (2) to facilitate cooperation of the national government and county governments or between two or more counties for the performance of the functions of county governments including the provision of county infrastructure and services.
- **County Government Corporations and Companies**: county governments can set up their own county-level corporations (e.g. the current water and sewerage companies that are wholly owned by local authorities).

Alternatives for financing Counties

- **State Corporations**: county governments can also contract state corporations falling under the National Government for the latter to provide both finance and management of county infrastructural projects and management contracts or concessions.

- **Public-private partnerships (PPPs):** Infrastructure PPPs are cooperative ventures between the public sector (county governments) and the private sector built on the expertise of each partner that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards.

Alternatives for financing Counties

The Public Procurement and Disposal Regulations (2009) of Kenya identifies five types of partnerships that can be adopted for the delivery of county infrastructure:

(1) Management Contracts (MCs). MCs are short term PPP arrangements under which the public sector procuring entity entrusts private companies with management services on a contract term for a defined period. The public sector retains ownership and control of the capital assets.

(2) Leases: When the public sector leases an asset to a private entity on determined periodical rental sum for a specified period of time and the entity manage, operate and maintain the facility in exchange of fees or charges from consumers of the service provided.

Alternatives for financing Counties

(3) Concessions: concessions, is when the public sector leases an asset to the private sector for a period of time at a fee and share of profit with the private sector and the public sector sharing the risks. The concessions normally covers a period not exceeding 30 years under which the private party maintains, rehabilitates upgrades and enhances the facility under consideration in the course of the concession.

(4) Build-Own-Operate Transfer (BOOT): these are long term PPP concessions in which private companies invest, build, operate and own infrastructure until capital is recovered through fees under a concession from the county, and the facility in question is then transferred back to the county government.

Alternatives for financing Counties

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(5) Build-Own-Operate (BOO): contracts where the private sector invests, builds and permanently owns asset under contractual terms that secure public interest under county supervision.

Other types of PPPs that county governments can utilize are:

- Design-Build-Maintenance (DBM);
- Design-Build-Operate (DBO);
- Build-Lease-Operate-Transfer (BLOT);
- Design- Build-Transfer-Operate (DBTO);
- Design-Build-Finance-Operate (DBFO) also called the Private Finance Initiative (PFI) in Britain; and
- Purchase-Upgrade-Operate (PUO).

Alternatives for financing Counties

Borrowing

- The Constitution and the Public Finance Management Act 2012 provide conditions under which national and county governments may borrow. Article 212 of the Constitution permits county governments to borrow funds for development provided they obtain a guarantee from their respective county assemblies.

- Section 50 of the PFM Act provides obligation and restrictions on how national government guarantees and borrows.

- Section 58 confers upon the Cabinet Secretary responsible for Finance the power to guarantee loans (including those of county governments), which must receive parliamentary approval. Sections 140, 141, 142 of PFM Act specifically provide conditions under which county governments can borrow.

Alternatives for financing Counties

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Grants and Donations

- County governments can obtain grants from development partners except that the approval must be given by the County Executive member for finance, rather than the national Cabinet Secretary for Finance.

- This is in accordance with section 138 and 139 of the Public Finance Management Act, 2012. This provides conditions for receiving grants and donations by county governments, its entities or third parties.

Alternatives for financing Counties

Grants and Donations

- According to the budget implementation review report by the controller of budget, 13 county governments reported to have entered into agreements with development partners to fund development programmes.

- They include: Mombasa, Isiolo, Meru, Kitui, Makueni, Siaya, Kisumu, Homa Bay,West Pokot, Nyamira, Baringo, Nakuru and Bomet.

Solutions: Counties leading the way

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- In 2014, Bungoma county began the transition from manual revenue collection system to fully automated collection system by digitalizing their revenue collection system.
- The purpose was to introduce a single tax collection mechanisms and curb double taxation of local traders who have had to pay fees to different local authorities.
- implementation of effective enforcement for payment compliance and enacting internal accountability

Solutions: Counties leading the way

- Counties such as Meru and Nakuru have partnered with the private sector including banks to automate their revenue collection systems in order to seal the collection loop-holes and enhance their own revenues.

- Through partnerships with private sector like Governor Dr. Alfred Mutua of Machakos County when initiating a settlement project that got pledges worth Kshs 289 billion.

Solutions: Counties leading the way

Nakuru, Elgeyo Marakwet, Turkana and Kakamega have entered into PPPs:

- Nakuru on large scale farming,
- Elgeyo Marakwet and Turkana on provision of health-care
- Kakamega on fencing of the Kakamega forest
- Trans-Nzoia has also partnered with the private sector on town cleaning.

Recommendations to reduce inefficiencies

- There must be a consistent effort to ensure a proper and integrated revenue management that guarantees the collection of all potential revenue in a manner that is efficient, effective and accountable.

- County governments invest in technology through automation of the revenue collection and administration process. Automation will eliminate leakages and contribute toward achievement of the set revenue targets.

Recommendations to reduce inefficiencies

- Revenue administrators and collectors need to be facilitated through regular capacity building on new and emerging trends in order to keep abreast with the new ways and systems as well as international standards.

- Invest in mobility e.g. through motorbikes and or automobile in order for revenue administrators to move swiftly through a greater area of deployment. This way, fewer revenue collectors will be required translating in to less administration cost.

A county case study: Kiambu

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- Kiambu County Government collaborated with UN-Habitat to develop a program that seeks to achieve three main purposes:

1. Increased revenues to deliver better services to Kiambu citizens.
2. Improved capacity to administer revenue management system innovatively and accountably with an expanded tax base
3. Expanded own local revenue sources to meet local needs and ensure stable and predictable local revenues

A county case study: Kiambu

- The program adopted an approach which would result in:

1. A good integrated revenue management system that will ensure that all potential revenues collected in an efficient and effective manner with accountable process and results,
2. Boosting local economic development and income generation leverages untapped local potentials which in turn strengthening Kiambu county's revenue stream and widening its tax base.
3. Public participation to ensure that the revenues stream is stable, predictable and clearly aligned to public services in a fair and accountable manner.

A county case study: Kiambu

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Benefits of good revenue management

- An integrated revenue management would ensure a revenue administration that includes identification and registration of tax payers, subscribers and beneficiaries, billing, collection and enforcement of payments.
- Automation of the administration process with information technologies may support accurate, timely and accountable revenue administration.
- Internal accountability within the county also plays a very important role to avoid the leakages, informal payments and inefficiency of revenue administration costs. Action aid in 2011 notes that potentially 30%-70% more revenues can be billed and collected at local levels if the revenue administration is conducted in a professional manner.

A county case study: Kiambu

Strategies to mobilize collected revenue

Kiambu may utilize these strategies to mobilize collected revenue through its systems and procedures:

- connecting revenue collection to service provision;
- charging cost of service provision to beneficiaries;
- ensuring user charges to expenditures aggregately and or by services; and
- improving revenue collection efficiency using historical or benchmarking results and better communication strategies.

A county case study – Kiambu

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Boosting Local Economic Development

- Creating the right mix of the economic ventures initiated by the county government to stimulate local development: infrastructure, leveraging public lands into development with private partners, creating enterprise centres, and others.

- Identifying, adapting, and establishing organizational/governance frameworks for the ongoing management of development processes in the different phases (start-up, institutionalization, and ongoing operation).

- Creating the financing instruments, public/private partnerships, financial support services, and tax revenues/incentives, bonds, land banks and other tools

A county case study – Kiambu

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Boosting Local Economic Development

1. Project/venture promotion that grows out of publically owned lands by the county:

- Extensive lands in the markets that are in prime real estate locations
- Publically owned housing that is highly undervalued in terms of rents and in terms of the potential for joint ventures with private developers and upgrading of housing
- Public facilities such as the arena can be utilized for multiple urban purposes e.g. parking, festivals, commercial supplementary businesses

Boosting Local Economic Development

2. Utilizing the geographic location of Kiambu County along the major trans-Africa transportation corridor and leveraging the agricultural based economy in proximity to the capital city of Nairobi/

- logistical service centres around the transportation industry
- Leveraging the Agro-processing industry and the creation of County managed industrial parks
- Organizing the farmers in an effective forum to promote common interests and development.

A county case study – Kiambu

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Boosting Local Economic Development

3. Leveraging the construction industry into Local Economic Development ("LED")

- Identification of strategic location of economic anchors and land use/allocation policy - Integration of LED into urban extension planning
- planning as tool for leveraging land values for local development in new residential neighbourhoods
- Linking residential demand with infrastructure development

A county case study – Kiambu

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Boosting Local Economic Development

- Dealing with the issue of waste management (liquid and solid) as a resource rather than as hazard, e.g. recycling sewage into water for agriculture and processing solid waste into a source for fertilizer and energy. Especially here there is potential for public economic action that could reduce costs to agriculture and agro-processing.

- Use public ownership of land (purchasing land or acquiring land in lieu of unpaid taxes) and then leverage it with private partners into local development anchor projects

A county case study – Kiambu

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Boosting Local Economic Development

- The upgrading and expanded use of a public attraction or facility such as the football stadium can be done on the basis of a public investment whose return will come from future increased tax revenues and rents to be paid by the new business located in commercial space of an expanded stadium.

- The placement of commercial businesses within the stadium could create a "captive market" of people attending sports events who can then easily access commercial services in the same location.

A county case study – Kiambu

Boosting Local Economic Development

- Kiambu county can use public funds to purchase land possibly in cooperation with a private investor and then leverage that ownership into an income producing venture such as an industrial park.

- The intention is both to stimulate economic activity and return the public investment that can again be reinvested to promote other such ventures.

A county case study – Kiambu

Boosting Local Economic Development

- The public funds can also be used to cover development costs of high expense infrastructure, by the leveraging of public resources – land, water, minerals or other, so as to be available to private initiatives.

- This could be structured as a straight ***"sale"*** or ***"leasing"*** of the public good or used as the equity in a joint public-private venture that generates income to the public coffers. It could also be a *BOT (build operate transfer)* venture in which the private entrepreneur is given the right to operate a public service in return for financing the construction cost of the infrastructure/facility. This is particularly appropriate for sewage treatment, energy, and industrial park developments.

Potential sources of increased revenue

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- Invest in ICT and cross-institutional engagements to realize maximum impact in own revenue collection;

- Leverage on domestic tourism as a source of revenue;

- Maximise on business licences and in so doing, develop the most economic approach to collecting this revenue. This may involve partnering with the KRA;

Potential sources of increased revenue

- Create a favourable environment that supports entrepreneurship and attract investments through reform of the business regulatory frameworks. This will enhance volumes of trade and consequently create taxation opportunities;

- Lobby for share of royalty payments from extraction of natural resources within counties;

Potential sources of increased revenue

- Develop a transparent and accountable system of incentives (reward) for early payments and disincentive (penalties) for those in tax arrears to promote compliance.

- Implement this tax compliance program including enforcement strategies in a robust change management approach.

- Develop and implement an effective, transparent, fair and accountable appeal system.

Potential sources of increased revenue

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- Private partnership in revenue collection: County Governments should partner with the private sector to devise innovative mechanisms of increasing their revenue collection and delivery of services;

- Public Private Partnerships, County Governments should seek avenues to partner with the private sector through:

  (i) Tapping into private capital to fund development initiatives;

  (ii) Outsourcing services from the private sector to enhance efficient and effective service delivery


Q&A