

TAXATION AT THE COUNTY LEVEL

A review of County Levies, Charges and Taxes

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KEY FOCUS AREAS



Historical Perspective

Legal Provisions on County Taxation

County Own Source Revenue
enhancement

Policy on Counties Own
Source Revenue

County Government Finance
Bills

INTRODUCTION



- ❑ Fundamental and simultaneous transitions – political, economic, fiscal, administrative. Far reaching impact.
- ❑ 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:
 - The Local Government Act (Cap 265, sections 216 and 217)
 - The Valuation for Rating Act Cap 266, and the Rating Act Cap 267:
 - The Trade Licensing Act (Cap 497) and
 - The Local Government Act (section 222).

HISTORICAL CONTEXT CONT....

- ❑ Series of political reforms and Constitutional amendments led to the removal of LAs' powers to Central Government ministries and departments i.e,
 - ❑ 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.
 - ❑ Further removed the right of municipalities to levy the Graduated Personal Tax (GPT) which had been their most important source of revenue
 - ❑ In 1989, the specific grants were replaced by a service charge levied on business premises and employees in formal and informal sector
 - ❑ In 1998, the service charge was itself abolished, following introduction of the Local Authorities Transfer Fund (LATF)
 - ❑ 2013 County Governments inherited all revenue streams that were previously being administered by the defunct LAs

INTRODUCTION



- ❑ ‘Big Bang’ Fiscal Decentralization 2013: PFM Act 2012 and Regulations 2015, PPAD Act 2015
- ❑ Expenditure responsibilities for public service delivery decentralized to Counties
- ❑ Raises some very fundamental issues on administrative capacity, fiduciary management and accountability.

TAX TERMINOLOGIES



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

TAX MEASURES

Tax measures are introduced to:-

- ❑ Raise additional revenue to bridge the financing gap
- ❑ Promote economic growth
- ❑ Expand employment opportunities
- ❑ Simplify the tax system
- ❑ Make goods and services more accessible by the poor

CONSTITUTIONAL PROVISIONS ON COUNTY REVENUE GENERATION



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

CONSTITUTIONAL PROVISIONS ON REVENUE GENERATION....

National Government



Income tax;



Value-added tax;



Customs duties and other duties on import and export goods;



Excise tax.

CONSTITUTIONAL PROVISIONS ON REVENUE GENERATION....

Power to Impose Taxes- Art. 209

County Government

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



Property rates;



Entertainment taxes; and



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



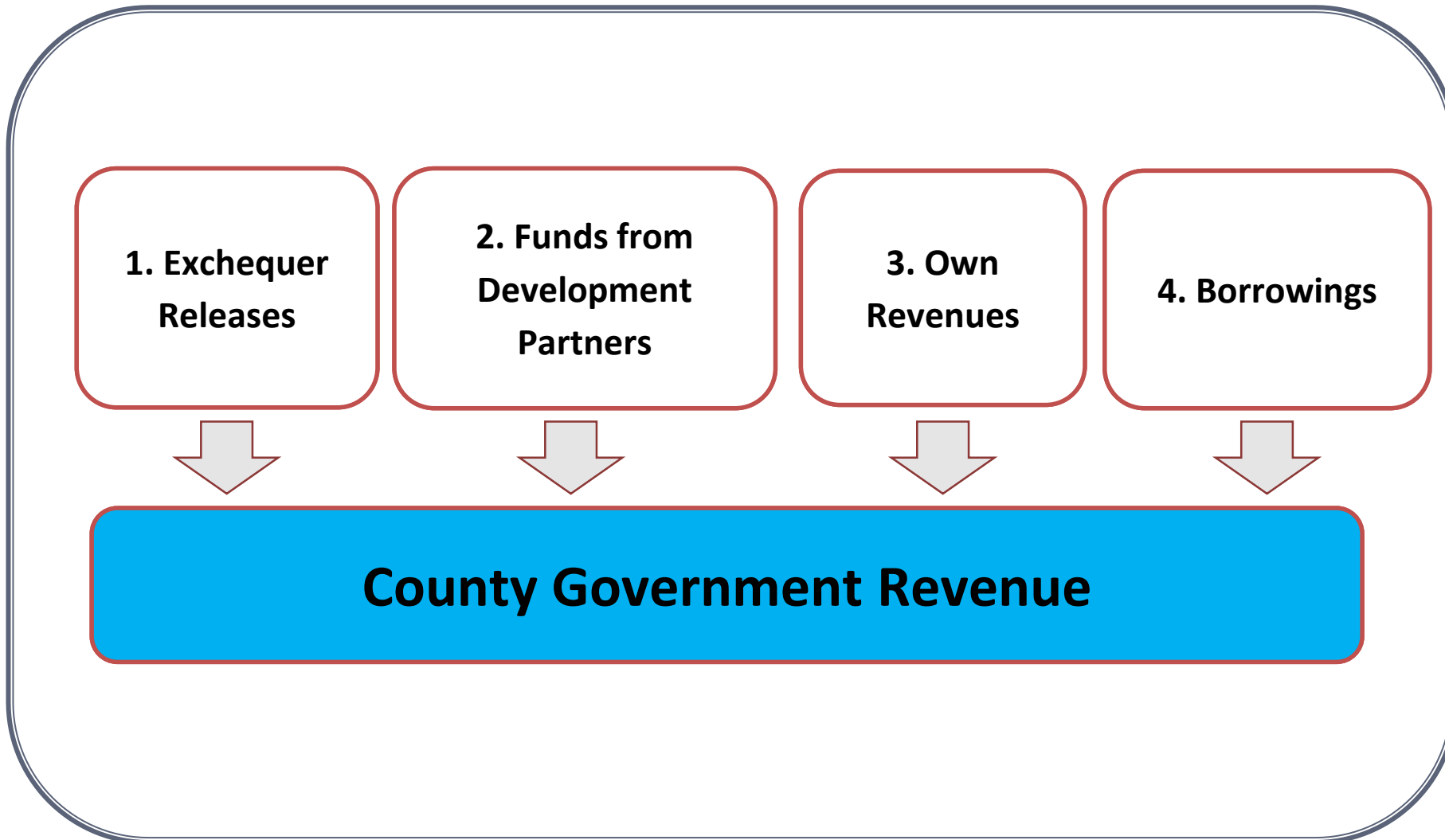
Service Charge

CONSTITUTIONAL PROVISIONS ON COUNTY REVENUE GENERATION....



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

MAIN SOURCES OF FUNDING FOR COUNTIES



SOURCES OF FINANCES FOR NATIONAL & COUNTY BUDGETS



a) Tax Revenue

- i) Income tax
 - ❖ PAYE
 - ❖ Corporation tax
- ii) Excise duty - cigarettes, beer, mineral water, juices, soda, wines and spirits, motor vehicles
- iii) Value Added Tax
- iv) Import duty
- v) Stamp duty
- vi) Fees and charges- fee under Traffic Act
- vii) Profit and dividend
- viii) Rent on land
- ix) Import declaration fees
- x) Railway development levy

b) Non Tax Revenue

- i. Borrowing – domestic and foreign
- ii. Grants from the development partners
- iii. Dividend from investments
- iv. Fines and forfeitures
- v. Surplus from Regulatory Authority – CAK, RBA, CMA etc
- vi. Loans repayment

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

REVENUE BASKET FOR COUNTIES SO FAR...

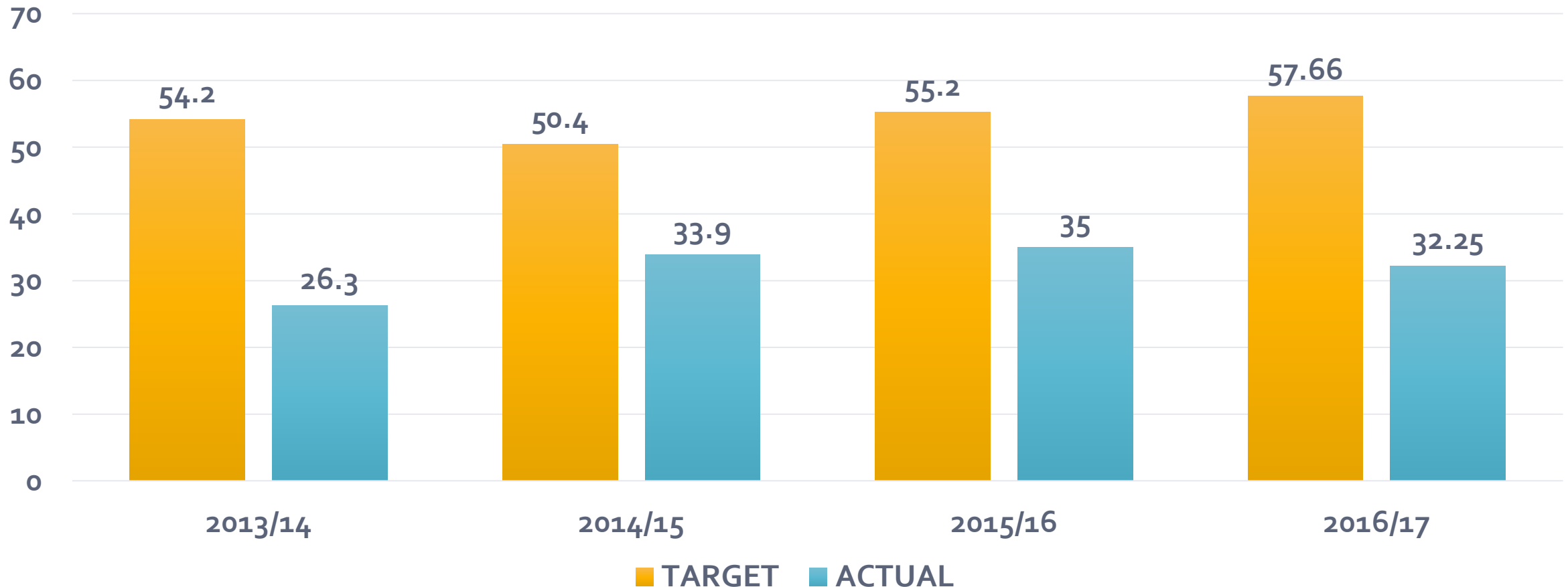
FY 2016/17 Total approved budgets for the County Governments amounted to Kshs.399.24 billion (369.45b)

- ❑ Kshs.240.89 billion (60.3 per cent) for recurrent expenditure and Kshs.158.36 billion (39.7 per cent) for development expenditure;
- ❑ Kshs.280.3 billion as the equitable share of revenue raised nationally
- ❑ Kshs.21.90 billion as total conditional grants from the National Government and Development Partners.
- ❑ Expected to raise Kshs.57.66 billion from local sources;
- ❑ Utilize Kshs. 37.19 (38.55) billion cash balance from FY 2015/16.
- ❑ Counties remain highly dependent on fiscal transfers from National Government.



Kenya's Story so far.....

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



COUNTIES OWN SOURCE REVENUE COLLECTION

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

Source of data: National Treasury

THE PROPERTY RATES



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

THE PROPERTY RATES



- 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 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.

THE PROPERTY RATES



- ❑ Currently **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.

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

THE SINGLE BUSINESS PERMIT



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

USER FEES AND CHARGES



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

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

ROAD

BLOCKS

**TO
SUFFICIENT
COUNTY RESOURCING**

ROADBLOCKS TO SUFFICIENT COUNTY RESOURCING



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

Roadblocks to sufficient County Resourcing(Contd 2)



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



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

CONCERNS THAT TRIGGERED THE OSR POLICY



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

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

OSR POLICY OBJECTIVES



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.

Specifically proposing measures to:

- (i) Broaden County Governments' tax bases
- (ii) Enhance County Governments' revenue administrative capacity

OSR POLICY SCOPE & THEMES



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

OSR POLICY GUIDING PRINCIPLES



- ❑ **Simplicity and enforceability**- 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.
- ❑ **Efficiency and effectiveness**: To ensure that County Governments achieve their fiscal policy objectives at minimal costs
- ❑ **Equity**: To ensure that imbalances— vertical and horizontal, amongst the counties or across generations over time are averted
- ❑ **Good governance**- necessary internal controls and reporting mechanisms to enhance transparency, accountability and financial reporting.
- ❑ **Buoyancy** - a tax base that is responsive to developments in the economy over the long term

PROPOSED STRUCTURE



- Where a County Government proposes to introduce a new tax, fee or charge which has not previously been imposed, that County Government shall
 1. Submit the tax, fee, charge proposal ten months prior to the commencement of the financial year; ii)
 2. The proposal above should have been included as a fiscal policy strategy, in the most-recent County Budget Review and Outlook Paper (C-BROP)

PROPOSED STRUCTUREcont..



3. 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;

PROPOSED STRUCTUREcont..



4. The proposal shall also indicate procedures for collection and administration, including;
 - a) The tax collection agency,
 - b) The person or entity responsible for remitting the tax and timing of payments;
 - c) The costs and methods for administration and enforcing compliance;
 - d) Proposed penalty provisions;
 - e) An assessment of the compliance burden for taxpayers; and
 - f) Procedures for taxpayer assistance and resolving taxpayer complaints

PROPOSED STRUCTUREcont..



5. Estimated revenue collections per quarter and per annum
6. Indication of likely economic impact and tax burden on residents and businesses and risk of tax burden shifting
7. Prove that other counties were consulted in respect of fiscal competition; and,
8. Timelines for review, submission and approval of the county proposal in order to guard against undue delay

ISSUANCE OF WAIVERS AND VARIATIONS OF TAXES, FEES AND CHARGES



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

THE COUNTY GOVERNMENTS (TAX REGULATION PROCESS) BILL, 2016

THE PROPOSED BILL



A Bill for:

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



DEVELOPMENT OF FINANCE BILL

DEFINITION




- A finance Bill: This is a bill that contains proposals to the Parliament or County Assembly to amend or introduce taxes in case of national Government or fees or charges in case of County Government to raise monies to finance the budget deficit.
- It may also contain proposals to enhance the administration of the existing laws for raising revenue.

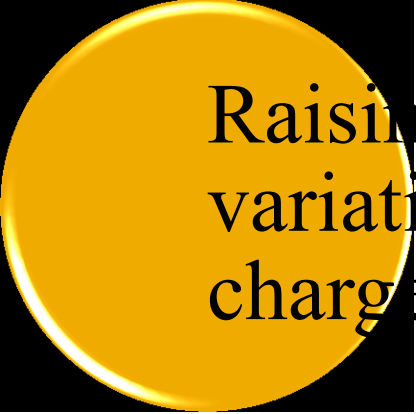
OBJECTIVES OF A FINANCE BILL



The County Finance Bill has two main objectives-



To provide clarity on legal basis for the County government to continue collecting fees, charges or rates that were being collected by the local Authorities.



Raising funds to finance the budget gap. This is through variation or imposition of previous rates or new fees and charges.

FINANCE BILL – NATIONAL LEVEL



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

PREPARATION OF FINANCE BILL- NATION GOVERNMENT



- i. Request for proposals by putting adverts in the daily newspapers with wide circulation four times – Mondays and Fridays for two weeks
- ii. Constituting a technical team to analyse the proposal submitted by various stakeholders.
- iii. Key institutions that submit proposals to for the Finance Bill are invited to make presentation and elaborate on the proposals – some key institutions invited include Institute of Certified Public Accountants of Kenya, Price Water House Coopers, Association of Manufactures.

Preparation of Finance Bill- National Government...



- iv. Proposals from the Department within the National Treasury as well as from other Ministries including Kenya Revenue Authority are considered.
- v. The Committee analyses the proposals and make recommendation.
- vi. The report is discussed with the director and if there are changes, the recommendations are amended accordingly.
- vii. The revised report is discussed with the Cabinet Secretary, Principal Secretary, Director and the technical team. At this level, the recommendation can be rejected, modified or approved as recommended.

Preparation of Finance Bill- National Government...



- viii. The Cabinet Secretary signs on every recommendation indicating whether he has accepted or rejected the recommendation. In some instances he can request the Committee to review the recommendation and obtain more information before the final decision is made.
- ix. After the approval is granted by the CS, the technical committee prepares the finance Bill, which is submitted to the Attorney General's office for legal drafting. The Attorney General office sends the Legal drafters to the national Treasury to draft the Bill since there are lot of consultation and explanation need before the Bill is finalised.

Preparation of Finance Bill- National Government...



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

PREPARATION OF THE COUNTY FINANCE BILL



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

- i) **An Act that deal with Public Health matters.** That Act should specify fees and charges for authorising or permitting to operating a business or an institution. The requirement in order to meet public health requirement, annual inspection fees to be charged among others.
- ii) **Act that deals with market matters** - specifying market days, fees charged on market entrance for various commodities, maintenance of the market among other issues
- iii) **An act on advertising-** the Act should specify the requirement for advertising, fees to be charged on advertising

iv) An act of building plans

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

- ❖ If the above Acts are in place the purpose of the Finance Bill will be to amend those Acts, there is need for more revenue.
- ❖ In the absence of the specific Acts that raise revenue for the County, the County Government can enact the Finance Bill as a temporary measure to provide clarity on the legal basis for continuing charging fees and charges that were introduced by the local authorities.
- ❖ The County Finance Bill is important for raising monies to finance the budget, but going forward the County should start preparing specific Acts on each or combinations of fees and charges.

PROPOSED PROCESS FOR PREPARING FINANCE BILL IN THE COUNTY



1. Advertisements to be put in the daily newspapers requesting for proposals.
2. Circular to be sent to all county executive members requesting for proposals.
3. Technical committee to be formed to analyse the proposals and make recommendations.
4. Technical team to invite stakeholders that have submitted proposals, especially groups or associations

PROPOSED PROCESS FOR PREPARING FINANCE BILL IN THE COUNTY



5. The county executive responsible for finance to discuss each recommendation with its technical team and approve or reject the recommendations.
6. Technical team to draft the Finance Bill.
7. The legal officer to review the Bill.
8. The Bill to be submitted to the Law Reform Commission.
9. The Bill to be submitted to a legal drafter.
10. The Bill to be submitted to the County Assembly

REVENUE FORECASTING



Basic Approaches to revenue Forecasting

Baseline projections that assume no policy changes

Adjustments are made on baseline projections based on policy changes

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

Revenue Forecasting Cont

There are four main basic approaches to revenue forecasting:

Model Based;

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

Effective Tax Rate:

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

Revenue Elasticity;

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

Time Series;

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

Thank You!

