



**REPUBLIC OF KENYA**  
**THE NATIONAL TREASURY**

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**Draft National Policy to Support  
Enhancement of County Governments'  
Own-Source Revenue**

**This Draft is for Discussion Purposes only!**

*Dated: October 2016*

## Foreword

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## List of acronyms

AFAT	Area Fixed Asset Tax
AVM	Automated Valuation Model
CAMA	Computer Aided Mass Valuation
CARPS	Capacity Assessment and Rationalization of the Public Service
CEC	County Executive Committee (Member)
CILOR	Contributions in Lieu of Rates
CoB	Controller of Budget
CoK	Constitution of Kenya
CRA	Commission on Revenue Allocation
ERP	Enterprise Resource Planning
GCCN	Government Common Core Network
GFS	Government Finance Statistics
IBEC	Intergovernmental Budget and Economic Council
IFMIS	Integrated Financial Management Information System
KDSP	Kenya Devolution Support Program
KRA	Kenya Revenue Authority
LA	Local Authority
LAIFOMS	Local Authority Integrated Financial Operation Management System
LATF	Local Authority Transfer Fund
MLPP	Ministry of Land and Physical Planning
MoDP	Ministry of Devolution and Planning
NACADA	National Authority for the Campaign Against Alcohol and Drug Abuse
NLC	National Land Commission
OSR	Own-Source Revenue
PFMA	Public Finance Management Act (2012)
SBP	Single Business Permit
SCoA	Standard Chart of Accounts
SRC	Salaries and Remuneration Commission
TCC	Tax Compliance Certificate

# CHAPTER 1: INTRODUCTION

## 1.1 Background

The Constitution of Kenya, 2010 (CoK) ushered in a decentralized system of governance comprising of a National Government and 47 County Governments, replacing a centralized system of governance. The system features significant political and administrative devolution, in addition to fiscal decentralization, in which County Governments are granted responsibility for raising revenue as well as budgeting for devolved functions. The need for County Governments to have reliable sources of revenue to enable them to govern and deliver services effectively is among key principles of devolution arrangements, as stated in Art. 175(b). The Constitution identifies funding sources for counties to include:

- a) Equitable share of at least 15 percent of most-recently audited revenue raised nationally (Art. 202 and 203(2));
- b) Additional conditional and unconditional grants from the National Government's share of revenue (Art. 202(2));
- c) Equalization Fund based on half of one percent of revenue raised nationally (Art. 204);
- d) Local revenues in form of taxes, charges and fees; and,
- e) Loans and grants.

This policy focuses on County Governments' Own-Source Revenues (OSRs), in which context the CoK allows the counties to impose: i) property rates and entertainment taxes; ii) charges for services they provide; and, iii) any other tax or licensing fee authorized by an Act of Parliament. For the purpose of this policy, the following broad revenue definitions will apply:

### Insert definitions

In the first three years of devolution, locally-generated revenue accounted for approximately 13 percent of County Governments' total income, with National Government transfers accounting for more than 84 percent of receipts. (*Table 1*). A general concern is the small and declining share of locally-generated revenue as a proportion of counties' total resources, which signifies high and growing reliance on transfers.

<b>Table 1: Receipts by County Governments (Kshs) Source of revenue</b>	<b>2013/14</b>	<b>2014/15</b>	<b>2015/16</b>
<b>Own source revenue</b>	30,533,404,128	36,264,309,063	37,374,104,192
<b>Transfers from National Treasury</b>	187,238,849,774	225,649,582,224	260,709,123,527
<b>Transfers from other government agencies</b>	3,136,608,523	1,009,124,631	10,278,137,293
<b>Proceeds from domestic borrowings</b>	1,855,576,704	298,237,393	861,691,751
<b>Proceeds from domestic &amp; foreign grants</b>	8,371,923	255,716,385	269,417,766

<b>Tax receipts</b>		268,079,362	254,587,612
<b>Reimbursements &amp; refunds</b>	7,395,633	994,422,849	118,492,607
<b>Grants received from other levels of government</b>		36,344,951	100,000,000
<b>Social security contributions</b>		25,723,565	41,998,476
<b>Proceeds from foreign borrowings</b>		12,430,000	-
<b>Proceeds from sale of assets</b>	7,351,012	10,734,535	-
<b>Grand Total</b>	<b>222,787,557,696</b>	<b>264,824,704,957</b>	<b>310,007,553,224</b>
<b>OSR as % of total revenue</b>	<b>13.7%</b>	<b>13.7%</b>	<b>12.1%</b>

*Source of data: National Treasury*

**Table 2** shows broad categories of OSRs reported by County Governments over the first three years of devolution, and the average proportion of each revenue stream. A number of observations can be made from the Table on the trends in counties' aggregate revenue collections, and in composition. In terms of collections, there has been remarkable growth in local revenue generation even though counties display extreme disparities; and the growth rate has dropped significantly from 18.8 percent between FY 2013/14 and 2014/15 to 3.1 percent between FY 2014/15 and 2015/16. In terms of composition, the biggest consolidated revenue streams are: administrative fees and charges (collected as AIA); property-related income; and, business permits/license which account respectively, for 27.8 percent, 9.6 percent and 7.6 percent of total OSR over the three-year period, on average. The importance of each revenue stream varies across counties.

**Table 2: Own-source revenue collections by County Governments**

<b>Local revenue stream</b> ( <i>Figures in Kshs unless indicated otherwise</i> )	<b>2013/14</b>	<b>2014/15</b>	<b>2015/16</b>	<b>Percentage</b> ( <i>Average</i> )
Administrative fees & charges	19,092,911,053	5,621,266,115	4,207,348,078	27.8%
<b>Property-related income (Including rates)</b>	1,694,913,057	3,939,031,847	4,393,350,697	9.6%
<b>Business permits &amp; licenses</b>	363,874,302	3,517,261,477	4,056,070,237	7.6%
<b>Vehicle parking fees</b>	302,675,130	2,982,683,057	3,570,365,416	6.6%
<b>Rental income (Houses, premises &amp; leases)</b>	2,153,365,933	2,417,757,328	2,232,281,129	6.5%
<b>Natural resources &amp; conservancy</b>	1,525,587,720	1,921,522,268	1,997,904,682	5.2%
<b>Markets, trade services &amp; slaughter houses</b>	1,058,654,208	1,047,875,350	1,408,784,946	3.4%
<b>Cess</b>	76,747,762	975,959,936	967,337,415	1.9%
<b>Other fees, levies &amp; charges</b>	4,264,674,962	13,840,951,684	14,540,661,592	31.3%
<b>Grand Total</b>	<b>30,533,404,128</b>	<b>36,264,309,063</b>	<b>37,374,104,192</b>	<b>100.0%</b>

*Source of data: National Treasury*

Two other broader observations may be made from **Table 2**. First is the magnitude of two revenue categories namely 'administrative fees & charges' (especially in FY 2013/14) and 'other fees, levies & charges'. The latter category contains more than 50 different imposts all being incoherently reported by counties, specifically with regard to definitions. Such inconsistency suggests the need for standardized categories for taxes, fees and charges, with comparable

definitions. Second is the difficulty of arriving at any conclusions about the efficiency with which different counties are generating their local revenue. This challenge suggests the need for an improved understanding of each county's revenue potential, and particularly the difference between what is actually being collected and what in theory should be collected.

Lessons from international experience illustrate that the design of any policy framework aimed at supporting subnational revenue systems should cover the following three key dimensions, which must be properly coordinated to ensure effectiveness of the overall decentralized system. The dimensions are:

- a) *Assignment of revenue sources among types or levels of Government.* In principle, revenue assignment should be guided by:
  - the principle of 'finance follows functions';
  - the fact that local revenues should not introduce economic distortions; and,
  - the principle of subsidiarity i.e. assigning revenue functions to the lowest level of Government.
- b) *Degree of autonomy with which subnational governments can exercise their assigned authority.* In most cases, subnational governments -- Kenya's counties included -- tend to have relatively limited revenue-raising powers (i.e. fiscal autonomy), which raises the issue of whether the subnational governments have adequate capacity to generate sufficient and sustainable OSR.
- c) *Efficiency of the revenue administration system.* Kenya's County Governments have not yet developed clear revenue policy, legislative and administrative frameworks to enable them impose the assigned taxes, fees and charges. For instance, many counties continue to rely on Finance Acts as the primary legislation for revenue collection, which has led to legal disputes. In 2014, following a petition, the High Court made a ruling on the illegality of cess (See High Court petition No.385/2013).

Against such a backdrop, this policy is specifically intended to provide for measures to improve the collection and management of County Governments' OSR, by strengthening the legal, regulatory and administrative underpinnings.



## **CHAPTER 2: SITUATION ANALYSIS**

### **2.1 The Kenyan context before and after devolution**

At Independence, Kenya inherited a sub national government system of Local Authorities (LAs), whose basis was the Local Government Act (Cap. 265) rather than the Constitution. The LAs derived their revenue-raising powers from a variety of legal instruments including:

- a) the Local Government Act (Cap 265, sections 216 and 217) which empowered LAs to establish and maintain a General Rate Fund;
- b) the Valuation for Rating Act Cap 266, and the Rating Act Cap 267: The Rating Act provided for imposition and collection of property rates by rating authority while the Valuation for Rating Act (Cap 266) provided for valuation of properties for the purpose of levying property rates. Further, it laid out procedures to be followed in preparing a valuation roll, in addition to providing for a special methodology for valuing Government land for purposes of rates, hence the Contribution in Lieu of Rates (CILOR);
- c) the Trade Licensing Act (Cap 497) which empowered the LAs to impose business license fees; and,
- d) the Local Government Act (section 222) which empowered LAs to borrow, including through issuance of stocks or bonds, although this facility was never used.

Between 1969 and 1989, a series of political reforms and Constitutional amendments led to the removal of LAs' powers to Central Government ministries and departments. For example, through the Transfer of Functions Act (1969), functions such as primary health and health services were removed from LAs, except in the seven major municipalities. As a consequence of the removal of functions, the revenue base of the LAs was considerably eroded, leading to a decline in income. Most notably, the Transfer of Functions Act (1969) removed the right of municipalities to levy the Graduated Personal Tax (GPT) which had been their most important source of revenue. The GPT was replaced with a specific grants system to cover certain services. In 1989, the specific grants were replaced by a service charge levied on business premises and employees in formal and informal sector. (A county council grant system then in existence was also removed). In 1998, the service charge was itself abolished, following introduction of the Local Authorities Transfer Fund (LATF). Thus, by the end of this period, LAs were only permitted a narrow range of local taxes, fees and charges, which left the Authorities with poor OSR potential, and also caused wide variations in this potential between rural and urban authorities.

Under the LAs, administration of OSR was undertaken directly by Finance Departments headed by Town Treasurers. The Treasurers reported to Town Clerks, who in turn were accountable to Finance Committees comprising elected councilors or ward representatives.

In general, LAs experienced persistent shortfalls in OSR collection, which caused deficits, in turn generating demand for borrowing and leading to mounting debt. Thus, introduction of the LATF in 1998 was designed to forestall a financial crisis among the Authorities, most of which ended up depending almost entirely on the Fund. LATF's objectives included assisting the LAs to reduce their debt. The goal was to eliminate all debt arrears by 2009/10, but this was never attained. Up until their dissolution in 2013, many Authorities remained unable to remunerate their councilors, let alone finance crucial service delivery operations. Moreover, outstanding debt repayment by the LAs remained significant, causing incoming county administrations to inherit considerable liabilities<sup>1</sup>. A major impediment to OSR enhancement by the defunct LAs was their laxity in enforcing legislation requiring citizens to pay rates, user fees and other charges. For instance, while section 26 of the Rating Act gave the LAs powers relating to publication and service of notices, most LAs did not fully utilize this power<sup>2</sup>.

Following the 2013 general elections, County Governments inherited all revenue streams that were previously being administered by the defunct LAs. The counties also took over the old structures including revenue administration procedures and guidelines, as well as revenue collection personnel. Inevitably, old inefficiencies were also transferred, such as weaknesses in the general regulatory framework for managing local revenue processes e.g. billing, laxity among revenue collectors and poor setting of annual revenue targets, among other problems. While some County Governments have made progress in resolving these problems, others continue to struggle with issues such as technology and implementation of administrative guidelines on the payment of fees and charges by the public.

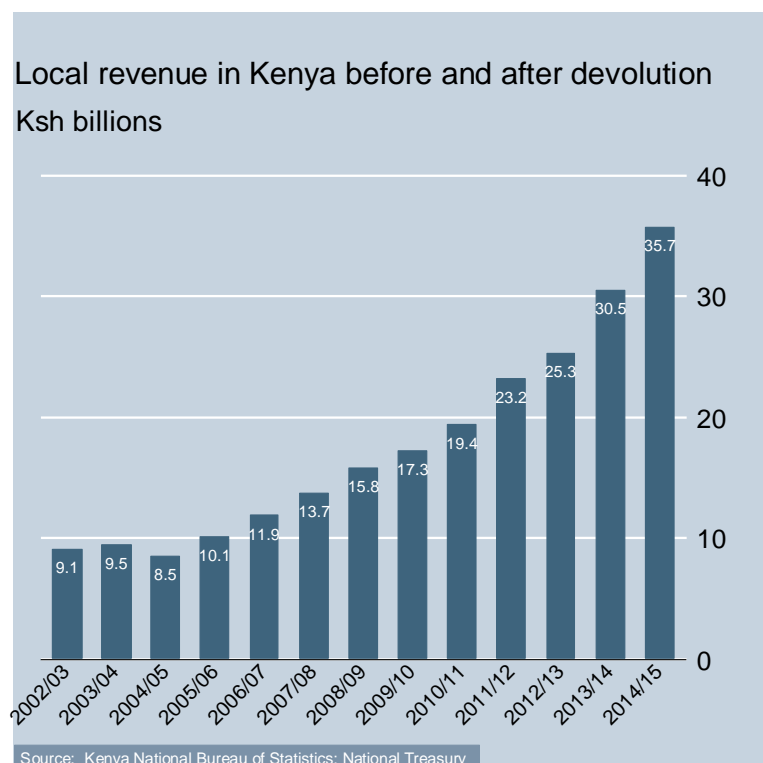
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<sup>1</sup> An exercise to determine and audit liabilities (as well as assets) inherited by County Governments from the defunct LAs is still ongoing, under the Intergovernmental Relations Technical Committee (IGRTC).

<sup>2</sup>Institute of Economic Affairs (IEA) (2009). Understanding the Local Government System in Kenya: A Citizen's Handbook

## 2.2 County own-source revenue after devolution

The performance of OSR in Kenya before and after devolution is illustrated in **Figure 1**. An



important conclusion from the Figure is that whereas aggregate revenue collection has grown, this does not fully reflect counties' full potential. Neither does the growth necessarily reflect efficiency improvements in all counties, especially considering that the growth has been accompanied by upward review of rates in many counties as well as introduction of new revenue streams. A better understanding of the extent to which County Governments have enhanced OSR in the post-devolution period might be possible if objective revenue potential figures were available.

### 2.2.1 Property rates

Property rates is currently being levied by County Governments within the terms of the unrevised Rating Act (Chapter 267) read together with the Valuation for Rating Act (Chapter 266). The current property rating system is undermined by the absence of a comprehensive database of real properties outside of the existing paper-based valuation rolls, which are mostly outdated. In general, County Governments are experiencing difficulty estimating accurately the number of properties that should be on their valuation rolls. In some cases, counties are still maintaining several valuation rolls, related to defunct LAs.

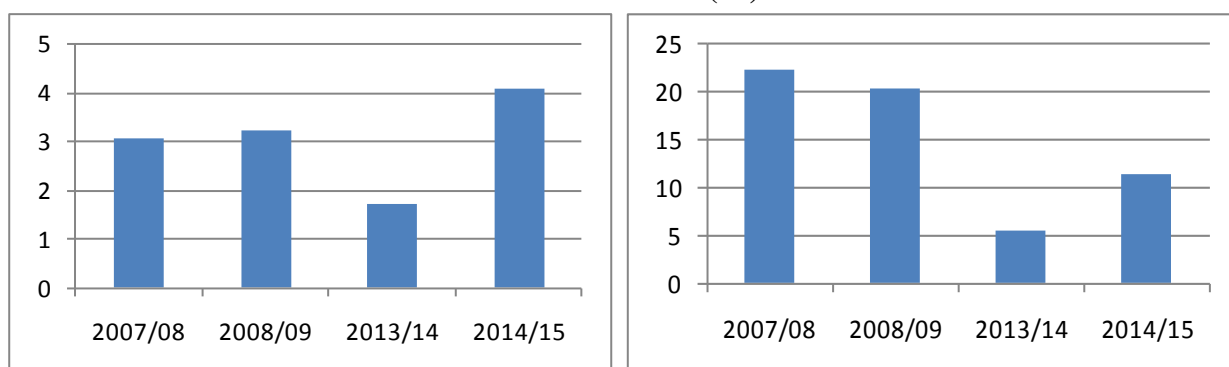
Each County Government determines property tax rates applicable within its jurisdiction. In undertaking the valuation of property, the County Governments tend to use valuation services from either the private sector or the Ministry of Land and Physical Planning (MLPP). The challenge is that the process of valuation is unregulated, which could lead to different valuation outcomes. In addition, there are no standard contracts or guidelines for use by counties in procuring valuation services from the private sector. Hence, not only are valuations irregular but also counties are struggling with revaluations which (due to the lack of data on land parcels) is both difficult and expensive. Even where (re)valuations are undertaken, there is no quality assurance.

Currently in Kenya freehold agricultural land located outside urban areas is not liable to property rates, although agricultural land held on leasehold tenure within an urban area can be liable to a flat rate. In addition, agricultural land which is either idle or unproductive and being held for speculative purposes tends not to be liable to property rates.

The levying of property rates in Kenya is further complicated by the current system of surveying, registration and titling of land. A major issue is the unclear roles within the land registration process of the MLPP and the National Land Commission (NLC). Both entities appear to issue land titles which can result in confusion, the potential of duplication and non-harmonized procedures and processes. There is therefore a pressing need for clarity to ensure the development of a transparent land registration system (IMF 2015). Furthermore, the country does not have a single national system of land registration.

It is possible that the combined effect of the above challenges has contributed to the observed weak and inconsistent performance of property tax revenues. **Figure 2** shows revenues collected from property rates and its proportion to County Governments OSR before and after devolution.

**Figure 2(a): Property rates (Kshs billions)**<sup>3</sup> **Figure 2(b): Property rates as proportion of OSRs (%)**



*Source of data: LATF reports for 2007/2008 and 2008/2009 FY; and, National Treasury*

From **Figure 2**, revenue from property taxes grew in absolute terms between 2007/08 and 2008/09. However, the performance dipped sharply in 2013/ 2014 with the onset of devolution. This may be attributed to the transition to devolved system of Government. This underscores the importance of a clear legal framework and administrative structures for enhanced and stable revenue generation. In 2014/15, the total revenue on property rates increased to a level not realised before devolution, most likely due to improvements in the underlying administrative structures. However, collections from property rates as a proportion of total OSRs declined, which could be attributed in part to an expanded revenue base.

<sup>3</sup> Property rates data shown in Figures 2 and 3 include poll rates, plot rents and “other property income”.

There exist wide disparities in land tenure patterns across the country. Ownership can be categorised into private, public and communal land tenure systems. The bulk of land in Kenya falls under the communal land tenure system. Land that has not been adjudicated and/or registered falls under this category and comprises approximately 65 percent of all land in Kenya. This ownership pattern also varies significantly across the counties, with a large proportion of land around central Kenya (e.g. Kiambu, Murang'a and Nyeri) having been adjudicated and registered. In Nairobi, most of the land belongs to Government, but is leased to individuals and corporate bodies. In northeastern Kenya (e.g. Mandera, Wajir and Garissa) virtually all land is communally owned. Other regions with vast unregistered land are the coastal region (covering counties like Kilifi, Tana River, Taita Taveta and Kwale) and parts of the Rift Valley (covering counties like Samburu and Turkana, which together account for approximately 75 percent of the total unregistered land in the Rift Valley region). These land ownership patterns have important implications for land-based revenue. In recognition of these differences, the policy to enhance counties' land-based OSRs will need to be accompanied by clear measures to improve land registration and adjudication, which will ideally vary from county to county.

There remains lack of clarity concerning collection of land rents for public land belonging to County Governments. Article 67(2(a)), has mandated the NLC to manage public land on behalf of the National and the County Governments. Article 62(1) and (2) indicates categories of public land and their vesting in the County and the National Governments. As per the Land Act 2012 (Section 28(1)), NLC is required to collect rent, royalties and all payments under public land leases or licences. Further, Section 28(3) requires NLC upon collecting the above revenues to account to the National and the County Governments, as the case may be. These collections on behalf of County Governments shall be deposited in the Revenue Fund for each County as per Article 2017(1) of the CoK. In view this lack of clarity, this policy seeks to address issues of land rents by affirming the need for each level of Government to collect land rents due to them either directly or through appointed receivers of revenue.

### *2.2.2 Entertainment tax*

Entertainment tax is imposed on entertainment and borne by the consumer of the entertainment and mostly remitted by the provider of the service. It is levied on the services that are consumed and is generally non-regressive. This is also the practice in other countries as far as imposition of entertainment tax is concerned within decentralized units such as in the American State of Nevada, India and in Nigeria, among others. In India and Estonia, entertainment tax is mainly levied on entertainment activities or services that require purchase of tickets such a cinema, theatre and access to amusement parks, among others.

Entertainment taxes include taxes on theaters, movies, cultural and sporting events, nightclubs, casinos, racetracks, restaurants and hotels. Entertainment taxes are important to counties that have significant tourist activity, where taxes on hotels and lodges can be significant or in urban areas.

The base of the tax can be turnover or a levy per bed, in the case of a hotel or lodge. Large sporting or cultural events such as concerts should preferably be subjected to value capture through charges for specific services such as security or traffic control or a charge per ticket can be levied. Hotel taxes on the other hand can be made progressive by charging higher taxes according to the star rating. The incentive effect is however negative and unfair, particularly since more luxurious hotels already pay higher income and property taxes.

In the Kenyan context, 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. It is clear that the largest element of entertainment taxes will be taxes on gambling, which can generate significant revenue. There is clearly a need for proper and careful regulation of this industry, the nature of which will have a significant impact on revenue potential at both levels of Government. In Kenya, 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.

Legislation enacted by Nairobi County to regulate entertainment was suspended by the High Court, following a suit by operators. Enacted in 2014, the Nairobi City County Betting, Lotteries and Gaming Act established a Betting License and Regulation Board, from which all gaming operators within the county were required to obtain licenses. Gaming operators challenged the new law in court, arguing that they had already been licensed by the national Betting Control and Licensing Board (BCLB), and that the county legislation was in breach of the Constitution and in conflict with national legislation i.e. the Betting, Lotteries and Gaming Act. In addition to issuing order suspending the county legislation, the court referred the matter to the defunct Transition Authority (TA) for resolution within 90 days, and subsequent refilling in court. After several engagements under the auspices of an interagency technical committee, the assignment of functions shown in Table 3 was proposed<sup>4</sup>:

**Table 3: Proposed assignment of functions relating to licensing of gaming activities**

	<b>National Government</b>	<b>County Governments</b>
1	<ul style="list-style-type: none"> <li>• Policy formulation, legislation and development of standards and norms</li> <li>• Regulation of the gaming industry</li> <li>• Capacity building and technical assistance</li> </ul>	<ul style="list-style-type: none"> <li>• Implementation of policy, standards and norms</li> <li>• Periodic monitoring and evaluation of betting, lotteries and gaming</li> <li>• Development and implementation of county legislation on betting and other forms of gambling</li> </ul>

<sup>4</sup>In addition to the defunct TA, the interagency committee comprised of County Government representatives under the Council of Governors (CoG), the Kenya Revenue Authority (KRA), National Treasury, Commission on Revenue Allocation, Ministry of Devolution and Planning, Ministry of Interior and Coordination of National Government, and the Association of Gaming Operators of Kenya.

	<b>National Government</b>	<b>County Governments</b>
2	Licensing of public gaming (i.e. casinos)	<ul style="list-style-type: none"> <li>• Licensing of public gaming (casino) premises</li> <li>• Enforcement of compliance (spot checks, daily supervision of casinos)</li> </ul>
3	Vetting, security checks and due diligence	N/A
4	Licensing of prize competitions cross-cutting several counties (on promotion of products and services)	Licensing and supervision of prize competitions for promotions confined to the counties
5	N/A	Licensing of amusement machines
6	Licensing of national lotteries	Licensing and supervision of county lotteries confined to the counties
7	<ul style="list-style-type: none"> <li>• Licensing of on-course totalisators<sup>5</sup></li> <li>• Licensing of off-course totalisators</li> </ul>	Licensing of premises for totalisators
8	N/A	Licensing and issuance of pool table permits within the counties
9	Licensing of bookmakers	Licensing of betting premises
10	Online gaming	N/A
11	Handling of complaints and arbitration	Handling of complaints and arbitration

*Source: Transition Authority*

On the above assignment of functions between the National and the County Governments, stakeholders initially agreed on all proposals, except the one on licensing of public gaming activities and authorization of lotteries within the counties. The National Government argued that there is need to exercise caution in licensing betting and gambling activities because world over, the sector could potentially attract money laundering, and it could also be linked to insecurity. This issue has now been resolved, and an agreement has been reached that the National Government shall be in charge of licensing of public gaming activities while the County Governments shall license premises for gaming.

### *2.2.3 Business licensing*

The purpose of the Single Business Permit (SBP) licensing regime is to consolidate County Government revenue raising instruments. A Committee formed on the backdrop of a web of laws, regulations and administrative procedures that were impeding private sector development in the country, came up with various recommendations to streamline business activity in Kenya<sup>6</sup>. The Committee proposed a roadmap to the gradual reform or revision of the SBP system “towards a well identified long term and sustainable alternative”. The road map involved a systematic rationalization of SBP, and the reduction in the number of its bands or fee categories, from 16 to 10. The goal was to increase the certainty of application of SBP rules, and reduce the scope for

<sup>5</sup>Totalisators are computerized systems which run pari-mutuel betting, calculating payoff odds, displaying them and producing tickets based on incoming bets.

<sup>6</sup> Working Committee on Regulatory Reforms for Business Activity in Kenya.

arbitrary decisions by LAs in allocating businesses to fee categories. Despite these recommendations and subsequent legislations, the challenge of multiplicity of taxes, fees and charges being levied by County Governments on businesses still persists. This could be attributed to lack of clarity regarding primary institutions for business regulation, failure to enact primary SBP regulations and reluctance to implement the structures to operationalize SBP.

#### *2.2.4 Other taxes, fees and charges*

The main rationale for user fees and charges is not to generate revenue but to encourage efficient use of resources within the public sector. However, there appears to be a weak link between fees charged and services provided. Some examples of this weak link include levying of water charges without guarantee of uninterrupted supply of clean water and parking fees without clearly designated parking spaces. When properly designed, user charges and fees provide information to public sector suppliers on how much clients are willing to pay particular services and ensuring that the public sector supplies are valued by the citizens.

Most user fees and charges imposed by the counties are not properly anchored in policy and legislation. Instead, they are implemented every financial year through Finance Acts. In the absence of clear policies and legislations, County Governments reserve no basis to levy any service charge or fees. Lack of a clear policy and legal basis can also act as a disincentive against compliance by citizens.

Governments have also signed international trade protocols and agreements to allow for ease of movement of goods, services and labour across member countries of economic blocs. In the case of Kenya, such international protocols and agreements are applicable across the Republic and therefore should be adhered to by the devolved units as they endeavor to rise own revenue. Thus, to avoid County Governments interfering with Kenya's international protocols and agreements, there is need for legislation on the process of introduction of taxes, fees and charges.

The experience so far is that some counties are imposing fees and charges even where related administration costs exceed resultant revenues. A major objective of fiscal policy is to minimize the administration costs, so as to ensure positive yields. In this context, unless a fee is directly linked to a regulatory role, it makes sense for counties to undertake a cost-benefit assessment as a basis for imposing the fee.

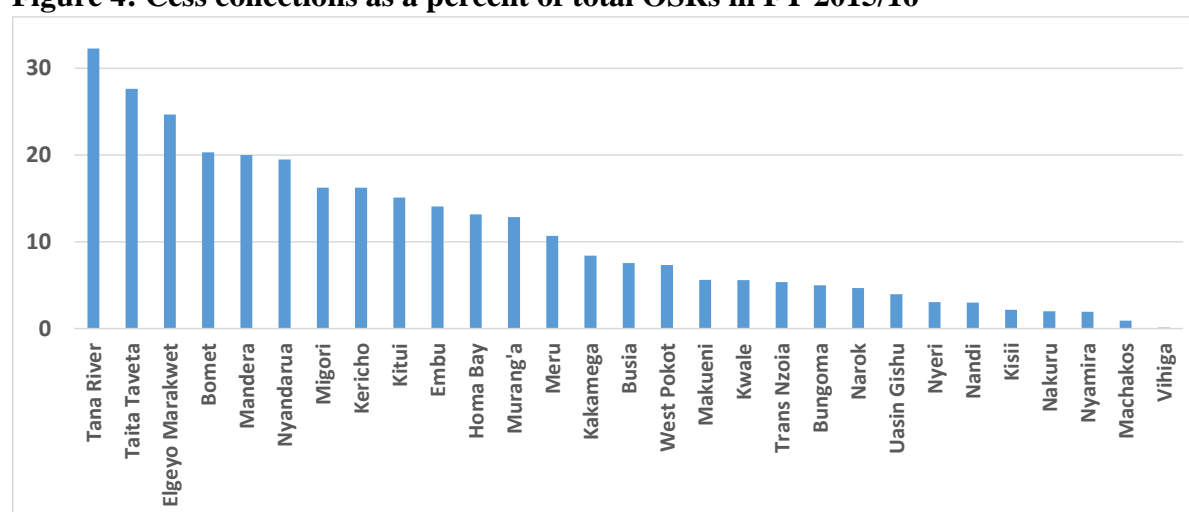
#### *2.2.5 Cess*

Cess is a charge levied on goods as they pass through and/or across county boundaries. It is levied on *ad valorem* basis on the value of the consignment, although the criteria for determining value do not appear to be straightforward. When levying cess, counties often make the case for infrastructure improvement around locations with productive and extractive activities, mainly in agriculture and mining (including extraction of sand, titanium, etc.). However, it is not clear the



extent to which the relatively low reported cess collections are adequate for infrastructure development purposes. In the sugar sector, cane farmers are charged a percentage of the tonnage value delivered to the factory. Thus, the factory deducts the cess from the amount due to a farmer, and this deduction is thereafter transferred to the County Government. There are a number of policy concerns relating to cess. The first relates to the low revenue yields. For instance, in FY 2015/16, County Governments collected Kshs. 967 million in cess, equivalent to 2.6 percent of aggregate OSR. **Figure 4** shows cess collections as a proportion of total OSRs in 29 counties, for which cess collection data is available. For the cess levy to make economic sense, its cost of collection would need to be sufficiently low.

**Figure 4: Cess collections as a percent of total OSRs in FY 2015/16**



*Source of data: National Treasury*

The second policy concern relates to the manner in which cess is collected. Typically, counties collect cess by stationing numerous clerks along transportation routes, which itself suggests high administration and enforcement costs. Besides, the actual collection is inadequate for any meaningful infrastructure development. Similar trends have been observed in other counties. The second concern is that since cess is levied across county borders, it means that though producers of commodities are liable to make the payment, final consumers are forced to pay higher prices. Potentially, this offends Article 209(5) of the Constitution, which requires that county fees and charges should not disrupt economic activities. In addition, the method of administration of the cess leads to delays, as farmers and their produce transporters are held up at the roadblocks, negotiating and seeking clearance. This presents an opportunity for rent seeking behavior from the officials. In this regard, the policy proposes that counties consider to either abolish the various cesses or incorporate them in the SBP.

#### 2.2.6 Natural resource revenues

Provisions on how revenues from natural resources are to be shared between the National and the County Governments are contained in various national legislations. With the exception of the

Mining Act, 2016, most of the legislations have not been concluded, for instance the Energy Bill, 2015; the Petroleum Bill, 2015; the draft Kenya Sovereign Wealth Fund Bill, 2015; and, the Natural Resources (Benefit Sharing) Bill, 2014. A summary of these legislations and their revenue sharing proposals is shown in Annex 1. The legislations contain proposals on how natural resource revenues will be shared, and thus the potential amounts due to County Governments will only become clear once the legislations have been finalized. Nevertheless, from a policy standpoint, the following recommendations are worth consideration:

- a) Sharing of natural resource revenues with host County Governments should be aimed at compensating the respective counties for extraction costs, as well as other externalities such as congestion, pollution and environmental degradation. Moreover, in the context of section 191 (2, 3) of the PFM Act, 2012, counties' resource revenue share should be channeled through the Division of Revenue Act (DORA), and reflected in the County Allocation of Revenue Act (CARA), with a transparent and objective distribution criteria. At the very least, the resource revenues should not make worse the inequalities within and among counties, and also vis-à-vis the National Government..
- b) International best practice points to the importance of saving/investing as much of the proceeds from natural resources as possible, rather than sharing. Considering that majority of these resources are finite, and that carbon-based resources in particular are subject to extreme volatility (based on international pricing), this policy recommends that there should be minimal reliance by County Governments on natural resource revenues.

## **2.3 Challenges of revenue administration and management**

### *2.3.1 Inadequacy and lack of clarity on county revenue legislation*

#### *a) Multiplicity of fees and charges*

Since 2007, business associations and tax practitioners have raised concerns that local authorities, and later County Governments across Kenya levy a multiplicity of user charges, levies and permit fees for supposedly regulatory services. County Governments have created multiple regulations, which they use as “tax handles”, compelling businesses to pay for numerous licenses and permits. As a result, Government Ministries, Departments and Agencies (MDAs) continue to receive complaints from citizens and business enterprises about the haphazard manner in which user fees, charges and rents are being levied, and in particular, limited consultation and public participation. In some instances, these complaints have ended up in court<sup>7</sup> due to the fact that some Counties are contravening Article 209(5) of the Constitution. Due to transition issues, some functions are concurrently run by both levels of government. The multiplicity of taxes and levies that results from this has created a high tax burden to the public. One example of this is in export of agricultural produce and minerals by road that attracts multiple cess charges as they pass across county

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<sup>7</sup>An example is the 2014 the High Court ruling on the illegality of cess. The ruling (in petition No. 385 of 2013, Cereal Growers Association & another v County Government of Narok and 10 others) is available here: <http://kenyalaw.org/caselaw/cases/view/101346/>.

boundaries to the point of export. The cess is levied on an ad valorem basis on the value of the consignment. There are also instances where the multi-layering of user charges or administrative fees continues to undermine the notion of reducing the cost of doing business.

Multiplicity of fees and charges exists due to lack of clarity in the process relating to their introduction. There is therefore need to anchor in law a structured and regulated tax analysis procedure for County Governments prior to their introduction. This would provide a transparent process through which the main stakeholders will ensure that new tax proposals do not prejudice Kenya's national economic policies or disrupt economic activities across county frontiers as contemplated under Article 209(5) of the Constitution and Section 161 of the PFM Act, 2012.

*b) Unclear and inconsistent process for issuance of waivers and variations*

To encourage voluntary compliance, most of the County Governments are also availing waivers to the ratepayers. However, some of these waivers/exemptions -- including waivers on penalties, interest and fines -- have no legal basis since they do not conform to Article 210 of the Constitution that provides that no tax or licensing fee may be imposed, waived or varied except as provided by legislation. To remedy this, some of the County Governments have included a clause on waivers in their Rating and Valuation Act. There is need to ensure that the provisions contained therein are in line with the Constitution and other legislation.

*c) Failure to anchor the fees and charges in clear policy and legislation*

The forty seven County Governments impose and continue to levy a plethora of user fees and charges. The charges levied by the defunct local authorities were regulated through by-laws and are now maintained by counties through their annual tabling of finance bills that promulgate the same charging regime. A majority of County Governments lack principle legislations to support revenue collection in all the sectors. It is envisioned that the origin of these laws is the county executive, who then forward them to the county assembly for legislation. Ultimately, the Governor assents them after which they become law. It is important to note that both arms of government are expected to hold meaningful stakeholder engagement and public participation.

Currently, County Governments are at different stages of developing the aforementioned legislation, with most of them yet to draft, enact and/or operationalize these laws. The laws will be useful in supporting revenue administration, property rating, trade licensing and public participation. Due to the absence of these laws, most of the County Governments are relying on their Finance Acts as the sole instrument for collection of rates, user fees and charges, which should not be the case. In some instances, counties continue to mobilize local revenue on the basis of outdated guidelines developed by defunct Local Authorities.

To compare with similar legislation at a national level, the National Finance Act does not in itself impose taxes, fees and charges. Instead, it alters the amount or rate of a tax or fee by amending the

clause in the principal law that dictates the rate. In effect, the National Finance Act operates like an annual Statute Amendment (Miscellaneous) Bill. This approach is consistent with accepted revenue-raising practice, whereby sector specific legislation imposes taxes, fees and charges, and it also provides for easier financial regulation of each sector. Below are examples of how lack of clear policy and legal frameworks affects OSR collection and management where property and entertainment taxes and user fees and charges are concerned:

- **Property taxes:** There is no clear national legal framework to guide counties in their legislation so that they can domesticate it to suit their needs. However, some counties (e.g. Embu) have already enacted Rating Acts. It is worth noting that revenue potential from property rates is hampered by low coverage/base of properties since most of the valuation rolls in use are outdated. For instance, the Machakos county valuation roll was prepared in 1983 and has some 120,000 parcels against the estimated current number that is estimated to be 400,000 rateable properties.
- **Entertainment taxes:** A major challenge in levying Entertainment taxes has been defining what entertainment is for purposes of tax. To this end, entertainment tax includes taxes on theaters, movies, cultural and sporting events, nightclubs, casinos, racetracks, restaurants and hotels. Entertainment taxes are important to counties that have high levels of tourist activity, or in urban areas, where taxes on hotels and lodges can be significant. The basis of levying this tax can be turnover or a levy per bed occupancy in the case of a hotel or lodge. Large sporting or cultural events such as concerts should preferably also be subjected to value capture through charges for specific services such as security or traffic control or a charge per ticket can be levied. Where the levy is based on hotel activity, the rate should be progressive to the extent that higher tariffs are charged on facilities with a higher star rating. On the flip side, this approach is at times deemed to be negative and unfair since more luxurious hotels already pay higher income and property taxes.
- **User fees and charges:** Article 209(4) of the Constitution of Kenya provides that the National and County Governments may impose fees and charges for the services they provide. Generally, it is envisioned that these user charges and fees are based on user pay principle all aimed at creating a conducive business environment. It is important to note that Section 120(1) of the County Governments Act 2010 provides that a County Government or any agency delivering services in the county shall adopt and implement a tariffs and pricing policy for the provision of public services. Section 120(2) further provides that a County Government or agency delivering services through service delivery agreements, shall comply with the provisions of this section. However, the current status in some of the counties reveals incidences of multiple user charges, tariffs and fees which are not anchored in law but are somehow legitimized by renewing them annually by way of a finance bill. It's important to note that most of the fees and charges for a service

rendered by a county exceed the realistic cost of providing that service. In some cases, fees and charges are levied even where no discernable services are provided.

*d) High cost of revenue collection vis-à-vis yields*

It has been a challenge obtaining precise costs of OSR generation from the counties. The main interest is to understand how fixed costs of revenue collection and administration compare with yields, so as to determine the economic rationale of collection activities. Majority of fixed revenue collection costs are related to personnel emoluments, which are not easily divisible. While counties should in general be concerned about the sustainability of some of their revenue streams vis-à-vis the collection and administration costs, it appears that no counties undertake cost-benefit analysis.

*e) Need for tariff and pricing policy*

All counties lack tariff and pricing policy and currently set their rates based on an ad hoc basis contrary to section 120 of the County Government Act. As a result, counties do not set rates using objective criteria. Setting rates using objective criteria will improve predictability and stability of the rates across all counties, in addition to enhancing efficiency in revenue administration.

The relationship between tax rates and tax revenues is that changes in tax rates have two effects on revenues: (i) if tax rates are lowered, tax revenues will decrease by the amount of the decrease in the rate. Of course there is a minimum below which tax revenues cannot go, otherwise the fixed costs will not be covered. The reverse is true for an increase in tax rates. (ii) lower tax rates will have a positive effect on work, output, and employment and thereby the tax base--by providing incentives to increase these activities. Again, it may be unrealistic to increase taxes beyond a certain level, because it would act as a disincentive to citizens, thereby encouraging avoidance and evasion. Therefore, raising tax rates has the opposite economic effect by penalizing participation in the taxed activities. Compliance levels among ratepayers is very low and there is need for concerted efforts to reverse this trend. In this context, there is need for guidance to counties in terms of setting their tax rates, taking into consideration the above. This will help reverse the current practice where County Governments arbitrarily set their rates.

*f) Outdated laws on property taxation*

There are out dated valuation rolls for example, Nairobi City County valuation roll was last prepared in 1982, Machakos in 1983 and Mombasa in 1991. Some counties have more recently updated their valuation rolls e.g. Kisumu (2008); Nyeri (2009); and Kiambu (2014). Generally, valuation rolls should according to the existing legislation be prepared every 10 years though this requirement has never been achieved. Supplementary valuation rolls may also be prepared as necessary. There is a possibility that counties which have not undertaken recent updates have multiple valuation rolls. Moreover, with the legal vacuum, most counties are yet to prepare or effect any legal rating system to operate in their jurisdictions. Most of them are still operating

under the rating systems inherited from the now defunct Local Authorities. Further, property tax revenues are characterized by:

- High administration costs resulting from inflated cost of preparations and implementation of the valuation rolls
- Difficulties in enforcement and compliance, due to the outdated mode of billing which entails sending of bills by post office annually. In view of numerous vacant properties and absent owners, this mode of billing undermines enforcement.
- Inadequate qualified personnel at the county level who can regularly update the valuation rolls in case of changes in ownership and land use
- There is a problem with communally-owned land, a phenomenon mostly found in areas with pastoralist communities. In these areas, land ownership cannot be assigned to specific individuals, which means that assigning tax responsibility is a challenge
- Multiplicity of taxes levied on land i.e. property rates, land rent, capital gains tax and stamp duty. Whereas the latter two are transaction-based and are collected by KRA on the realizable market value, at the moment property rates does not take into account appreciation due to improved infrastructure and amenities. For this reason, there is need to prepare supplementary valuation rolls at more regular intervals as these would take into account changes in the values of properties
- Missing policy linkages: For example, the property tax should be aligned with and even used to strengthen land use and planning policies. Property tax may be applied to motivate efficient land use e.g. differentiate rates for unimproved land and residents to encourage construction
- Institutional framework prescribed in the current legislation is not tenable under the current constitutional dispensation and needs to be revised.

All the above factors point to the need for an updated legal framework governing property taxation, including the Valuation for Rating, and the Rating Acts. Such a legal framework should seek to align property taxation to the provisions of the Constitution, besides providing the policy anchorage of taxes relating to property. Since processes and structures for imposing property taxation do not vary significantly between counties, there is a case for a National Framework Legislation covering valuation and rating for valuation. Nevertheless, such a National Framework Legislation does not preclude county-level legislation, which would be aimed at strengthening links between each county's fiscal and spatial plans, its land use policies and the national goals and objectives as far as land use management and taxation are concerned. As an illustration, it would be necessary for County Governments' land tax policies to distinguish between land used for private commercial, residential and industrial activities, verses land used for provision of public goods such as national security. In such a case, there would be need to discriminate applicable property rates.

*g) Poorly streamlined business licensing at the county level*

The SBP was introduced to consolidate local government revenue raising instruments that pertain to the licensing and regulation of commercial enterprises. However, despite the payment of SBP fees, business firms are still required to pay additional fees and charges in the form of fire permits, health related levies, hotel licenses and liquor licenses among others. Levying and administration of SBP has subsequently become challenging and it has resulted in a lot of discretion by sub national officials who adjudicate into which category a firm falls.

Some counties lack substantive SBP legislation that would ideally be in the form of the Trade Licensing Act. This would serve a dual purpose as providing a revenue-raising objective (and thus sustainable growth in this area) while doubling up as a regulatory instrument to guide the type and number of businesses operating in a given county. Firms are taken through an elaborate registration and approval process yet Counties mainly view SBP primarily as a revenue-raising measure.

It should also be noted that in most Counties, there is no demonstrable linkage between SBP (revenue raising) and service delivery. The largest result of this is the push back by most professionals (such as advocates, auctioneers and accountants) who have been challenging its basis given that they do not see any discernible service in return. Another concern is the lack of automated registers of businesses which would assist in determining levels of compliance and setting realistic revenue performance targets and non-standardization of the SBP regime across counties which may lead to distortion of the business environment.

In light of the above, it is recommended that for each County Government:

- The tool for regulating and/or licensing business activities shall be the Single Business Permit, which should be anchored in a county-specific trade licensing policy
- Proposals for the introduction of new business licensing instruments outside the SBP regime will therefore be subject to the National Framework Legislation on County Governments' Tax Regulation Process
- Any business regulatory activities at the county level shall be subject to the National Trade Policy as well as any other relevant law relating to business regulation

*h) The challenge of entertainment tax*

In the Kenyan context, it is clear that the largest element of entertainment taxes will be taxes on gambling, which can generate significant revenue. In the past, the challenge has been lack of consensus in terms of assignment of functions relating to the control of gambling activities. Consensus has however been reached regarding the roles of the two levels of Government as far regulation of betting, casinos and other forms of gambling is concerned.<sup>8</sup> Table 3 above shows

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<sup>8</sup> Refer to the *Report on the Validation Meeting of the Interagency Technical Committee on the Devolution of Function*.

the agreed functional assignment. The agreed assignment needs to be anchored in law. This notwithstanding, there is need to clarify in law how this sector will be regulated, as well as the powers of each level of Government in terms of imposing taxes, fees and charges on the assigned functions. This will help to unlock the potential of revenues that can be generated from this sector.

### *2.3.2 Weak revenue administration*

#### *a) Human resources capacity issues*

Majority of county revenue collectors in County Governments were inherited from defunct Local Authorities, together with the inherent weaknesses particularly low skill levels and integrity levels. Many County Governments have tried to mitigate these weaknesses, especially by redeploying staff, recruiting additional staff and by outsourcing some of the revenue collection functions. The effectiveness of these reforms is however likely to be constrained by institutional and administrative constraints facing the County Governments, such as:

- Slow pace or lack of integration of staff inherited from defunct local governments and devolved functions of ministries, primarily because they are yet to be accepted by the County Governments. Therefore, there are many who are underemployed or redundant;
- Disparities in earnings between personnel inherited from defunct local governments (with comparatively high remuneration), those inherited from National Government and those recruited by the County Governments (also comparatively higher than that for staff in National Government with the same competencies). This challenge is also highlighted in the CARPS Report.
- Inadequate remuneration and incentives to attract adequate numbers of personnel with scarce professional and technical competencies (education, skills, knowledge, experience, attitude etc.);
- Corrupt practices, which results in leakage of revenue, as reported in the Auditor-General's reports; and
- Ambiguity of roles within the revenue department, including lack of clarity in reporting lines.

#### *b) Need for professionalizing revenue administration*

In a number of counties, lower cadres of revenue administration are staffed by personnel who were originally recruited as cleaners, gardeners or guards. This implies that former staff hired for those support positions have been redeployed as revenue clerks and/or revenue collectors. There is a need to change the mindset among the county leadership to understand that revenue collection is a profession that should be entrusted to qualified staff.

The enforcement process in revenue administration and collection is not ideal since most of the staff involved in this role are county askaris with limited knowledge of revenue laws or other less confrontation strategies. Currently, most County Governments consider the use of brute force (arrests and street chases) as the ideal mode of enforcing the provisions of their Finance Acts.



### *2.3.3 Low levels of automation and integration of revenue administration systems*

Most County Governments are still grappling with effects of poor ICT infrastructure. This has led to less than optimal levels of adoption and deployment of ICT systems in revenue collection and management. Currently, most counties are using ICT infrastructure that was used by the defunct Local Authorities. They have gone ahead and improved on it by procurement of additional ICT equipment. A number of counties have been experiencing internet connectivity challenges. For effective deployment of Integrated Revenue Management Information System (IRMIS), provision of adequate network infrastructure in the counties is critical. Although the Government has made significant progress in rolling out power connection through the national grid to most part of the country, some regions within some counties have no power connection or have unreliable power supply, which is characterized by long spells of downtime. Most counties do not have Wide Area Network which is necessary to connect all the revenue collection points in the sub-counties.

Lack of standard revenue collection systems: The different revenue collection and management systems in use in the counties can be clustered into these categories.

- There is the Local Authorities Integrated Financial and Operations Management System (LAIFOMS) – a system that was previously used by the defunct local authorities.
- There are those counties that are using the Integrated Financial Management Information System (IFMIS) revenue module which has not been fully exploited since the roll out has only been done in the county headquarters and yet as it is, the revenue module in the IFMIS system requires major customization to suit the needs of counties on OSR collection and management.
- A number of counties have developed/ are developing alternative revenue management systems through private sector developers.
- Currently, counties are procuring stand-alone receipting systems/solutions instead of investing in complete ERP system.

For effective revenue management across the counties, there is need for integration of the different systems for revenue collection and management. However, the current systems in use in the counties as described above, face a number of challenges that would limit achievement of this objective.

- With regard to IFMIS, the fees payable for the use of the system are based on the number of users, which means that use of the system for revenue collection (a user-extensive process) would require numerous licenses, and hence higher fees.
- Currently, Government accounts and financial reporting is done on cash basis, and thus IFMIS is designed to support only cash-based GoK operations. Revenue management would inevitably need to be based on accrual basis of accounting to facilitate tracking and follow up

of revenue arrears due to counties. In these circumstances, the IFMIS may not be an ideal system for revenue collection

- Even as a revenue management system, the effectiveness of IFMIS would be affected by connectivity issues, especially if the system was to be introduced at the sub-County level. Effective collection of some of the revenue streams would require a system that is spread beyond the county headquarters and head office, for instance to market centres, which would require Internet connectivity. For a number of counties, there may not be adequate or robust infrastructure to support this.
- LAIFOMS, the system currently in use by County Governments for revenue collection does not operate effectively in a Wide Area Network (WAN) setting can only operate as a standalone

Given the above limitations of both the IFMIS and the LAIFOMS, it is recommended that for purposes of revenue collection, an alternative system be developed for use by County Governments. Such a system could be managed either centrally (i.e. at the national level) or at the county level, which implies multiple control points. While decentralized management of the revenue system would offer autonomy to the counties, a system at the national level has numerous advantages. For instance, it would avoid County Governments having to incur system-related investment, license and maintenance costs. It also facilitates comparison and synchrony between the two levels of Government, and across County Governments. For these reasons, it is recommended that a system for collection of county OSRs be developed at the national level.

#### *2.3.4 Inappropriate institutional arrangements*

Revenue collection structures vary from county to county – while other counties use revenue departments, located within the Treasury or the County Secretary’s office, others have established semi-autonomous authorities. Yet other counties have outsourced collection of specific revenue streams to private firms. For instance, in Narok County, entry fees to the Maasai Mara are collected by KAPS Ltd., while in Nairobi County, collection of parking fees is undertaken by JamboPay Ltd.

In a number of counties, collection of revenue in specific sectors appears to have been decentralized to respective departments within the County Government structure. For example, in many counties, collection from health facilities in the form of user fees is handled directly by respective Health Departments, with little reporting to the County Executive Committee Member for Finance. The impact of such arrangements has been loss of control by County Treasuries of the revenue collection function. In addition, it has led to weak coordination of OSR collection within the County Governments. Moreover, this has created room for spending of revenue at source, in contravention of the PFM Act, 2012.

Section 104(d) of the PFMA authorizes the County Treasury to mobilize resources for funding the budgetary requirements of the County Government and putting in place mechanisms to raise revenue and resources. Further, section 157 of the Act authorizes the CEC Member of Finance to designate receivers of county revenue.

In order to ensure effective and efficient collection and management of the revenue, it is recommended that for each stream of revenue, the CEC Member for Finance shall designate a Receiver of Revenue who shall be accountable to the County Assembly. A Receiver of Revenue can be responsible for more than one revenue stream<sup>9</sup>. For this purposes, each County Government shall determine the revenue streams to be administered pursuant to Article 209(3) of the Constitution. In addition, there shall be a policy and legislation, which should be aligned with the national policy and the relevant national legislation for each revenue stream. For every revenue stream, the CEC Member for Finance shall give revenue targets, which will be included in the annual Estimates of Revenue. The revenue targets will be developed using an objective forecasting criteria referred to above.

For its effective functioning, the designated Receiver of Revenue is expected to have a fully-fledged accounting unit according to Guidelines issued by the National Treasury. Responsibilities of the accounting unit will include preparation of monthly, quarterly and annual accounts. The Receiver of Revenue will also have a cash office to oversee day-to-day revenue collection, sweeping of collections to the CRF, bank reconciliation, and support other related functions. The Receiver of Revenue may appoint collectors of revenue.

In terms of administrative arrangements for revenue collection and management, the PFMA allows the CEC Member for Finance to pursue four possible institutional arrangements. The four options are: internal revenue administration; establishment of an autonomous revenue authority (or County Corporation); contracting the Kenya Revenue Authority; or contracting a private firm or other agent. Table xx contains an analysis of these four options against various considerations e.g. possibility for economies of scale, degree of autonomy to County Governments, administrative capacity required and scope for uniformity. The pros and cons of each of the four options for institutional arrangement are presented in Table 4.

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<sup>9</sup> In this context, a revenue stream refers to a category of taxes, fees, charges and levies that coherently support a specific policy objective (and/or relate to a particular sector) as defined in the Standard Chart of Accounts.

**Table 4: Pros and cons of legally-permitted administrative arrangements for revenue collection and management**

Option	Pros	Cons	Comments
Internal revenue administration departments	<ul style="list-style-type: none"> <li>• This option does not require any further legislation</li> <li>• It enables County Governments to remain fully in control of the revenue function, and thus retain fiscal autonomy</li> </ul>	<ul style="list-style-type: none"> <li>• If not well implemented, this option is prone to interference and capture by politicians</li> <li>• Unless standard formats are prescribed, this option presents a risk of losing uniformity in reporting, which complicates cross county comparisons</li> </ul>	This is the option currently in use by most County Governments
Autonomous County Revenue Authority / Corporation	<ul style="list-style-type: none"> <li>• Need for consideration of the costs of such authorities to ensure that they do not become a drain on county resources</li> <li>• Guidelines on establishment of county corporations, which are contained in the PFMA and the PFM (County Government) Regulations, need to be followed</li> <li>• If well structured, can eliminate conflict of interest between formulation of revenue policy and implementation</li> </ul>	<ul style="list-style-type: none"> <li>• Considering the fact that an authority or corporation comes with some fixed costs, this option is not recommended for smaller counties with comparatively low OSR potential. Such high fixed costs may lead to imposition of high taxes</li> </ul>	Whereas the PFMA provides for this option, it will requires enabling legislation at the County level
Contracting KRA	<ul style="list-style-type: none"> <li>• KRA has necessary expertise and systems and thus economies of scale</li> <li>• KRA is better equipped legally and in terms of resources to enforce compliance</li> <li>• Option allows specialization of personnel, and may permit more sophisticated technology</li> <li>• KRA would be able to handle taxable activities county jurisdictions</li> <li>• Option permits information exchange as well as capacity building of counties by KRA</li> </ul>	<ul style="list-style-type: none"> <li>• Operationalization of this option may require further new legislations or amendments to existing ones (To discuss with KRA)</li> <li>• Conceals responsibility for tax being levied</li> </ul>	This option would require an appropriate/enabling Subsidiary Legislation (Regulations) under both or either of the KRA Act and the PFM Act, 2012 to operationalize Section 160 of the PFM Act
Contracting private firms and other agents		<ul style="list-style-type: none"> <li>• Could potentially be expensive to County Governments</li> <li>• Requires strong capacity to manage and supervise the private agent</li> </ul>	<ul style="list-style-type: none"> <li>• The success of this option would depend on the county putting in place a good system to manage and supervise the private agent. It also requires a transparent process to procure the agent to ensure value for money</li> <li>• Is recommended in cases where the County Government has demonstrated no internal capacity, and where projected benefits far exceed potential costs</li> </ul>

*Source: Interagency Working Committee on County Own-Source Revenue Enhancement*

### *2.3.5 Weak enforcement of PFM legal and regulatory requirements*

#### *Weak capacity for revenue forecasting and analysis*

Previous statistics on county own source revenue reveal that a large number of the counties have not met their revenue targets over the past three years. According to the reports by the Office of the Controller of Budget, counties locally raised Kshs. 33.85 billion in FY 2014/15, which was 67.2 per cent of the total annual local revenue target of KShs.50.38 billion and an increase from Kshs. 26.3 billion generated in FY 2013/14. One possible reason for the underperformance of revenue collection is the inability by counties to prepare credible revenue projections, which could partly be attributed to the lack of capacity to carry out scientifically based forecasting. Since OSR projections form part of counties' expected resources, failure to realize the projections implies budget deficits.

#### *Use of multiple bank accounts*

Article 207(1) of the Constitution provides that there shall be established a Revenue Fund for each County Government, into which shall be paid all money raised or received by or on behalf of the County Government, except money reasonably excluded by an Act of Parliament. Section 109(1) of the PFMA provides further guidance on the operations of this account. The aim of this is to ensure that any withdrawals from this account are done in compliance with Article 207 of the Constitution.

However, some County Governments operate and maintain multiple revenue funds/collection accounts into which money raised by/received by County Government is paid into. This has resulted in revenue leakage with monies collected being spent at source due to lack of supervision/oversight into the operations of the said account(s). Leakage of counties' locally collected revenue is well documented in various reports, including the *2015 County Revenue Baseline Study*, and the *Budget Implementation Review Reports*, both by the Controller of Budget.

#### *Lack of effective internal controls and audit mechanisms*

One of the key challenges facing county own revenue generation is the lack of effective internal controls and audit mechanisms, which leads to significant revenue losses. Examples of gaps in internal controls and audit processes include: delayed banking of collected revenues; delays and/or lack of bank reconciliations; non-rotation of staff in revenue departments as well as allocation of duties among staff in ways that do not enable proper checks and balances; and, cases where revenue officers produce separate sets of receipt books leading to low revenue collection. Many of these issues arise due to inadequate qualified personnel. There is also lack of effective internal audit function as per Section 155 of PFMA; as most counties have internal audit departments but lack the oversight having not set up fully functional internal audit committees. Further, some counties have not fully implemented audit manuals.

### *Cash handling*

A number of county revenue streams are collected in cash on a daily basis. Two examples are parking fees and market charges. Based on a 2016 study by the National Treasury, fees paid by public service vehicles (PSVs) in Mombasa County as well as rent collections from the county's buildings are collected in cash. According to a 2015 County Revenue Baseline Study by the Controller of Budget, nearly 80 percent of revenue collectors reported being paid on cash basis. Whereas some of the activities forming the basis for these collections may by their nature, warrant the need for daily cash collections, this model of revenue management is generally risky and prone to leakage. Therefore, as a policy measure, collection of county OSR should adopt cashless payment systems.

## **2.4 Subnational revenue: A regional and international perspective**

**NB: Team is still working on this section, to be updated.**

## **2.5 Rationale for a coherent policy on County Governments' own-source revenue**

The policy focuses on four thematic areas as follows:-

### *2.5.1 Legal and institutional framework for own source revenues for County Governments*

The Constitution of Kenya, 2010 under Article 209, assigned powers to County Governments to raise internal revenues through assignment of specific taxes and other revenue raising measures such as user fees and charges. In addition, the amended Local Government Act, the Rating Act and the Valuation Act and their subsequent amendments had assigned powers to Local Authorities to raise internal resources from various tax and non-tax revenues. In addition to the revenue from tax sources, the County Governments are also empowered to impose different types of fees and service charges on their service delivery. County Governments generally complain that the sources of tax and non-tax revenues assigned to them are not adequate to meet their needs. On the other hand, the National Government is of the view that the County Governments are not making the required efforts to collect revenue to their potential. It is also increasingly felt that the overall system of grant, transfer and revenue assignment to County Governments should consider and ensure adequate resources to cater the needs of County Governments to perform the assigned responsibilities in line with Article 187 of the Constitution. It is in these contexts the present policy aims to address by recommending a standard legal framework for the tax and non-tax raising measures. The policy will also assess the impact of local taxation on national economy and is expected to have comprehensive theoretical base on the principles and practices of National and County Governments taxation. These can then serve as the basis for guiding future devolution objectives, strategies and to provide policy framework for the introduction of reform measures in the field of local taxation.

### *2.5.2 Revenue potential of County Governments*

The own source revenue accounts for a very small proportion of annual budget of County Governments in the country. It is generally believed that County Governments, at present, are only collecting a limited percentage of the potential revenue from internal sources assigned to them. Based on data for FYs 2013/14 and 2014/15, County Governments' OSR account for approximately 14 percent of total receipts. Such a low revenue generation is mainly attributed to inefficient assessment and collection procedures as well as revenue administration structures in the County Governments. Local revenue plays an important role in the fulfillment of responsibilities assigned to County Governments by the law. It is, however, believed that the contribution of internal revenue towards sharing the development and administrative cost needs of the County Governments is minimal. As a result, they are overly dependent upon the fiscal transfer provided by the National Government. It is also not certain whether the County Governments have been able to utilize all the sources assigned to them and whether such utilization is to the extent of maximum potential or not. There is, however, consensus among all the concerned that there is enough room for improvement in local revenue collection. It is a common belief that the County Governments have the tendency of seeking more fiscal transfers from the National Government without making any intensive effort on their part to raise local resources through the mobilization of more revenues from tax and non-tax sources authorized to them by the law. Furthermore, the effectiveness of tax collection of County Governments is often linked with and measured in terms of internal revenue collection without considering how much rich the particular County Government is in terms of endowment. The policy aims to guide the assessment of the revenue potential of County Governments by examining both possibilities of increasing the tax efficiency and also by examining the prospects of imposing the new taxes.

### *2.5.3 Revenue assignments*

The third important component of the policy is the revenue assignments to County Governments. County Governments are entrusted with fiscal powers to raise their revenue bases to finance their functions. However, the legal provisions made in the Constitution, and the repealed Local Government Act suffers from the problem of overlapping and duplication in the provisions made for County Governments at different levels. In this background, the policy is expected to clearly delineate the revenue assignments considering both the functional assignment and various tax and non-tax provisions made in the Constitution and other National Legislations for County Governments. While assigning revenue responsibilities utmost care is required to be taken so that no overlapping and duplication in the provisions would crop up. There are also disputes among County Governments regarding the entitlement of collection of certain type of revenue for branding of commercial vehicles, cess and modalities of revenue sharing between County Governments. The policy also sets a lower and upper limit within which the County Governments have to levy taxes and non-taxes across the entire country as well as share certain revenue collected among the County Governments affected. This issue has remained unresolved. One of the reasons attributed to the low level of revenue mobilization from internal sources is the assignment of

revenue sources, which are not potential revenue yielder. The underlying principle behind any assignment of revenue source to County Governments is the ease in collection and administration and the source assigned should yield substantial revenue. It is also generally believed that County Governments have not been able to collect revenue from sources assigned to them even when there is high potential for revenue rising. In these circumstances, a policy to clarify on assignment of revenue sources (tax and non-tax) to each layer of Government has become essential. The policy has taken into consideration international best practices on revenue assignment, and has assessed applicability of those arrangements in Kenyan context. The policy will recommend on any clarification on revenue assignments which are feasible and practical considering the present capacity of County Governments.

#### *2.5.4 Institutional capacity for revenue administration*

The policy intends to assess the existing capacity of County Governments to administer the new responsibilities of revenue assessment, collection and administration. Based on the assessment the policy would recommend measures to strengthen the institutional capacity of County Governments for better tax administration.

### *2.6 Objectives of the policy*

The main objective of the policy is to propose a standardized institutional, policy and legal framework which is applicable in all counties for County Government own source revenue raising measures and enforcement. The policy will also seek to propose measures of:

- (i) Broadening County Governments' tax bases
- (ii) Enhancing County Governments' revenue administrative capacity

### *2.7 Scope of the policy*

The OSR policy largely focuses on eight key themes, which include: (i) the Legal and Institutional Framework for OSR collection (ii) the 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, which will include guidelines on: standardization on taxes and user charges; variation of taxes and user charges and; stakeholder engagement and public participation in the process of variation of taxes and levies (v) Technological Change and Innovation, including a review of existing ICT infrastructure for revenue administration and management; integration of county revenue administration and management information systems; regulation and standardization of ICT systems for revenue management and administration and; capacity building among staff of the counties. (vi) Revenue Administration and HR Systems, including Revenue Administration institutional set up model; partnerships between national and County Government (Outsourcing of revenue collection and



data sharing); revenue analysis and forecasting; revenue measurement and reward system; data recording, management, and sharing and; capacity building and staff development (vii) Tax Assignment, Administration and Sharing (viii) Governance, Accountability and Oversight.

The policy will also generate a global list of all taxes, levies, charges and fees that are currently being imposed at the County level from County Finance Bills and categorize them into the four broad categories as listed below for ease of interpretation.

## CHAPTER 3: POLICY GUIDELINES FOR REVENUE ENHANCEMENT BY COUNTY GOVERNMENTS

### 3.1 *Guiding principles of policy on County Governments' own-source revenue*

This chapter presents policy guidelines aimed at supporting enhancement of revenue collection from the taxes, fees and charges assigned to County Governments. The policy is guided by provisions of the Constitution of Kenya (2010), the County Governments Act (2012), Public Finance Management Act (2012) and Public Finance Management (County Government) Regulations (2015) among other policy, legislative and regulatory frameworks. In addition, the policy is guided by the following principles:

- a) **Simplicity and enforceability:** The intention is to ensure that County Governments administer their taxes, fees and charges using uncomplicated instruments and rules, which rate payers can easily understand and comply with, thereby facilitating enforcement. In this context, the policy aims to remove all ambiguity in the manner in which counties are imposing taxes, fees and charges
- b) **Efficiency and effectiveness:** To ensure that County Governments achieve their fiscal policy objectives at minimal costs
- c) **Equity:** The policy does not create imbalances between the two levels of Government, amongst the counties or across generations over time
- d) **Good governance:** Put in place necessary internal controls and reporting mechanisms to enhance transparency and accountability
- e) **Buoyancy:** The tax base should be responsive to developments in the economy over time

### 3.2 *National Framework Legislation*

#### 3.2.1 *Legislation to regulate the process of introduction of new taxes, fees and charges as well as waivers and variations by County Governments*

In introducing new taxes, fees and charges, each county should consider its administrative/collection capacity in order to ensure effective and efficient collection and guard against introduction of disguised taxes in the form of user charges. This process should ensure proper policy coordination among counties in order to prevent multiplicity of small fees and charges with low revenue productivity and high compliance cost. To achieve this, the process should be guided by the following principles:

- i. A request for assignment/imposition of new fees may be initiated by the National Government or a County Government.
- ii. Neither the National nor the County Governments have the right to impose a tax, fee or charge on an activity falling under the jurisdiction of another County Government. This principle will put a stop to fees and charges being imposed on goods transiting through several counties.

- iii. County taxes, fees and charges should be source- and destination-based to avoid incidences of double taxation. Thus, even within the same county, taxes, fees and charges should be levied either at the source or destination of the good in question
- iv. A decision to expand county revenue raising powers shall be supported by demonstrable county's capacity in tax policy analysis and administration.
- v. County revenue raising measures shall be aligned to the national tax policy/strategy.
- vi. New taxes, fees and charges shall be introduced only after review and ratification through a process to be prescribed in law.

The process referred to in vi) above shall entail the following:

- i) Where a County Government proposes to introduce a new tax, fee or charge which has not previously been imposed, that County Government shall submit the tax, fee, charge proposal ten months prior to the commencement of the financial year;
- ii) The proposal referred to in i) above should have been included as a fiscal policy strategy, in the most-recent County Budget Review and Outlook Paper (C-BROP)
- iii) The County Executive Committee member for Finance shall submit the proposal, setting out the reasons for the tax proposal with identification of the following:
  - a. tax base or economic activity or income subject to tax, fee or charge;
  - b. identification of the statutory taxpayer;
  - c. the rate structure; and
  - d. tax relief measures / exemption to protect certain classes of taxpayers;
- iv) The proposal shall also indicate procedures for collection and administration, including tax collection agency, the person or entity responsible for remitting the tax and timing of payments; the costs and methods for administration and enforcing compliance; proposed penalty provisions; an assessment of the compliance burden for taxpayers; and procedures for taxpayer assistance and resolving taxpayer complaints.
- v) Estimated revenue collections per quarter and per annum
- vi) Indication of likely economic impact and tax burden on residents and businesses and risk of tax burden shifting
- vii) Prove that other counties were consulted in respect of fiscal competition; and,
- viii) Timelines for review, submission and approval of the county proposal in order to guard against undue delay.

Further to the provisions contained in section 159 of the PFMA, issuance of waivers and variations of taxes, fees and charges by County Governments shall be in accordance with the process prescribed in an Act of Parliament. For the purposes of this policy, the process for waivers and variations shall apply to the interest, penalties and fines in addition to the principal. In order not to discourage compliance, the variation or waiver process shall bar County Government from issuing waivers or variations to the same category of rate payers in a financial year following a similar waiver in the preceding year. The process shall include a proposal submitted by the CEC Member for Finance, containing the request for variation or waiver and:

- i) indicating reasons and/or policy objectives of such a variation/waiver;
- ii) identifying the category of tax payers to benefit from such variation/waiver;
- iii) outlining the impact of the variation/waiver on revenue collection;
- iv) the likely economic impact of the variation/waiver as well as potential shifts in tax burden and benefits

In order to ensure that the intentions of the SBP are not reversed through introduction of multiple business license fees, it is recommended that the legal instrument for regulating business activities at the county level shall be the SBP. This requirement shall be anchored in an Act of Parliament. Any exception to this requirement (e.g. where a County Government intends to introduce a business license outside the SBP regime) then the procedure provided above for introduction of new taxes, fees or charges shall apply.

### *3.2.2 National legislation to regulate property taxation by County Governments*

In terms of legal framework relating to property matters in Kenya, two crucial laws are already in place namely the Land Act, 2012, and the Land Registration Act, 2012. The Land Act gives effect to Article 68 of the Constitution, to revise, consolidate and rationalize land laws; to provide for the sustainable administration and management of land and land based resources. The purpose of the Land Registration Act is to deal with registration of titles to land, to give effect to the principles and objects of devolved government.

However, the legal framework relating to rating and valuation of land have not been revised to reflect the devolved system of Government, and only a few County Governments have put in place appropriate legislation to enable them effectively value land for property rating purposes. Among counties that have enacted valuation and rating legislation(s) are Nairobi, Laikipia and Kiambu. This policy therefore is aimed to address this legal vacuum.

There is need for new legislation on property taxation to repeal the outdated Valuation Act and Valuation for Rating Act, so as to align them with Constitutional provisions relating to devolution. It is recommended that the new legislation be enacted at the national level for the following reasons:

- The process by which each County Government would prepare its own valuation and rating legislation is time consuming and cumbersome, especially considering that the small pool of experts would be overstretched. Thus, developing this legal framework at the national level will ensure that within a reasonable timeframe, all counties have the necessary legal authority to impose and collect property rates.
- A national level legislation will ensure that there is uniformity in the underlying property valuation and rating law (e.g. with respect to the tax base, means-tested waivers, exemptions, deductions, and payment periods) without taking away County Governments' ability to determine their own rates

- Counties are currently preparing their property tax laws based on outdated Rating and Valuation for Rating laws, which refer to entities that no longer exist such as “rating authority”. This means that the valuations and/or re-valuations can be legally challenged, hence the urgency to have a new legal framework that would correct these anomalies. In this context, the quickest solution is to have legislation at the national level.
- Legislation at the national level will further enable the National Treasury to put in place regulations to ensure that Art. 209(5) of the Constitution is not offended with respect to guarding national economic policies and economic activities across county boundaries. This can be achieved for instance by defining boundaries on the basis of valuation, as well as providing mechanisms for effective engagement of stakeholders, some of who may reside outside the county.

In preparing the national legislation, it is recommended that the adopted property valuation approaches respond to growth in the tax base, thereby ensuring an element of buoyancy in the potential revenue streams. The national level legislation will contain all integral parts of a property rates e.g. property discovery and tax base coverage, valuation and assessment, setting appropriate tax rates, billing, collection, and enforcement. Borrowing from Rwanda (see section 2.3), the national law would also set the legal foundation of a reformed rating and valuation system with inbuilt key policy decisions (like tax rate and tax exemptions). It is recommended however that the more administration procedures (like billing, collection, enforcement, remedies) be anchored in county laws on property rates. Further, as is done in Uganda and Botswana (see section 2.3), this policy recommends that the national level law prescribes the maximum and minimum rates for property. This will provide a safeguard to ensure that property rates are not imposed in a manner that prejudices national economic policies contrary to Article 209(5) of the Constitution.

### *3.2.3 National framework law on entertainment tax*

Significant progress has been made with regard to unbundling functions for each level of Government, where entertainment is concerned. Through the Interagency Technical Committee on the Devolution of Betting Control and Licensing Function, consensus was reached with regard to the mandates of the National and the County Governments in the regulation of activities related to betting and gaming. What remains is gazettment of the unbundled functions, which provides further clarity to the function assignment, and give it legal force.

Notwithstanding the above, there is need for a legal framework enabling the two levels of Government to regulate activities under their assigned mandates, including the power to impose and collect related taxes, fees and charges.

### **3.3 County Government laws**

Imposition of taxes, fees and charges at the County level has been characterized by a weak link to services provided. There is need to improve this linkage. As an illustration, for parking fees, there

is need for ring fencing some of the revenues to be ploughed back in the areas where this has been collected. Counties should also provide parking spaces for citizens who would like to access the same for short periods. Currently, county parking fees do not distinguish between short and long term stay.

In addition, there is evidence that fees and charges in particular are being imposed in an ad hoc manner, resulting to multiplicity of the fees and charges. These challenges can be attributed to the lack of clear policy and legislation to provide necessary guidance in the imposition of fees and charges.

In light of the above, it is recommended that for each revenue stream, County Governments develop principal policies and laws on which to anchor their tax, fees and charges in line with Article 210 (1) of the Constitution and section 132 of the PFMA (2012). Such laws may include property rates, revenue administration, business and trade licensing and entertainment.

The Commission on Revenue Allocation in conjunction with the Kenya Law Reform Commission, the Council of Governors has already developed a County Model Revenue Legislation Handbook containing model laws on Property Rates, Trade Licenses, Revenue Administration and Finance Law. There may however be need to provide technical assistance to specific counties on a case-by-case basis to assist them develop or customize their revenue legislation.

### ***3.4 Tariffs and pricing policy***

Section 120(1) of the County Governments Act 2010 provides that a County Government or any agency delivering services in the county shall adopt and implement a tariff and pricing policy for the provision of public services. The tariff policy is intended to provide the basis of setting the fees, rates or taxes for services provided by the County Government in order to comply with the necessary legal provisions, including Section 107 (2)(g) of the PFMA and. Subsequently, the tariffs policy represents the key` policy statement of the County Government explaining basis of rates of taxes, fees and charges. Simply put, the tariff policy provides citizens with information that helps them to understand and interpret the taxes, fees and charges they pay and the services that they should expect from the County Government in return. In this context, the objective of the tariff policy is to ensure that:

- a) The tariffs of the County Government comply with the legislation prevailing at the time of implementation.
- b) The County Government services are financially sustainable, affordable and equitable.
- c) The needs of the poor, aged and people living with disabilities are taken into consideration.
- d) There is consistency in how the tariffs are applied throughout the County.
- e) The policy is drawn in line with the principles as outlined in Section 120 of the County Government Act 2012

### *3.4.1 Principles of a tariffs policy*

The principles to guide the tariffs policy shall be as set out in the Section 120(3) of the County Governments Act, 2012. Among aspects to be regulated in a county Tariffs Policy are the following:

- A minimum amount of basic services: The policy shall prescribe a minimum amount of basic service which shall attract a minimal rate of tax, fee or charge. Such basic services may include water, domestic wastewater and sewerage treatment, refuse removal and health. For these services, amounts beyond the minimum shall be subject to a stepped tariff structure in which charges increase progressively with higher consumption levels.
- Keeping tariffs affordable: The Tariffs Policy shall include measures to keep tariffs at affordable levels.
- The “Consumer must pay principle”: The Tariffs Policy shall be designed such that consumers must pay for services consumed beyond the basic minimum amount on the basis of usage.
- Promoting Local and Economic Competitiveness and Development: In preparing and implementing its Tariffs and Pricing Policy, the County Government shall take into account the need to promote local economic competitiveness, development and growth.
- Ensuring Financial Sustainability of Service Delivery: A County Government’s Tariffs Policy shall ensure that tariffs for services are sufficient to cover the cost of the initial capital expenditure as well as operation and maintenance manage, including any externalities

The Tariffs Policy shall clearly prescribe the process by which tariffs will be determined and reviewed, including the process of public and stakeholder consultations.

## **3.5 Revenue administration structure**

### *3.5.1 Provide tools, training and incentives to meet HR demands under the revenue function*

The County Revenue office shall review and evaluate its workload and competency needs. Upon determining its workload and competency needs, the County Government should assess the existing staff involved in revenue collection and administration to identify gaps in skills and numbers as well as the training needs. Once the gaps are identified, an appropriate training programme shall then be designed and delivered. Where new recruits are needed to fill identified gaps, the recruits should be taken through a training programme focusing on the following aspects of revenue management: planning, collection, inspection, accounting, reporting and legal enforcement. It is recommended that new recruits possess appropriate qualifications as set out in a Scheme of Service for the revenue function in each county. Further, a competitive salary and incentive system is recommended to retain staff once they have been trained. For purposes of continuous training, counties should enter into partnerships with the Kenya School of Revenue Administration. To deal with the issue of large numbers of under qualified casuals currently

involved in revenue collection, it is proposed that they be absorbed within or without the department and allocated duties that fit their qualifications.

### *3.5.2 Improving enforcement of PFM principles and practices*

#### ***Enhancing the capacity to prepare credible revenue forecasts***

Given the challenge of meeting revenue targets, the following measures need to be put in place to ensure credible revenue forecasts by counties in future:

- a) Revenue forecasting should be evidence based. In this regard, every year the Estimates of Revenue (accompanying the budget) should be accompanied by a statement clearly explaining the basis for the estimates. That statement shall provide the following details for each category of tax, fee or charge:
  - The previous years' collection;
  - A description of the base;
  - The applicable rate;
  - The total projected collections;
  - The assumptions made;
  - Reasons for previous year's performance for major revenue streams.
- b) County Governments shall build the capacity of their staff in revenue forecasting and analysis.
- c) The National Government shall build the capacity of County Governments to generate more comprehensive data that is needed to support more accurate revenue forecasting.
- d) Counties shall include details of their revenue projections by revenue stream in the CBROP. While counties are required to prepare the County Budget Review and Outlook paper (CBROP) in line with the Public Finance Management Act, 2012 section 118, most of them do not include detailed revenue forecasts.
- e) There should be full implementation of the fiscal responsibility rewards/sanctions as contained in the revenue sharing formula approved by Parliament, whereby counties with credible revenue projections could be rewarded with larger shares of the fiscal responsibility resources.

### *3.5.3 The role of ICT and automation in enhancing revenue administration*

Based on the challenges being experienced by County Governments from the use of fragmented systems for revenue collection and management including LAIFOMS, IFMIS and various other county-specific systems, it is important to develop a standardized ICT-based system that can be used by the County Governments. Such standardization of ICT based systems of collecting and managing revenue across counties is critical in order to ensure uniformity in reporting. Inevitably, standardization of ICT based systems will be accompanied with integration and automation. Integration will facilitate monitoring, financial control and oversight by the National Treasury



including by enabling cross county comparisons. Automation on the other hand will help to eliminate the challenge of county revenue officials handling cash, which contributes to revenue leakages.

It is important to note that Article 190(2) of the Constitution requires County Governments to use financial management systems that are compatible with requirements prescribed by a national legislation. This requirement is intended to ensure some minimum level of standardization. Section 12(1(e) of the Public Finance Management Act of 2012 requires that National Treasury to prescribe a financial management system to be used by the National and County Governments. Pursuant to this legal provision, the National Treasury should gazette guidelines to ensure standardization of revenue collection systems used by National and County Governments. In addition, National Government should develop a system for revenue collection and management that meets the prescribed standards for use by the counties. This will save counties the huge costs associated with procurement of tailor-made systems for collection and management of revenue.

The prescribed revenue collection and management system should be compatible with the IFMIS. Such a system must at the minimum support the following processes:

- a) Revenue Sources Management, including identification of revenue sources, classification of revenue sources, and segmentation and optimization of revenue sources.
- b) Revenue forecasting
- c) Requesting for disbursements from National Government
- d) Revenue Collection, including invoicing/billing and receipting
- e) Process of receiving and processing payment through multiple electronic payments including mobile money, direct bank debits, credit and debit card and e-wallet.
- f) Cash and Bank reconciliation, including monitoring cash position
- g) Credit Control and debt management
- h) Management of Revenue Collectors by registering internal collection staff and external collection agents against revenue sources.
- i) Customer management by clustering them into unique segments based on predefined parameters.
- j) Workflow management
- k) Reporting and auditing (as per County and National requirements)
- l) Integration with IFMIS and other existing technologies

To allow seamless integration between IFMIS and the county revenue collection and management systems, the design and structure of the revenue collection system for all counties will be based on the Government Standard Chart of Accounts (SCOAs).

The Guidelines should also be regularly reviewed in order to ensure completeness and that any flaws are promptly detected and corrected. The Guidelines must also require high levels of security for the ICT based systems adopted by County Governments for revenue collection and

management. The Guidelines must entrench the practice of regular audit of such systems to check for systems vulnerability.

The success of the system designed will depend on its ability to overcome the connectivity challenges that continue to undermine other systems used to manage public finance. In this context, counties should also diversify delivery channels to extend the services to as many businesses as possible for example use of mobile digital telephony. To address the challenge of frequent power outages, counties should invest in alternative sources of power to reduce the systems downtime.

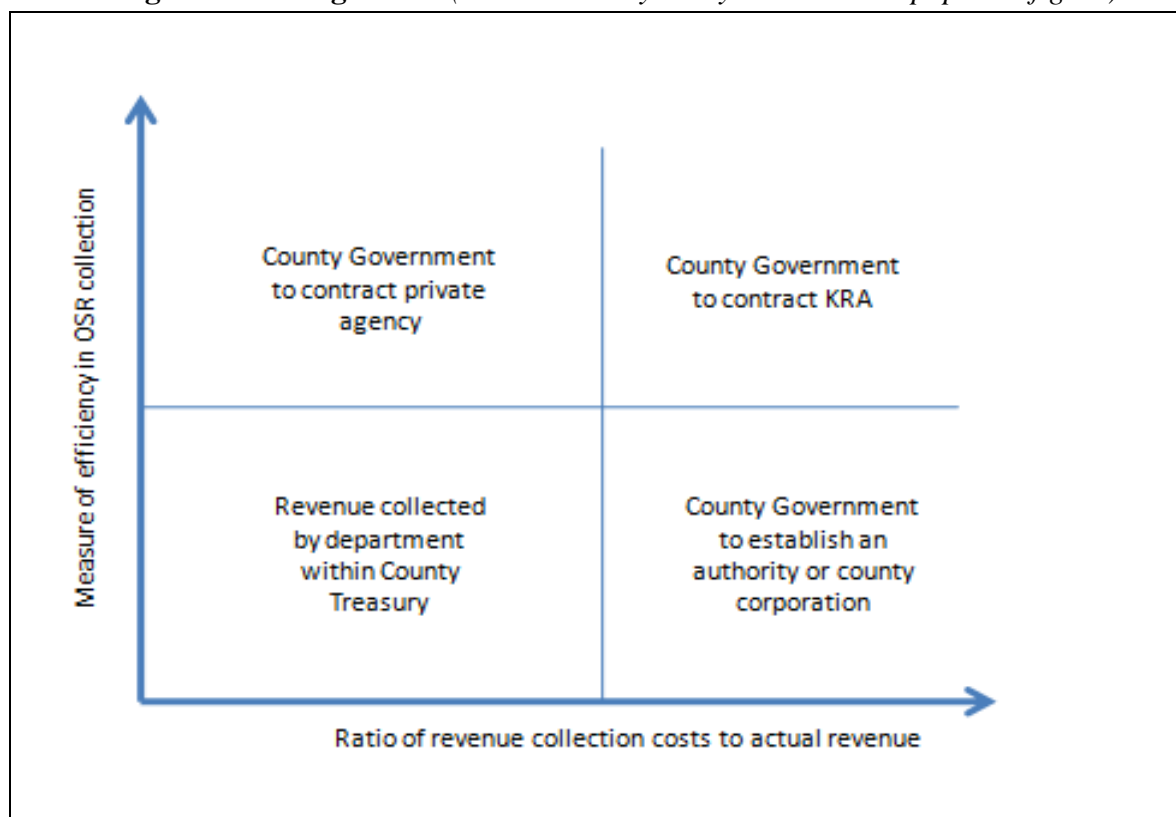
#### *3.5.4 Enhancing revenue administrative efficiency*

Existing legal framework allows for four possible organizational arrangements for collection of revenue at the county level.

1. Respective County Governments can set up tax collection departments or divisions for purposes of revenue collection.
2. Respective County Governments can contract out the task for revenue collection to private organizations.
3. Each County Government could establish an independent Authority to assist in the collection of revenues.
4. Any County Government could appoint the KRA as a collection agent in accordance with Section 150 of PFMA.

This policy provides guidance to County Governments to enable them determine the most appropriate institutional revenue collection and management arrangement, given their specific context. Figure 5 illustrates the four possible legally available institutional options, and an attempt has been made to map each county to a particular quadrant, based on available data on efficiency of revenue collection and productivity.

**Figure 5: Guidance for counties in determining appropriate institutional revenue collection and management arrangements** *(Further county analyses needed to populate figure)*



*Source: Computations by the Interagency Working Group on County Own Source Revenue*

### 3.5.5 Enhancing property tax revenues

To enhance property tax revenue, there is need to

- (i) Develop a national land registry that links the 52 county registries.
- (ii) Digitize land titles and register untitled parcels, which would give important insights on the sustainability of the property rating system.
- (iii) Develop a comprehensive national cadaster, which should be updated regularly to include buildings and physical improvements.
- (iv) Introduce incentives that encourage registration of properties including agricultural land by reducing the cost of registration, survey and legal fees. Consideration could be given to make registration compulsory irrespective of the legal status (include informal settlements).
- (v) Introduce measures to audit new valuation rolls with oversight by the National Land Commission for jurisdiction unity.

Another proposal is the development of an appropriate Fiscal Cadaster based on the land cadaster (LAIS) but supplemented with detailed technical data on buildings, value zones, property values, and taxation records; Issuing Valuation Manual with detailed instructions for: single market valuation; using mass valuation instruments; defining value zones, and guiding revaluation of

AFAT unit taxes. Additionally, migrating land subject to rent (leaseholds) to either Area Fixed Asset Tax or Value Fixed Tax (to mitigate low tax collection on Leases which are charged per-square-meter fee with no charge for improvements).

The computer aided mass valuation system (CAMA) or automated valuation models (AVMs) centralizes procedures and utilizes the modern instruments like the digitized land records and the GIS mapping, supplemented with technical details from owners. (In Lithuania, CAMA was legislated as the basic method for real estate valuation including land, buildings, and improvements). CAMA models are well regulated and can handle well the information from the computerized land cadaster and the GIS. CAMAs uses the same information as the single property valuation and can handle and mix the various valuation methodologies, including the market value, the cost based, and the income based valuations. CAMA system stores cadastral records, increases analytical capabilities, makes routine calculations, and produces reports, including property records, assessment rolls, assessment notices, and tax bills.

## CHAPTER 4: GOVERNANCE, ACCOUNTABILITY, REPORTING AND OVERSIGHT

### 4.1 Accountability

The Constitution lays down the National values and principles of governance under Article 10(2), which include the rule of law, public participation, good governance, transparency, inclusiveness, accountability, integrity and sustainable development. The Constitution also requires all state organs, state officers and public officers to observe the principles in the formulation and implementation of public policy decisions. This has been operationalized through the Public Finance Management Act, 2012, which establishes institutions and assigns them responsibilities for purposes of ensuring that the principles are effectively implemented.

It is clear from the Constitution and Legislation that accountability is imperative in the carrying out of State and Public duties. In light of this, it is recommended that accountability mechanisms be built into the process of county revenue collection and management. Enhancing accountability, transparency and good governance in the management of county own source revenue will create awareness, reduce cost, minimize cash transactions, improve control on the accountable documents, increase compliance and promote ownership leading to enhanced own revenue collection by counties. With increased own source revenues, County Governments will have more resources to implement their priority projects and programmes.

In order to ensure that the framework for collecting and managing county revenue facilitates accountability, it should adhere to the following principles:

- **Transparency and Access to information** by enhancing accessible and timely provision of information. This can be achieved by opening up of county processes, structures and procedures relating to county own source revenue.
- **Stakeholder Engagement and Public Participation:** The public should be involved in the planning, implementation, control and oversight of revenue collection and management. Moreover, counties should ensure that there are effective feedback mechanisms once members of the public raise issues of concern.
- **Mechanisms for enforcing compliance** on the offices responsible for revenue collection and management. County Governments should consider administrative sanctions where there is non-compliance as a result of failure of the mandated offices carry out their mandate. Where there is persistent material breach of the law, including failure to comply with Article 207 of the Constitution and Section 109 of the PFM Act, the provisions of Article 225 apply. Counties to develop their own guidelines and procedures that will be gazetted on enforcement.
- **Clarity on the roles of both levels of government**, relating to revenue collection and management through development of policies, legislation and administrative measures.

This would aid in the elimination of cases of multiple taxation by both levels of government. Moreover, this would eliminate an overlap of fees collection from different departments in the County Governments

## **4.2 Strengthening compliance and enforcement**

According to a study conducted by the Office of the Controller of Budget in 2015, County Governments faced a number of challenges in the collection and management of revenue.<sup>10</sup> 86% of County Governments reported resistance in compliance by taxpayers as a result of high rates. Moreover, 27% of revenue collectors interviewed reported that traders resisted paying taxes, fees and charges, as they did not see value for the rates paid. There was also evidence of weak accountability mechanisms in revenue collection, due to the fact that 77% of revenue collectors received payments in cash, while 10% of collectors received payments through direct bank deposits. In addition, it was reported that 75% of the mode of revenue collection was purely manual, whereas only 11% of the counties use an exclusively electronic system. The study further indicated that the main source of revenue leakage was at the point of revenue collection. The leakage was attributed to corruption of revenue collectors, issuance of fake receipts, non-payment and under-invoicing among others.<sup>11</sup>

In the above context, to improve compliance and enforcement mechanisms by taxpayers, it is recommended that County Governments embrace a mix of approaches, which include:

- Automation of revenue collection and management: This will minimize challenges encountered with the manual system which are prone to human errors and manipulation. Automation will also make tax forecasting, billing, collection and tracking more efficient.
- Incentive-based compliance mechanism which may include ‘easy to pay options’ such as mobile money, credit and debit cards, revenue collection agents and bank transfers will reduce the cost of compliance. Compliance is also likely to be enhanced by providing taxpayers with clear payment due dates along with adequate time within which to pay and the option of paying in installments.
- Use of alternative tax arbitration mechanism to resolve tax related disputes would facilitate collection of outstanding dues therefore enhancing compliance.
- In order to enhance tax compliance at the county level, there is need to entrench in law measures that require twinning of tax requirements with certain County Governments services. For example: tying of the issuance of the Single Business Permits (SBPs) to production of valid Tax Compliance Certificates (TCCs) by the applicants; and, awarding of tenders to businesses by County Governments to be tied to production of TCCs by the bidders. It is important to note that this will only work, if there is a centralized system of

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<sup>10</sup>County Revenue Baseline Study 2015, Pgs. 52 and 53

<sup>11</sup> Ibid, pg. 55

tax compliance where information can be shared between Counties and the two levels of government.

- To overcome tax, fees and user charge resistance, County Governments should improve service delivery. Improvement in service delivery would act as an incentive to the taxpayers to comply.
- Public participation in revenue collection and management will help create awareness, enhance ownership and therefore minimize resistance to tax, fees and user charge payment and in this in turn will help to improve compliance.
- Clarity on the mandate for imposing taxes, user fees and charges across counties and between the two levels of government, would help to avoid a multiplicity of charges, fees and taxes. Where clarity is lacking, unbundling of the function in question should be undertaken, and where concurrence exists, a mechanism should be developed through an intergovernmental forum to clearly assign regulatory and revenue raising responsibility.
- Where there is failure to comply, then sanctions and penalties as provided in law, shall be applied consistently.

#### **4.3 Internal control systems and risk management**

- National Treasury shall issue guidelines on the roles, responsibilities and reporting structures of the various County Government offices responsible for the collection and management of revenue.
- County Governments shall ensure that there are adequate numbers of qualified personnel to enforce revenue collection as well as ensure regular rotation of revenue collection staff. This will eliminate the possibility of collusion among revenue collectors. In addition, County Governments shall put in place appraisal performance systems, which shall have a reward and sanction mechanism to incentivize good performance.
- Each County Treasury should ensure that there is an internal control and risk management mechanism for the collection and management of revenue in accordance with the guidelines issued by National Treasury.
- The CEC responsible for Finance shall ensure that waivers and exemptions given shall have a basis, which is known and predictable in accordance with Article 210 of the Constitution, Section 159(c) of the PFM Act and the law contemplated in this Policy to regulate the issuance of waivers or variations of taxes, fees and charges. The process including the authority to grant waivers on penalties and interests should be prescribed. For the avoidance of doubt, waivers on penalties and interest shall be reported in accordance with the PFM Act.
- The County Treasuries shall constantly review performance of revenue collection against the targets and shall include a status report in the Quarterly and Annual reports. Interrogation of revenue forecasting will be conducted by IBEC, which will then make recommendations to the Counties.

- The revenue sharing formulae determined by Parliament pursuant to Article 217 of the Constitution, may, in accordance with Article 203(1)(i) incorporate a parameter that facilitates a reward mechanism on the basis of fiscal performance of counties in revenue collection and management. In addition, pursuant to Article 202, National Government may consider conditional or unconditional grants intended to incentivize good practices in revenue collection and management by County Governments.
- Where there has been material breach and/ or persistent material breach of the PFM Act with regards to the handling of public funds, including OSR, the Cabinet Secretary responsible for Finance may invoke Section 96 of the PFM Act, 2012 in accordance with Article 225 of the Constitution to stop the transfer of funds to any given County.

#### **4.4 Mechanisms for oversight**

- County Treasuries shall ensure that revenue accounts are prepared and submitted to the Auditor General for audit in accordance with the PFM Act and the Public Audit Act.
- County Assemblies shall review the audited accounts and make recommendations, and shall put in place mechanism for follow up on implementation of the recommendations.
- The Senate and the County Assemblies shall facilitate the submission of petitions by members of the public on revenue matters, and such petition shall be considered and determined.
- Where County Assemblies are not able to resolve the matters, then they shall be escalated to the Senate in accordance with the Constitution.

#### **4.5 Inter and intra-governmental coordination mechanism**

Both levels of government shall consult on revenue collection and management within the Intergovernmental Budget and Economic Council (IBEC) pursuant to Section 187 of the PFM Act.

There is also need to clarify and include in law that tax procedures for introducing new taxes should also specify how often counties can review their tax, fees and charges rates. The frequency can be annual. It should also determine how much variation in terms of percentage should be allowed. It should indicate the maximum variation that should be allowed.

#### **4.6 Centralized database system**

The National Treasury shall prescribe a centralized database containing information related to revenue collected by both levels of Government, and detailing how the information is to be shared.



#### **4.7 Reporting framework**

Reporting of revenue by County Governments shall be in accordance with the section 163 and 166 of the PFM Act, 2012 and the PFM (County Governments) Regulations, 2015. Notwithstanding these provisions, in order to enhance uniformity in reporting of revenue, it is recommended that the framework for reporting use the GFS classification and the Standard Chart of Accounts. There shall be a standard format for reporting on revenue to be determined by the Public Sector Accounting Standards Board.

## CHAPTER 5: POLICY IMPLEMENTATION PLAN

### 5.1 Monitoring and Evaluation Logical Framework

Table 5 contains a proposed Monitoring and Evaluation Log-Frame that is intended to guide the measuring of implementation of the objectives set out in this Policy.<sup>12</sup> Monitoring and Evaluation (M&E) of this Policy is necessary for the successful achievements of the objectives of the Policy. M&E shall be done periodically through the logical framework developed under this policy.

**Table 5: Proposed M & E log-frame**

COUNTY OWN SOURCE REVENUE ENHANCEMENT LOGICAL FRAMEWORK			
Objectives	Objectively Verifiable Indicators	Means of verification	Assumptions
<b>Goal:</b> To support enhancement of County Governments Own Source Revenue	G1: % of increase in County Governments own source revenue collection ( <i>XX% in 2 years; XX% in 5 years</i> )  G2: % of increase in counties' fiscal effort (percentage of revenue collected against the county fiscal capacity).	G1: County Governments' quarterly and annual reports  G2: Survey data by KNBS/NT.	Policy to support enhancement of own source revenue is adopted by National and County Governments.
Broadening County Governments' Tax Bases			

<sup>12</sup>The greater impact of this framework on the economy shall be monitored within the context of the National Integrated Monitoring and Evaluation System (NIMES).

## COUNTY OWN SOURCE REVENUE ENHANCEMENT LOGICAL FRAMEWORK

Objectives	Objectively Verifiable Indicators	Means of verification	Assumptions
<b>Outcome 1:</b> County tax bases broadened	1a: % of new tax payers captured in the county's revenue collection system ( <i>XX% in 2 years; XX% in 5 years</i> )  1b: % of County Governments that have mapped and assessed all key own source revenue streams ( <i>in 3 years</i> )	1a: County Governments' quarterly and annual reports.  1b: Survey data by KNBS/NT.	The political and security situation remains stable allowing county-level activities to be carried out. No disruption due to political regime change at the counties.
<b>Output 1.1:</b> National Framework Laws to guide imposition of county taxes, fees and charges is in place  <b>Output 1.2:</b> County Governments enact principal laws to anchor their revenue measures in line with Article 210 of the Constitution  <b>Output 1.3:</b> County Governments have approved a tariff and pricing	1.1a: A National Framework law is enacted by Parliament to regulate the process of introduction of taxes, fees and charges, as well as issuance of waivers and variations ( <i>within 2 years</i> ). 1.1b: A National law for property taxation is enacted ( <i>within 2 years</i> ). 1.1c: A National Framework law is enacted to define entertainment tax and regulate the gaming industry, including casinos ( <i>within 2 years</i> ).  1.2: No of laws enacted by County Governments to guide property rates, entertainment, revenue administration and trade licensing; ( <i>within 5 years</i> ).	1.1: Parliamentary reports      1.2: County Assemblies' reports   1.3a: Survey data by KNBS/NT. 1.3b: County Assemblies' reports	Local political leaders support implementation of policy and related laws.

## COUNTY OWN SOURCE REVENUE ENHANCEMENT LOGICAL FRAMEWORK

Objectives	Objectively Verifiable Indicators	Means of verification	Assumptions
<p>policy as required under Section 120(1) of the County Governments Act of 2012.</p> <p><b>Output 1.4:</b> Communities' awareness of their role as well as opportunities to hold government to account on revenue matters.</p>	<p>1.3: No of County Governments with a pricing and tariff policy.</p> <p>1.4a: % of people in communities have participated and contributed in discussions on revenue matters. <i>(50% within 2 year; 100% by year 5).</i></p> <p>1.4b: % of County Governments that have fully complied with the public participation guidelines issued by the National Government</p>	<p>1.4: Focus group discussions / survey data <i>(Annually; by National Treasury &amp; KNBS)</i></p>	
<p><b>Activities (for Output 1.1)</b></p> <p>1.1.1 Constitute an interagency committee to draft the national framework law to guide process of introducing taxes, fees and charges.</p> <p>1.1.2 Research and drafting of the law</p> <p>1.1.3 Conduct expert and peer review of the law</p> <p>1.1.4 Cabinet approval of the law</p> <p>1.1.5 Submission of the draft law to Parliament for approval</p>	<p><b>Inputs/resources</b></p> <p>1.1.1: Venues to hold meetings; reference material</p> <p>1.1.2: Per diems</p> <p>1.1.3: Computers, printers, etc.</p>	<p><b>Costs &amp; sources</b></p>	<p>Resources are available to carry out the proposed activities</p>

## COUNTY OWN SOURCE REVENUE ENHANCEMENT LOGICAL FRAMEWORK

Objectives	Objectively Verifiable Indicators	Means of verification	Assumptions
<b>Activities (for Output 1.2)</b> 1.2.1 Recruit TA to support counties in the development of principal laws to anchor their revenue measures. 1.2.2 Research and drafting of the law 1.2.3 Conduct expert and peer review of the law 1.2.4 Approval by County CECs and County Assemblies	<b>Inputs/resources</b> 1.2.1:Hire of TA 1.2.2:Venues to hold meetings; reference material 1.2.3: Per diems 1.2.4: Computers, printers, etc.	<b>Costs &amp; sources</b>	
<b>Activities (for Output 1.3)</b> 1.3.1 Recruit TA to support counties in the development of pricing and tariff policy. 1.3.2 County Governments prepare draft tariff and pricing policy 1.3.3 Draft policy is subjected to expert and public consultation. 1.3.4 Policy is approved by CEC 1.3.5 Policy submitted to County Assembly for approval.	<b>Inputs/resources</b> 1.3.1:Hire of TA 1.3.2Venues to hold expert and public consultations; 1.3.3: Per diems	<b>Costs &amp; sources</b>	
<b>Activities (for Output 1.4)</b> 1.4.1 Recruit TA to Develop program and material for civic engagement. 1.4.2 Mount civic engagement forums (through public fora and media)	<b>Inputs/resources</b> 1.4.1:Hire of TA 1.4.2: Material for civic engagement 1.4.3Venues to hold civic engagement 1.4.4: Hire of media space/air time 1.2.3: Per diems	<b>Costs &amp; sources</b>	

## COUNTY OWN SOURCE REVENUE ENHANCEMENT LOGICAL FRAMEWORK

Objectives	Objectively Verifiable Indicators	Means of verification	Assumptions
Activities for other outputs	Inputs & resources for other outputs	Costs & sources for other outputs	
<b>Enhancing County Governments' Revenue Administrative Capacity</b>			
<b>Outcome 2</b> The capacity of County Governments to collect and manage revenue is enhanced.	1a: % of County Governments using the prescribed automated own source revenue collection and management system ( <i>50% within 2 years, 80% within 3 years and 100% within 5 years</i> )  1b: % of County Governments with an appropriate organisational structure as well as staff numbers and skills mix based on guidelines issued by respective CPSBs ( <i>50% within 2 years and 80% within 3 years and 100% within 5 years</i> )	1a: Reports of the Controller of Budget and the Auditor General;  Survey data by KNBS/MoDP/NT.  1b: Survey by KNBS/MoDP/NT	The political and security situation remains stable allowing county-level activities to be carried out.  No disruption due to political regime change at the counties.
<b>Output 2.1:</b> County Governments have established appropriate revenue forecasting mechanisms/tools.  <b>Output 2.2:</b> County Governments have established appropriate institutional arrangement for revenue collection and management and staffed with adequate and skilled professional personnel.	2.1: % of County Governments with appropriate revenue forecasting tools ( <i>50% within year 1 and 100% in year 2</i> ).  2.2a: % of County Governments with an organisational structure for collection and management of revenue that meets the prescribed standards ( <i>within 2 years</i> ). 2.2b: % of County Governments with adequate staff in terms of numbers and skill mix in line with the standards prescribed.	2.1: Survey data by KNBS/NT   2.2: Survey data by KNBS/NT/MoDP	

## COUNTY OWN SOURCE REVENUE ENHANCEMENT LOGICAL FRAMEWORK

Objectives	Objectively Verifiable Indicators	Means of verification	Assumptions
<b>Output 2.3:</b> County Governments have adopted a standardised ICT based system of collecting and managing revenue.	2.2c: % of county registries that are linked to the national land registry.  2.3a: Guidelines on the standards of ICT based revenue collection and management system for use by County Governments are gazetted. <i>(within year 1)</i> . 2.3b: % of County Governments using a standardised ICT based system for collecting and managing revenue 2.3c: % of land titles that are digitized???	Reports from Ministry of Lands and Housing   2.3: Survey data by KNBS/NT   Reports from Ministry of Lands and Housing	
<b>Activities (for Output 2.1)</b> 2.1.1 Recruit TA to support counties in the forecasting of revenue 2.1.2 Training of county officials	<b>Inputs/resources</b> 2.1.1:Hire of TA 2.1.2Venues to hold training; 2.1.3: Per diems	<b>Costs &amp; sources</b>	
<b>Activities (for Output 2.2)</b> 2.2.1 Recruit TA to develop guidelines on the organisational structure for collection and management of revenue.	<b>Inputs/resources</b> 2.1.1:Hire of TA 2.1.2Venues to hold stakeholder consultation	<b>Costs &amp; sources</b>	

## COUNTY OWN SOURCE REVENUE ENHANCEMENT LOGICAL FRAMEWORK

Objectives	Objectively Verifiable Indicators	Means of verification	Assumptions
<p>2.2.2 Issue guidelines on the organizational structure for revenue collection and management of revenue</p> <p>2.2.3 County executives develop organisational structures for revenue collection and management.</p> <p>2.2.4 Subject the organisational structure to stakeholder validation.</p> <p>2.2.5 County Public Service Boards approve the organisational structure.</p> <p>2.2.6 Conduct capacity building of counties in revenue collection and management, including policy on county OSR and related legislation.</p>			
<p><b>Activities (for Output 2.3)</b></p> <p>2.3.1 Recruit TA to develop guidelines on the County standardized ICT-based system for revenue collection and management</p> <p>2.3.2 Issuance of guidelines by NT</p> <p>2.3.3 Capacity building on the use of the system</p>	<p><b>Inputs/resources</b></p> <p>2.3.1 Hire of TA</p> <p>2.3.2 Venues to hold stakeholder consultation</p> <p>2.3.3 Per diems</p>	<p><b>Costs &amp; sources</b></p>	



## **5.2 Progress reports**

The National Treasury shall prepare Quarterly and Annual M&E reports on the implementation of the policy. National Treasury shall also commission a Mid Term evaluation, which shall be conducted by an independent agency to measure the outcomes and impact of the Policy and to inform its review. NT jointly with other key actors/stakeholders should undertake these M&E studies.

## **5.3 Feedback mechanisms and stakeholder consultation**

The National Treasury shall hold a County Own Source Revenue Conference every two (2) years in order to monitor progress in the implementation of the policy and to receive feedback from the County Governments.

## **5.4 Timelines for reviewing the policy**

The policy shall be operational for a period of Ten (10) years and shall be subjected to a Mid Term Evaluation after five (5) years.

### Annex 1: Legislative provisions on sharing of natural resource revenues with counties

Legislation	Provisions on revenue sharing
<b>The Mining Act, 2016</b>	<p>This Act contains provisions on sharing of royalties accruing from minerals between County Governments and communities where mining operations take place. Section 183(5) of the Act states that royalties payable to the State by holders of mineral rights in respect of the various mineral classes shall be distributed as follows:</p> <ul style="list-style-type: none"> <li>a) 70% to the National Government;</li> <li>b) 20% to the County Government; and,</li> <li>c) 10% to the Community where the mining operations occur.</li> </ul>
<b>The Energy Bill, 2015</b>	<p>This Bill contains a provision for sharing revenues from geothermal resources with County Governments where the resources are found. Section 84(3) of the Bill states that any royalty received by the National Government from geothermal energy produced shall be apportioned as follows:</p> <ul style="list-style-type: none"> <li>a) 75% of the royalties received shall be National Government revenue to be dealt with in accordance with Article 203 of the Constitution;</li> <li>b) 20% of the royalties paid shall be allocated to the host County Government; and,</li> <li>c) 5% of the royalties paid shall be allocated to the local community in accordance with Regulations under the Energy Act.</li> </ul>
<b>Petroleum (Exploration, Development and Production) Bill, 2015</b>	<p>This Bill, which covers the upstream petroleum sector, contains a model Production Sharing Contract between the Government of Kenya (GoK) and the Contractor (Petroleum Company). The Bill proposes distribution of GoK's share of upstream petroleum (oil and gas) revenue ('Profit Oil/Profit Gas') as follows:</p> <ul style="list-style-type: none"> <li>a) Section 84(1) of the Bill states that profit oil/profit gas derived from upstream petroleum operations shall be shared between the Contractor and the National Government (i.e. profit split) in accordance with the Petroleum Agreement (Contract). The sharing of petroleum profit is after deduction of recoverable costs (based on cost recovery limit) allowable under the petroleum legislation.</li> <li>b) Section 85(1) further states that the National Government's share of profits derived from upstream petroleum operations shall be apportioned as follows: <ul style="list-style-type: none"> <li>i. County Government's share shall be equivalent to 20% of the National Government's share (Section 85(2)); and,</li> <li>ii. Local communities' share shall be equivalent to 5% of the National Government's share of profit petroleum.</li> </ul> </li> </ul>
<b>Draft Kenya Sovereign Wealth Fund (KSWF) Bill, 2015</b>	<p>This draft Bill is designed to consolidate and make prudent use of revenues from the non-renewable natural resources, specifically mineral royalties and the Government's share of profit petroleum. The sources of revenue of the Fund (Section 6(1)) make this Bill a money Bill (Article 114), as it entirely deals with monies accruable from non-renewable natural resources. The draft Bill is however still under internal review.</p>
<b>The Natural Resources (Benefit Sharing) Bill, 2014</b>	<p>This Bill focuses on revenues from both renewable and non-renewable natural resources in instances where no other written law exists. The Bill establishes a Benefit Sharing Authority (s.3(1)), which <i>'shall have the power to determine and review the amount of royalties and fees payable by affected organizations in each year in respect of a particular sector where a written law does not prescribe the royalties or fees'</i> (Section 24(1)).</p>

Source: Various national legislations

## References: