THE TAX AND PFM SEMINAR-NORTHERN BRANCH- 26TH- 28TH MARCH 2019

TOPIC: COUNTY PERFORMANCE:OWN SOURCE REVENUE(OSR) AND ITS IMPLICATION

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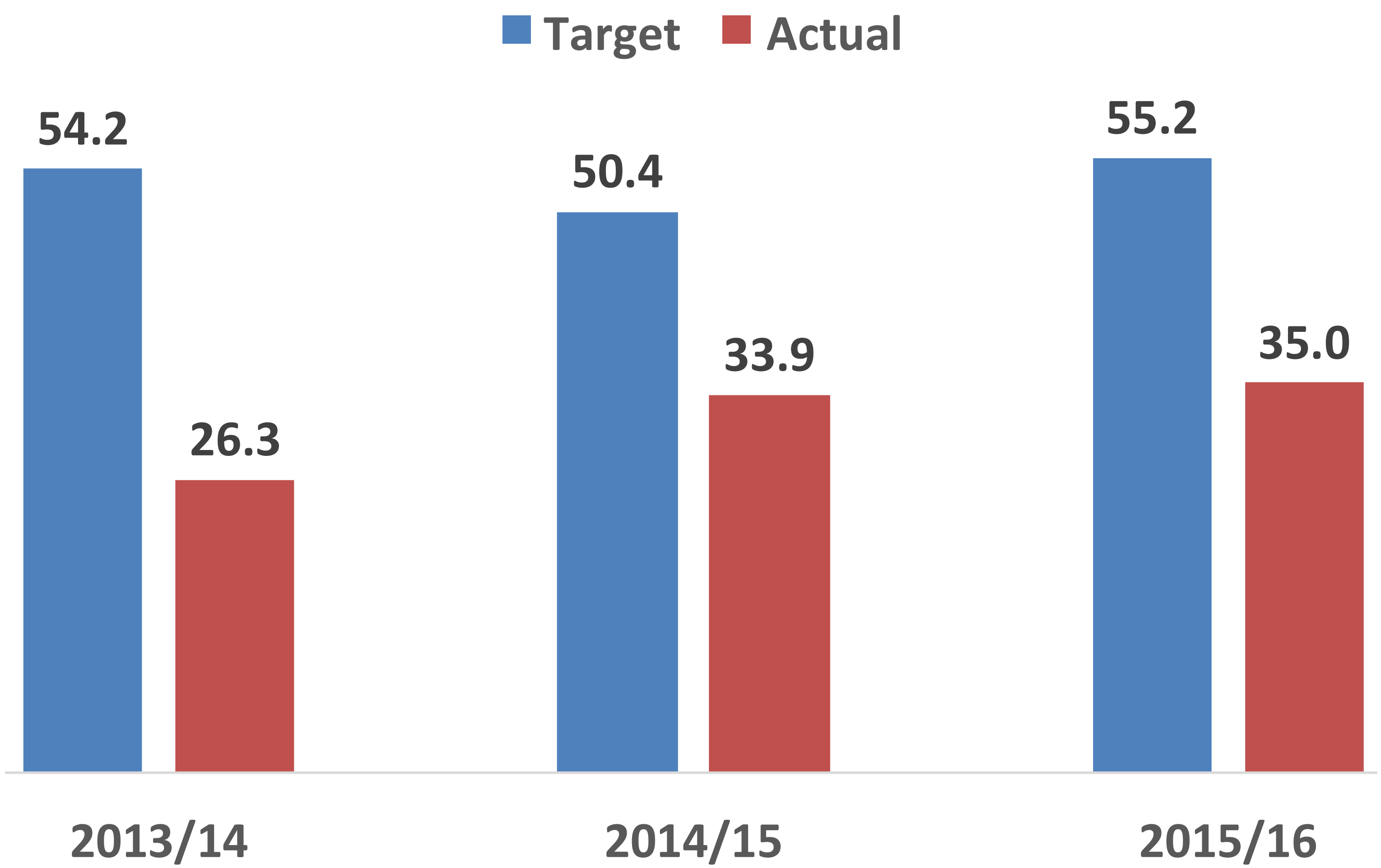
KEY FUTURES OF DEVOLUTION

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

THE STORY TO DATE

- **The aggregate budget estimates for the 47 County governments in FY 2016/17 amounted to Kshs.390.32 billion**
  - Recurrent expenditure Kshs.225.25 billion (57 per cent) and
  - Development expenditureKshs.168.07 billion (43 per cent).
- Development budgets remain scattered between the National and County governments – Conflicts likely.
- Counties remain highly dependent on fiscal transfers from National Government.
- Intergovernmental system of fiscal transfers is based

THE STORY SO FAR:OSR



LEGAL PROVISIONS ON COUNTY REVENUE GENERATION

- Art.202 - Provides Fiscal transfers;
- Art. 203 - The revenue raised nationally shall be shared equitably among the two levels of government and among 47county governments; criteria, >15%, Audit
- Art. 209- Counties with the powers to raise revenue;

  (Property rate, Entertainment, taxes)
- Art. 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;

LEGAL PROVISIONS ON REVENUE GENERATION

POWER TO IMPOSE TAXES: ARTICLE 209 – NATIONAL GOVERNMENT

Income tax;

Value-added tax;

Customs duties and other duties on import and export goods;

Excise tax.

LEGAL PROVISIONS ON REVENUE GENERATION

- Power to Impose Taxes- Art. 209-County Government

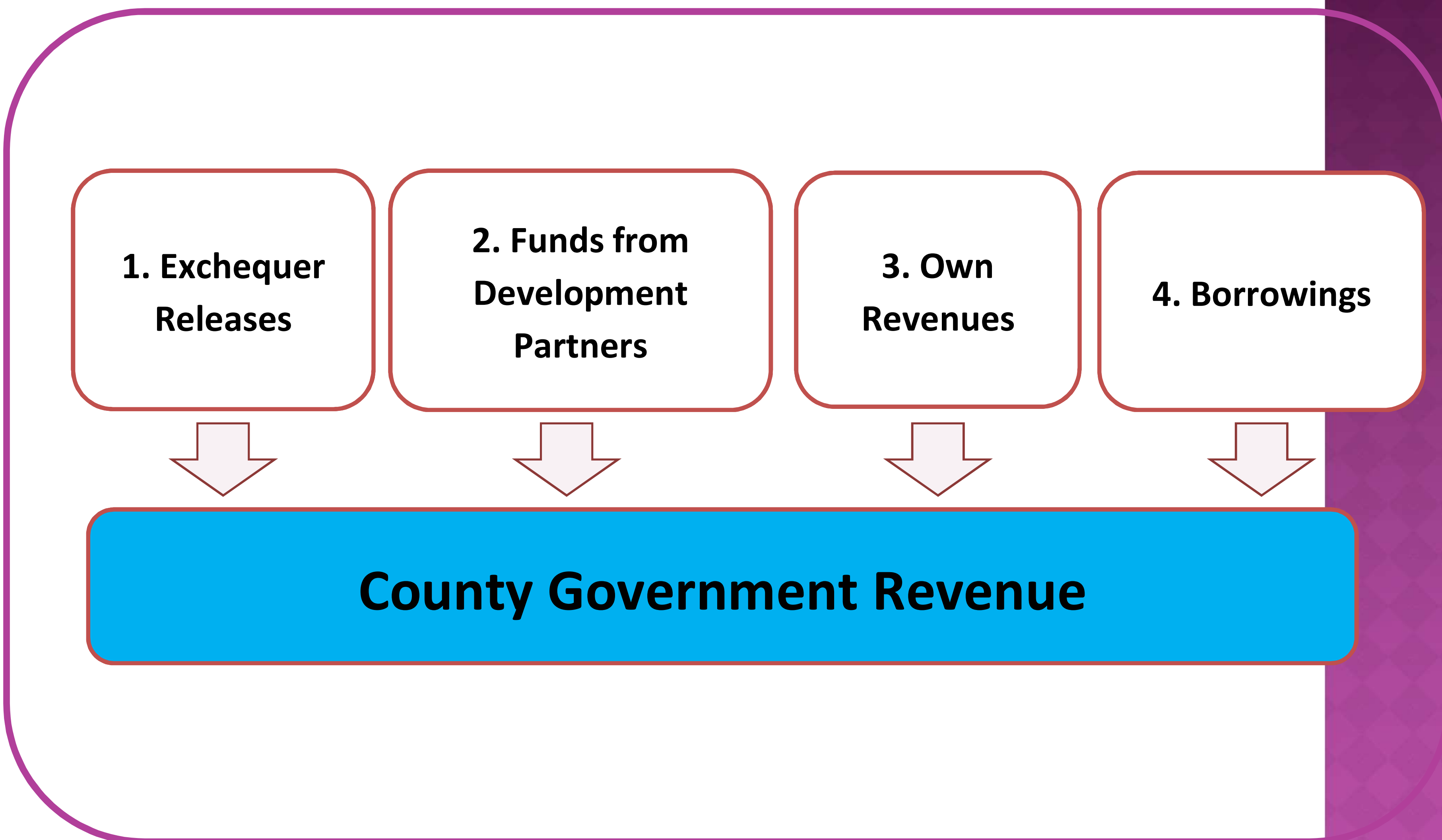
Property rates;

Entertainment taxes; and

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

Service Charge

MAIN SOURCES OF FUNDING FOR COUNTIES



PRECONDITIONS TO BORROW

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

CS TRESURY TO GUARANTEE LOANS

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

FISCAL RESPONSIBILITY PRINCIPLES

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

FISCAL RESPONSIBILITY PRINCIPLES

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

COB FINDINGS

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

- Kshs.234.73 billion (58.6 per cent) for recurrent expenditure and Kshs.165.51 billion (41.4 per cent) for development expenditure;
- Kshs.280.3 billion as the equitable share of revenue raised nationally
- Kshs.21.90 billion as total conditional grants from the National Government and Development Partners.

COUNTY PERFORMANCE: FIRST QUARTER FY 20018/2019

- NBI county collected 1.79B – an 11.8% of its 15.2B annual target
- Followed by Narok at 1.19B and Nakuru at 543M
- OSR revenue as a proportion of annual targets indicates Narok and Isiolo recorded highest at 48% and 35.8% respectively
- Wajir at 6.3%, Kisii at 6.2% and Kericho at 5% recorded lowest proportion of OSR against annual targets

COUNTY PERFORMANCE:

- The aggregate annual own source revenue target for all the 47 counties for FY 2018/19 is Kshs.**50.06** billion. During the reporting period, counties generated a total of Kshs.**7.41 billion**, which was **14.8 percent** of the annual target.
- This was an increase of **55** percent compared to Kshs.**4.82** billion generated in a similar period of FY 2017/18, which was **8.6** percent of the annual revenue target

ROAD BLOCKS 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

ROAD BLOCKS TO COUNTY RESOURCING

- 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

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

TRIGGER TO 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

OSR POLICY OBJECTIVES

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

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

OSR POLICY GUIDING PRINCIPLES

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

OSR POLICY SCOPE

(i) Legal and institutional framework for OSR collection

(ii) Different categories of taxes levied by County Governments (property taxes/rates, land rates, land rent, entertainment tax)

(iii) User charges and fees (including single business permit, parking fees, market fees, liquor licence fees, among others)

(iv) Introduction of new tax / review of existing tax, user charges and fees;

(v) Technological change and innovation, including a review of existing ICT

OSR GUIDING PRINCIPLES

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

THE PRACTISE

- 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 PRACTISE

- 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 PRACTISE

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

THE PRACTISE

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

THE PRACTISE

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

THE COUNTY GOVERNMENTS (REVENUE RAISING REGULATION PROCESS) BILL

- THE BILL -

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

THE FINANCE BILL

- 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

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

SOURCES OF FINANCES FOR COUNTY BUDGETS

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

PREPARATION OF 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

COUNTY FINANCE BILL….CONT

- 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

PROPOSED PROCESS OF PREPARING THE FINANCE BILL

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

PROPOSED PROCESS….. CONT

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

6. Technical team to draft the Finance Bill.

7. The legal officer to review the Bill.

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

REVENUE FORCASTING;BASIC APPROACH

- 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

REVNUE FORCASTING:BASIC APPROACHES

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!