MOBILIZING RESOURCES FOR COUNTY DEVELOPMENT

PFM Seminar, Mt. Kenya Branch

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KEY FOCUS AREAS

County Governments Budget Implementation Review Report – Controller of Budget

Strategies for own resource enhancement

Policy on Counties Resource Enhancement

County Government Finance Bill

Key Features of Decentralization

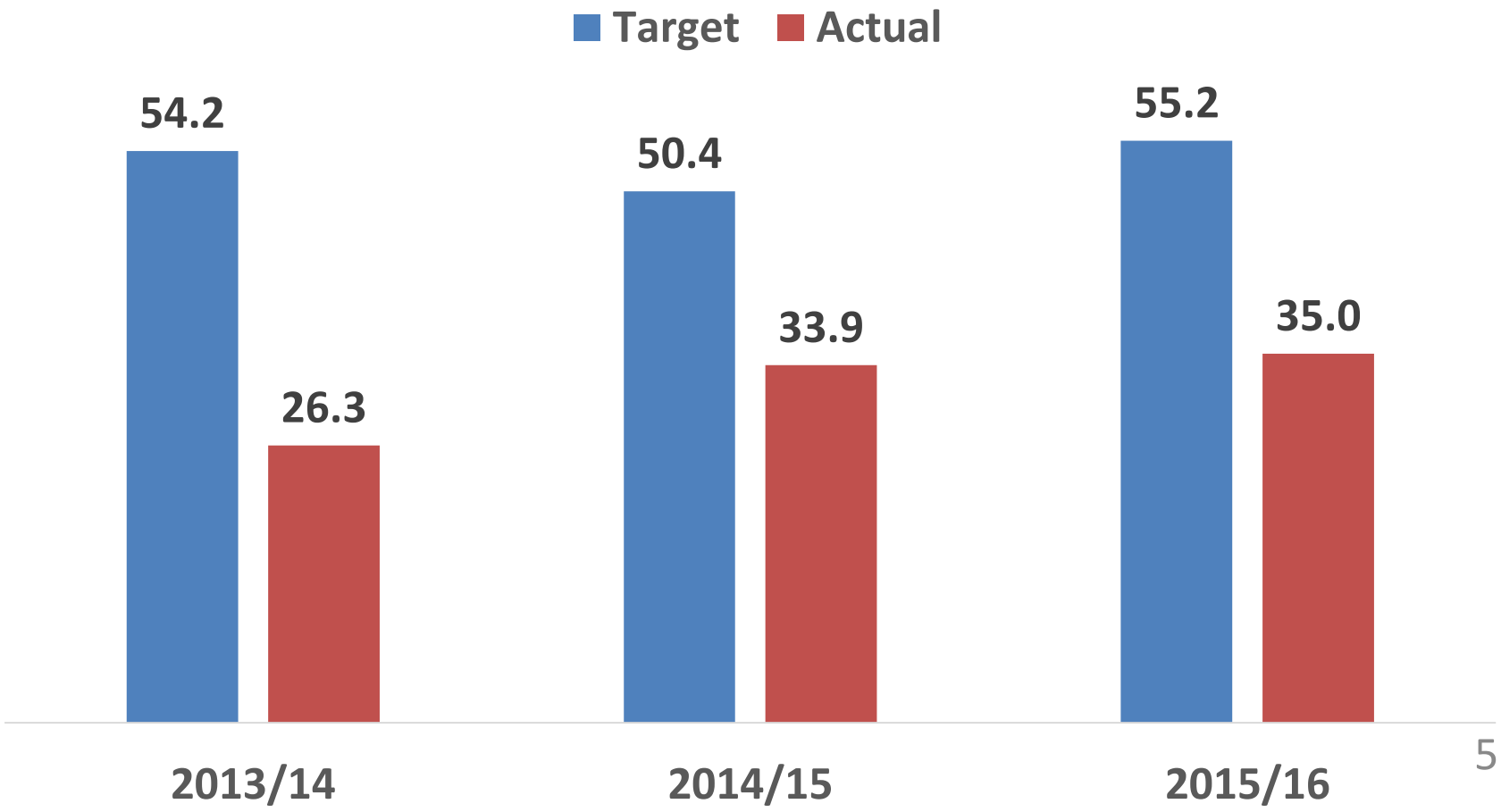
- Fundamental and simultaneous transitions – political, economic, fiscal, administrative. Far reaching impact.
- 'Big Bang' Fiscal Decentralization 2013: PFM Act 2012 and Regulations 2015, PPAD Act 2015
- Expenditure responsibilities for public service delivery decentralized to Counties
- Raises some very fundamental issues on administrative capacity, fiduciary management and accountability.

KENYA'S STORY SO FAR……

- **The aggregate budget estimates for the 47 County governments in FY 2016/17 amounted to Kshs.390.32 billion**
  - Recurrent expenditure Kshs.225.25 billion (57 per cent) and
  - Development expenditureKshs.168.07 billion (43 per cent).
- Development budgets remain scattered between the National and County governments – Conflicts likely.
- Counties remain highly dependent on fiscal transfers from National Government.
- Intergovernmental system of fiscal transfers is based on equalization fund, shareable revenues and taxes and Conditional grant.
- Borrowing is limited, needs approval by NT, thresholds
- Own source revenues limited but have increased over the past 4 years
- Data show trend of budgetary increases in the country

Kenya's Story so far……

The growth in counties' own-source revenue has slowed significantly



TAX TERMINOLOGIES

- **Tax** is a compulsory payment that does not necessarily involve the use or derivation of direct benefits from services, regulation or goods as defined in Article 209(3) of the Constitution.
- **User charge** is a charge for the use of a product or service and apply per use of the good or service or for the bulk or time-limited use of the good or service i.e water services charge
- **User fee** is a charge, or impost payment paid as a necessary condition for using a public facility i.e parking fees, market fees, health facility user fees and park entry charges
- **License fee** is a fee charged in respect of permission granted to an entity to undertake a certain action and is mainly issued for regulatory purposes

CONSTITUTIONAL PROVISIONS ON COUNTY REVENUE GENERATION

- Art.202 - Provides Fiscal transfers;
- Art. 203 - The revenue raised nationally shall be shared equitably among the two levels of government and among 47county governments; criteria, >15%, Audit
- Art. 209- Counties with the powers to raise revenue; (Property rate, Entertainment, taxes)
- Art. 210 - Limitation
- Art. 215- CRA to make recommendations concerning the basis for the equitable share;
- Schedule 4 assigns the responsibility for trade development and regulation to County governments;

CONSTITUTIONAL PROVISIONS ON REVENUE GENERATION....

Power to Impose Taxes- Art. 209

National Government

Income tax;

Value-added tax;

Customs duties and other duties on import and export goods;

Excise tax.

CONSTITUTIONAL PROVISIONS ON REVENUE GENERATION....

Power to Impose Taxes- Art. 209

County Government

Taxation & other revenue-raising powers shall not be exercised in a way that prejudices national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labor.

Property rates;

Entertainment taxes; and

Any other tax that it is authorized to impose by an Act of Parliament

Service Charge

CONSTITUTIONAL PROVISIONS ON COUNTY REVENUE GENERATION….

- Art. 210 – Imposition of Tax
- (1) No tax or licensing fee may be imposed, waived or varied except as provided by legislation.
- (2) If legislation permits the waiver of any tax or licensing fee—
  - (a) a public record of each waiver shall be maintained together with the reason for the waiver; and
  - (b) each waiver, and the reason for it, shall be reported to the Auditor-General.
- (3) No law may exclude or authorise the exclusion of a State officer from payment of tax by reason of—
  - (a) the office held by that State officer; or
  - (b) the nature of the work of the State officer.

MAIN SOURCES OF FUNDING FOR COUNTIES

1. Exchequer Releases
2. Funds from Development Partners
3. Own Revenues
4. Borrowings

County Government Revenue

COUNTY BORROWING

PRECONDITIONS FOR GUARANTEE O LOANS

- The loan is for a capital project;
- the borrower is capable of repaying the loan, and paying any interest or other amount payable in respect of it;
- The financial position of the borrower over the medium term is likely to be satisfactory;
- The terms of the guarantee comply with the <u>fiscal responsibility principles</u>

POWER OF CABINET SECRETARY TO GUARANTEE LOANS

- PFM Act (section 58) grants the CS powers to guarantee loans
- The CS may guarantee a loan of a county government on behalf of the national government;
- That loan shall be approved by Parliament
- The PFMA sets preconditions for loans Guarantee

FISCAL RESPONSIBILITY PRINCIPLES

- over the medium term, the government's borrowings shall be used only for the purpose of financing development expenditure and not for recurrent expenditure;
- short term borrowing shall be restricted to management of cash flows & shall not exceed 5% of the most recent audited county government revenue.
- The county debt shall be maintained at a sustainable level as approved by county assembly;
- fiscal risks shall be managed prudently

FISCAL RESPONSIBILITY PRINCIPLES Contd ….

- The county government's recurrent expenditure shall not exceed the county government's total revenue;
- over the medium term a minimum of 30% of the county government's budget allocated to the development expenditure;
- The county government's expenditure on wages & benefits shall not exceed a percentage of the county government's total revenue;
- a reasonable degree of predictability with respect to the level of tax rates and tax bases shall be maintained.

Findings from COB Reports

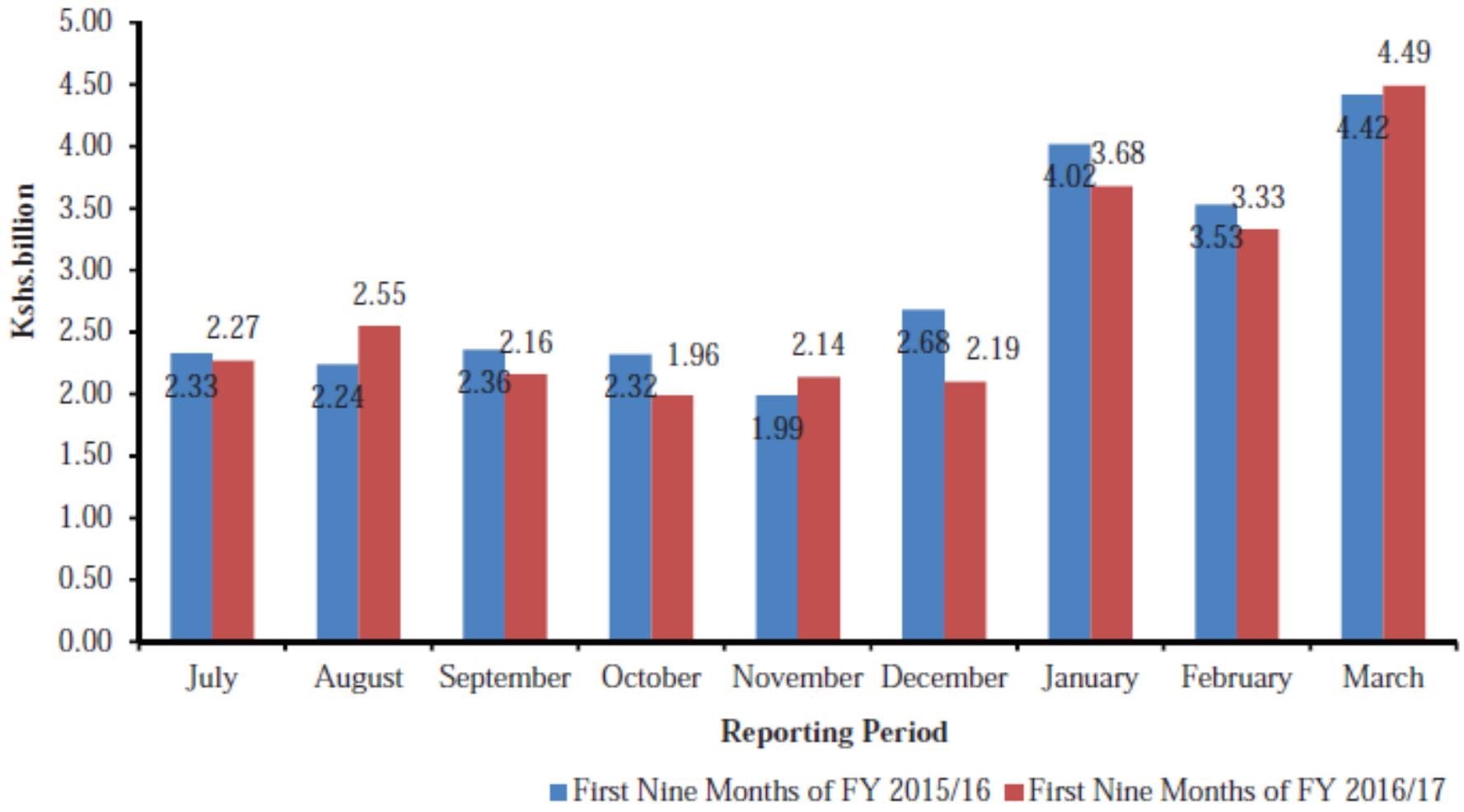
FY 2016/17 Total approved budgets for the County Governments amounted to Kshs.400.25 billion

- Kshs.234.73 billion (58.6 per cent) for recurrent expenditure and Kshs.165.51 billion (41.4 per cent) for development expenditure;
- Kshs.280.3 billion as the equitable share of revenue raised nationally
- Kshs.21.90 billion as total conditional grants from the National Government and Development Partners.
- Expected to raise Kshs.59.71 billion from local sources;
- Utilize Kshs.38.55 billion cash balance from FY 2015/16.

Performance on Revenue Allocation

- Total local revenue target for counties in FY 2016/17 Kshs.59.71 billion.
- During, 1st nine months County Governments generated a total of Kshs.24.71 billion, which was 41.4%.
- This was a decrease compared to Kshs.25.89 billion (46.9% of FY 2015/16 annual revenue target) realized in a similar period of FY 2015/16

Performance on Revenue Allocation



TO
SUFFICIENT
COUNTY RESOURCING

ROADBLOCKS TO SUFFICIENT COUNTY RESOURCING

- Weak accountability and by extension governance structures;
- Unpredictability of local revenues due to a lack of information, poor planning and implementation of the plans;
- Lack of capacity skills in counties to collect and effectively account for local revenues;
- Over dependence on National Government transfers;
- Lack of awareness by the small business enterprise on county taxation
- Limited research and innovation on the new tax sources
- Lack of appreciation of value by the tax-paying public in the services provided by the County Governments – **simply put, the public is often of the view that it does not get tax-worth of services from the county government and hence the sense of apathy would easily crop in**.

Roadblocks to sufficient County Resourcing(Contd 2)

- Inadequacy and lack of clarity on county revenue legislation
- Multiplicity of fees and charges
- Unclear and inconsistent process for issuance of waivers and variations
- Failure to anchor the fees and charges in clear policy and legislation
- High cost of revenue collection vis-à-vis yields
- Outdated laws on property taxation have presented a legal vacuum – property Tax
- The challenge of entertainment taxes is levied on activities of gambling, since they generate significant revenue yet there are others – poor definition & categorization
- Weak revenue administration - human resources capacity & low level of professionalism
- Low levels of automation and integration of revenue administration systems

Draft Policy to Support Enhancement of County Governments Own –Source Revenue

CONCERNS THAT TRIGGERED THE OSR POLICY

1) **the smallness of Counties' OSR and its diminishing share vis-à-vis total resources;**
2) **the manner in which Counties plan and budget for local revenue;**
3) **Legal questions relating to some revenue-raising measures;**
4) **Short- and long-term fiscal and macroeconomic ramifications of the measures; and**
5) **Utilization of collections as well as reporting and accounting procedures.**

Big Q? How each County can optimize its OSR within the existing rules of Public Finance Management (PFM)…….

COUNTY GOVERNMENTS SOURCES OF REVENUE

Source of revenue *(Figures in Kshs millions unless indicated otherwise)*	2013/14	2014/15	2015/16
Own source revenue	30,533	36,532	37,629
Transfers from National Treasury	187,239	225,650	260,709
Transfers from other government agencies	3,137	1,009	10,278
Proceeds from domestic borrowings	1,856	298	862
Proceeds from domestic & foreign grants	8	256	269
Reimbursements & refunds	7	994	118
Grants received from other levels of government	0	36	100
Social security contributions	0	26	42
Proceeds from foreign borrowings	0	12	-
Proceeds from sale of assets	7	11	-
Grand Total	**222,788**	**264,825**	**310,008**
OSR as % of total revenue	*13.7%*	*13.7%*	*12.1%*

County Governments Sources of Revenue (Categories)

OSR category	2013/14		2014/15		2015/16	
	Kshs M	*%*	*Kshs M*	*%*	*Kshs M*	*%*
Property-related revenue	3,805	12.5%	5,292	14.5%	5,587	14.9%
Administrative fees & charges	19,718	64.6%	6,250	17.2%	4,646	12.4%
Business permits	364	1.2%	3,517	9.7%	4,056	10.8%
Vehicle parking fees	303	1.0%	2,983	8.2%	3,570	9.5%
Natural resources, exploitation & conservancy	1,526	5.0%	1,922	5.3%	1,998	5.3%
Public health services	36	0.1%	705	1.9%	1,540	4.1%
Markets, trade services & slaughter houses	1,059	3.5%	1,048	2.9%	1,407	3.8%
Public health & sanitation services	162	0.5%	1,056	2.9%	1,116	3.0%
Cess	77	0.3%	976	2.7%	967	2.6%
Water & sewerage services	0	0.0%	229	0.6%	8	0.0%
All other revenue	3,485	11.4%	12,420	34.1%	12,594	33.6%
Grand Total	**30,533**	**100.0%**	**36,397**	**100.0%**	**37,490**	**100.0%**

OSR POLICY OBJECTIVES

The Policy proposes a standardized institutional, policy and legal framework for own source revenue raising measures and enforcement that would be applicable to all County Governments by;

1. Strengthening legal and institutional frameworks for County OSR:
2. Identifying opportunities for optimizing Counties' OSR potential:
3. Clarifying assignment of revenue-raising powers between the two levels of Government and among Counties:
4. Improving Counties' capacities for revenue collection and administration:

OSR POLICY GUIDING PRINCIPLES

- ***Broadening County Governments' tax bases***
- ***Enhancing County Governments' revenue administrative capacity***
- **Policy gap**
  - Streamline the practice and application of county revenues,
  - Challenges experienced in county taxation - adverse effects on businesses and the business environment,
  - Improve revenue collection to reflect counties' full potential

OSR POLICY SCOPE

(i) Legal and institutional framework for OSR collection
(ii) Different categories of taxes levied by County Governments (property taxes/rates, land rates, land rent, entertainment tax)
(iii) User charges and fees (including single business permit, parking fees, market fees, liquor licence fees, among others)
(iv) Introduction of new tax / review of existing tax, user charges and fees;
(v) Technological change and innovation, including a review of existing ICT infrastructure for revenue administration and management;
(vi) Revenue administration and human resource systems
(vii) Tax assignment, administration and sharing
(viii) Governance, accountability and oversight.

OSR POLICY GUIDING PRINCIPLES

- **Simplicity and enforceability**
- **Efficiency and effectiveness**: To ensure that County Governments achieve their fiscal policy objectives at minimal costs
- **Equity**: The policy ensures that a situation of creating of imbalances between – vertical and horizontal
- **Good governance-** necessary internal controls and reporting mechanisms to enhance transparency, accountability and financial reporting.
- **Buoyancy** - a tax base that is responsive to developments in the economy over the long term

THE PRACTICE

- Property rates are levied under Rating Act Cap 267 and Valuation for Rating Act (cap 266).
- The Rating Act Cap 267 allows for imposition of rates and the forms of rating that are applied.
- Valuation for Rating Act (cap 266) gives guidance in preparation of valuation roll.
- County governments inherited valuation rolls from the defunct Local Authority (a county is comprised of several LAs) hence different property rating systems.
- Lack a proper county legal framework; challenges of low number of professional to conduct timely valuation

THE PRACTICE

- Entertainment tax is imposed on entertainment and borne by the consumer of the entertainment and mostly remitted by the provider of the service.
- Entertainment taxes are generally difficult to administer fairly because of lack of clarity in the unbundling of this function so as to assign the revenue responsibility to either level of Government.
- The legal framework governing entertainment taxes is contained in the Constitution, the Entertainments Tax Act Cap. 479; and the Betting, Lotteries and Gaming Act Cap 131.

THE PRACTICE

- The Single Business Permit (SBP) - licensing of business in Kenya - was introduced in 1998 as one of initiatives of the Kenya Local Government Reform Programme (KLGRP).
- A permit that allows the conduct of a business or trade, including a profession or occupation, within the area of a local authority
- The introduction of SBP was to achieve a) simplification of the local regulatory environment, b) reduction of admin and compliance costs, c) generate consistent business data d) enhance revenues improved e) strengthen the link between local government and the business community.

THE PRACTICE

- Main rationale for user fees and charges is not to generate revenue but to encourage efficient use of resources within the public sector.
- Strengthen the link between fees charged and services provided. For example;
  - Levying of water charges - guarantee of uninterrupted supply of clean water,
  - User fee in hospitals – provision of reliable and quality health care
- Enforcement through Finance Acts - illegality in the absence of clear policies and legislations since there is no basis to levy any service charge or fees.
- Policy framework – guidance on formulation, development and introduction of tariff-pricing policies to guide fees and charges

THE PRACTICE

- Cess - a revenue type that is collected for the purposes of specific sector development.
- Proceeds from cess revenue from a articular product or produce should be ploughed back towards the development of that particular sector.
- Concerns have been raised especially by farmers on farm produce being charged cess in the farms as well as a second charge at the point of exit from the county.
- Multiplicity of charges - sand, building and timber attracting cess yet they were previously remunerated as royalties. T
- Policy proposes to bring clarity on collection of cess; eliminate confusion in processes and procedures of administration of cess.

THE COUNTY GOVERNMENTS (TAX REGULATION PROCESS) BILL, 2016

Introduction – The Bill

A Bill for:

An ACT of Parliament to regulate the process to be followed by county governments in the exercise of their power under Articles 209 and 210 of the Constitution to impose, vary or waiver taxes, fees, levies and other charges

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DEVELOPMENT OF FINANCE BILL

INTRODUCTION

- A finance Bill: This is a bill that contains proposals to the Parliament or County Assembly to amend or introduce taxes in case of national Government or fees or charges in case of County Government to raise monies to finance the budget deficit.

- It may also contain proposals to enhance the administration of the existing laws for raising revenue.

OBJECTIVES OF A FINANCE BILL

The County Finance Bill has two main objectives-

- To provide clarity on legal basis for the County government to continue collecting fees, charges or rates that were being collected by the local Authorities.
- Raising funds to finance the budget gap. This is through variation or imposition of previous rates or new fees and charges.

FINANCE BILL – NATIONAL LEVEL

- The Finance Bill of the national Government proposes amendments to various tax laws- Income Tax Act, VAT Act, Customs and Excise Act and Stamp duty Act and any other legislation on finance matters such as Capital Markets Act, Central Bank of Kenya Act, Banking Act, Insurance Act and Retirement Benefits Authority Act.

Sources of Finances for National Budget

ICPAK
Uphold Public Interest

a) Tax Revenue

i) Income tax
- PAYE
- Corporation tax

ii) Excise duty - cigarettes, beer, mineral water, juices , soda , wines and spirits, motor vehicles

iii) Value Added Tax

iv) Import duty

v) Stamp duty

vi) Fees and charges- fee under Traffic Act

vii) Profit and dividend

viii) Rent on land

ix) Import declaration fees

x) Railway development levy

b) Non Tax Revenue

i. Borrowing – domestic and foreign

ii. Grants from the development partners

iii. Dividend from investments

iv. Fines and forfeitures

v. Surplus from Regulatory Authority – CAK, RBA, CMA etc

vi. Loans repayment

Sources of Finances for County Budget

i. Transfer from the National Government
ii. Fees and Charges – market fees, parking fees, advertisement fees, approval of the building plan fees
iii. Rates
iv. House rent from the County Government Houses
v. Contribution in Lieu of Rates (CILOR)
vi. Business permit

Preparation of Finance Bill- National Government

i. Request for proposals by putting adverts in the daily newspapers with wide circulation four times – Mondays and Fridays for two weeks

ii. Constituting a technical team to analyse the proposal submitted by various stakeholders.

iii. Key institutions that submit proposals to for the Finance Bill are invited to make presentation and elaborate on the proposals – some key institutions invited include Institute of Certified Public Accountants of Kenya, Price Water House Coopers, Association of Manufactures.

Preparation of Finance Bill- National Government…

iv. Proposals from the Department within the National Treasury as wells a s from other Ministries including Kenya Revenue Authority are considered.

v. The Committee analyses the proposals and make recommendation.

vi. The report is discussed with the director and if there are changes, the recommendations are amended accordingly.

vii. The revised report is discussed with the Cabinet Secretary, Principal Secretary, Director and the technical team. At this level, the recommendation can be rejected, modified or approved as recommended.

Preparation of Finance Bill- National Government…

viii. The Cabinet Secretary signs on every recommendation indicating whether he has accepted or rejected the recommendation. In some instances he can request the Committee to review the recommendation and obtain more information before the final decision is made.

ix. After the approval is granted by the CS, the technical committee prepares the finance Bill, which is submitted to the Attorney General's office for legal drafting. The Attorney General office sends the Legal drafters to the national Treasury to draft the Bill since there are lot of consultation and explanation need before the Bill is finalised.

Preparation of Finance Bill- National Government…

- The Bill is sent to the Parliament for publication in line with the new Constitutional Requirement.

- The Chairman of the Finance, Planning and Trade Committee of Parliament invite the Cabinet Secretary to take the Committee through the proposed amendments. Other Stakeholders also appear before the same committee if they have any issues with the published bill. The Committee also consult national treasury on any proposal from other stakeholders on the Bill before the proposal is taken on board.

PREPARATION OF THE COUNTY FINANCE BILL

In an ideal situation, each County should have various Act that imposes fees, charges or rate or rent. They should have for example:

i) **An Act that deal with Public Health matters.** That Act should specify fees and charges for authorising or permitting to operating a business or an institution. The requirement in order to meet public health requirement, annual inspection fees to be charged among others.

ii) **Act that deals with market matters** - specifying market days, fees charged on market entrance for various commodities, maintenance of the market among other issues

iii) **An act on advertising-** the Act should specify the requirement for advertising, fees to be charged on advertising

County Finance Bill Cont…

iv) **An act of building plans**

v) **An Act on Housing** - this may specify the maintenance of the houses, rent to be paid and want action should be taken on failure to pay the rent

- If the above Acts are in place the purpose of the Finance Bill will be to amend those Acts, there is need for more revenue.

- In the absence of the specific Acts that raise revenue for the County, the County Government can enact the Finance Bill as a temporary measure to provide clarity on the legal basis for continuing charging fees and charges that were introduced by the local authorities.

- The County Finance Bill is important for raising monies to finance the budget, but going forward the County should start preparing specific Acts on each or combinations of fees and charges.

Proposed process for preparing Finance Bill in the County

1. Advertisements to be put in the daily newspapers requesting for proposals.

2. Circular to be sent to all county executive members requesting for proposals.

3. Technical committee to be formed to analyse the proposals and make recommendations.

4. Technical team to invite stakeholders that have submitted proposals, especially groups or associations

Proposed Process Cont…

5. The county executive responsible for finance to discuss each recommendation with its technical team and approve or reject the recommendations.

6. Technical team to draft the Finance Bill.

7. The legal officer to review the Bill.

8. The Bill to be submitted to the Law Reform Commission.

9. The Bill to be submitted to a legal drafter.

10. The Bill to be submitted to the County Assembly

REVENUE FORECASTING

REVENUE FORECASTING

Basic Approaches to revenue Forecasting

Baseline projections that assume no policy changes

Adjustments are made on baseline projections based on policy changes

Total revenue projection = revenue under baseline + revenue from policy changes

Revenue Forecasting Cont

There are four main basic approaches to revenue forecasting:

Model Based;

i) This requires more and accurate data on actual returns to facilitate macro simulation

Effective Tax Rate:

- This approach assumes unchanged tax system and structure and the compliance rate.

Revenue Elasticity;

- Revenue elasticity is the percentage change in revenue collection from a given structure to a percentage change in tax base. Elasticities are used together with the projected change in base to forecast the revenue.

Time Series;

- this require time series data for several years. Then use the econometric method to forecast the revenue.

Revenue Forecasting Cont…

Determinants of Revenue Forecasting

The determinants of revenue forecasted are:

i. Actual revenue collected for the base year;
ii. Proposed tax measures in the coming year;
iii. Estimate of macro-economic variables that have bearing on revenue forecasting.

Tax Measures

Tax measures are introduced to:-

i. Raise additional revenue to bridge the financing gap
ii. Promote economic growth
iii. Expand employment opportunities
iv. Simplify the tax system
v. Make goods and services more accessible by the poor

Thank You!