



REPUBLIC OF KENYA

THE NATIONAL TREASURY AND PLANNING

National Policy to Support

**Enhancement of County Governments'
Own-Source Revenue**

February, 2019

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Foreword

The *National Policy to Support Enhancement of County Governments' Own-Source Revenue* was considered and approved by the Cabinet on August 14th, 2018.

Justification for this Policy arose from an Intergovernmental Budget and Economic Council (IBEC) resolution in early 2015, on the need to address underperformance of County Governments' own-source revenue (OSR), which is caused by challenges in collection and administration of decentralized taxes, fees and charges. The identified challenges include: inadequate revenue policies and legislation; multiplicity of fees and charges; human resource capacity deficits; weaknesses in enforcing compliance by tax payers; low automation and integration of revenue administration; and, ineffective internal controls and audit mechanisms. The IBEC resolution also sought to deal with Counties' revenue measures that have negative implications for national economic policies and economic activities, including mobility of goods, services, capital and labour.

Following IBEC's resolution, a national conference took place in September 2015, during which stakeholders recommended that a coherent policy be developed, and legislation drafted to regulate introduction by Counties of new levies. Thereafter, an Interagency Working Committee was constituted, comprising 16 institutions, to develop the policy and draft the legislation. This process involved consultations with relevant State Organs and the private sector, as well as engagements with officials from all Counties. Before submission to Cabinet, the draft Policy and the draft legislation were subjected to public participation followed by discussions at IBEC and with the Council of Governors to deepen consensus.

This Policy proposes a standardized framework for County Governments' OSR measures as well as compliance enforcement. The measures generally aim at: strengthening the legal underpinnings for revenue collection and its link with policy objectives; achieving efficiency in revenue administration; enhancing governance and promoting transparency; and, making public participation more effective. To support implementation of the Policy, a range of national-level legislative reforms has been proposed encompassing land, entertainment, trade, tourism, agriculture, and the financing of urban areas and cities.

The legislation drafted alongside this Policy is the *County Governments (Revenue Raising Process) Bill, 2018*. It outlines the process to be followed by Counties in exercising their power under Articles 209 and 210 of the Constitution to impose, vary or waive taxes, fees, levies and other charges. Enactment of the Bill which has been approved by Cabinet for tabling in Parliament will be integral in this Policy's implementation.

Implementation of this Policy will be achieved through an intergovernmental institutional framework led by the IBEC and supported by a steering committee to make policy decisions, a technical committee to oversee capacity building to the Counties, and an interagency secretariat. It is expected that the Policy will be operational for ten years, with a midterm review after five years, and its impact on the economy will be monitored annually by the National Treasury jointly with all stakeholders.

It is expected that successful implementation of this Policy and realization of its objectives will: **i)** enable County Governments to enhance their OSR, thereby augmenting National Government transfers (i.e. equitable share of revenue and conditional allocations) in financing

service delivery; **ii)** assist in reducing fluctuations of receipts by the Counties and volatility of their expenditure; and, **iii)** contribute in increasing accountability of the Counties by clearly linking taxes paid by citizens to public services, thereby making decentralization more effective.

A handwritten signature in black ink, appearing to be 'H. Rotich', with a large, stylized flourish below the name.

HENRY K. ROTICH, E.G.H.
CABINET SECRETARY/THE NATIONAL TREASURY AND PLANNING

Acknowledgements

The National Treasury acknowledges contributions by different individuals and institutions that were involved in preparation of this Policy.

First, we acknowledge the intervention of the Intergovernmental Budget and Economic Council (IBEC), through which consensus was achieved in early 2015, on the need for a Policy to support County Governments' efforts to enhance collection of locally-generated revenue and improve its administration. Much of the subsequent work on this Policy was accomplished under the auspices of IBEC.

Secondly, during the 2015 national conference, a number of background papers were presented, which helped to shape the dialogue leading to many recommendations contained in this Policy. We acknowledge the Kenyan and international researchers who authored or reviewed these background papers.

Thirdly, we acknowledge the role played by the Interagency Working Committee (IAWC), which commenced its work in March 2016 to develop this Policy and draft the *County Governments (Revenue Raising Process) Bill, 2018*. Led by the National Treasury's Director-General for Budget, Fiscal and Economic Affairs, the Committee comprised of the: National Treasury; Council of Governors (CoG); Commission on Revenue Allocation; Intergovernmental Relations Technical Committee; Office of the Controller of Budget; Kenya Institute for Public Policy Research and Analysis; Kenya Revenue Authority; Kenya Law Reform Commission; Office of the Attorney General; Parliamentary Budget Office; National Land Commission; Ministry of Devolution and ASAL Areas; Ministry of Tourism and Wildlife; Ministry of Lands; Ministry of Agriculture and Irrigation; and, Ministry of Transport, Infrastructure, Housing and Urban Development.

Fourth, we acknowledge the comments and suggestions from all 47 County Governments during several field visits and consultative forums. We particularly acknowledge the supportive role played by the CoG in convening direct engagements with Governors. The National Treasury looks forward to collaborating closely with the CoG and all Counties in implementing this Policy.

Fifth, we acknowledge the support received from development partners. The International Monetary Fund (IMF) provided technical assistance on broadening the scope of property rates within Kenya's unfolding tax devolution framework. The IMF also reviewed an earlier draft of this Policy, and shared lessons from regional and international experiences. Besides assisting with the 2015 national conference and providing expert comments, the World Bank has supported a major activity under this Policy i.e. the *Own-Source Revenue Potential and Tax Gap Study of Kenya's County Governments*.

Sixth, we acknowledge a number of private sector agencies, which actively engaged with the IAWC and offered their professional inputs. Notable amongst these agencies are the: Kenya Private Sector Alliance; Kenya Association of Manufacturers; Institute for Certified Public Accountants of Kenya; and, Land Development and Governance Institute. Equally valuable contributions were received from members of the general public.

Finally, we are grateful to the core team in the National Treasury in particular the Intergovernmental Fiscal Relations Department, which has spent much time over the last two-and-a-half years, coordinating all the activities that went into preparation of this Policy.

A handwritten signature in black ink, appearing to read 'K. Thugge', with a stylized flourish extending from the end.

DR. KAMAU THUGGE, CBS
PRINCIPAL SECRETARY/THE NATIONAL TREASURY

Executive summary

Preamble

County Governments' own-source revenue (OSR) contributes less than 15 percent of total receipts, hence the Counties rely heavily on transfers. Constitutionally, the Counties can impose property rates, entertainment taxes and service charges and fees, although only about 10 revenue streams generate 70 percent of OSR collections. In FY 2016/17, 40 percent of collections came from four imposts. The Counties have maintained the upward trajectory in OSR growth achieved by defunct Local Authorities (LAs), but the pace is slower. Revenue targets are not being achieved, although most targets have a weak objective basis.

Challenges facing decentralized taxes and County fees and charges

Despite huge potential, property taxation is a low-yielding revenue source, largely because Counties' valuation rolls are outdated, and computation of rates is based on unimproved site value. Most Counties operate multiple rolls, one for each former LA, with different tax rates. Most land is communally-owned or unregistered, which complicates taxation. Regulatory responsibilities in the entertainment sector have been clarified through a Gazette Notice, but administration of licenses related to betting, casinos and other forms of gambling is still ineffective, because the two levels of Government have not been sensitized. The Counties are yet to develop liquor licensing legislation to enable compliance enforcement; existing national legislation for regulating liquor sale and supply does not support the Counties' role. Implementation of the Single Business Permit (SBP) is undermined by limited information on enterprises eligible for licensing, a complex license fee structure, and litigation by professionals seeking exemptions. Collection of cess -- an earmarked agricultural produce levy -- lacks policy and regulatory frameworks, and the 'barrier' method of collecting the levy disrupts free flow of goods and escalates costs. Licensing of outdoor advertising is also without clear policy context.

Absence of revenue policies and legislation, and multiplicity of fees and charges

Many Counties have not actualized policies to underpin revenue measures; none has prepared the mandatory Tariffs and Pricing Policy to guide levies. Failure to exploit legal provisions for enforcing revenue measures encourages noncompliance by ratepayers. To encourage compliance, some Counties are offering waivers, but this is being done irregularly. Only a handful of Counties have implemented legal provisions enabling urban areas to retain local revenue to defray municipal service costs. Multiplicity of levies is rampant, due primarily to legal and institutional overlaps and policy incoherence.

Administrative and institutional weaknesses, and their adverse effects

County revenue administrators generally lack requisite skills, a factor behind poor enforcement of OSR measures. Adoption of ICT systems is deficient; manual revenue collection is prevalent with its inherent risks. Standardization of revenue collection systems across Counties has not happened. There are no guidelines to assist the Counties determine appropriate administrative arrangements for revenue collection and management, out of four available alternatives. A number of Counties have adopted structures which undermine control by their Treasuries, leading to poor coordination. Weaknesses have emerged over the last five years such as expenditure of OSR at source; lack of effective internal controls and audit mechanisms; and, cash handling. Reporting on OSR is random; Counties' revenue data in financial statements are often unreconciled with balances in the Integrated Financial Management Information System (IFMIS). Overall, there is no strong link between user fees and charges imposed by Counties and the cost of services which form the basis for the levies. Both citizens and businesses are affected by haphazard imposition of County Government

levies, some of which are in contravention of Article 209(5) of the Constitution, including by inhibiting international protocols and agreements intended to ease regional trade.

Rationale, goal, objectives and strategies of the Policy

The rationale for the Policy emanated from an Intergovernmental Budget and Economic Council (IBEC) resolution on the need to address the above challenges and support Counties to enhance collection and administration of OSR. During a subsequent national conference, stakeholders recommended that a coherent policy be developed, accompanied with legislation to regulate introduction of additional taxing powers (including levies) by Counties. Thereafter, an interagency working committee was constituted, comprising 16 institutions to draft the policy and the legislation. The drafting process involved extensive consultations with relevant Organs of State and the private sector, as well as visits to all Counties. The committee received recommendations from the International Monetary Fund on how to broaden the scope of property rates within Kenya's tax devolution framework. Finally, the draft documents were subjected to public participation followed by a presentation at the IBEC and further discussions with the Council of Governors to broaden consensus.

Accordingly, the Policy aims to address the foregoing challenges, mitigate their negative effects, and assist Counties to optimize OSR. The overarching goal is to achieve a standardized policy, legal and institutional framework for local revenue-raising measures and enforcement that applies countrywide. The Policy's objectives are to broaden County Governments' revenue bases while enhancing revenue administrative capacity.

Specific Policy and legislative interventions

To achieve the above goal and objectives, a number of interventions have been proposed. First, the County Governments (Revenue Raising Process) Bill, 2018 has been drafted to regulate introduction of levies by Counties. According to this legislation, new revenue raising measures shall be introduced after review and ratification through a legal process, including submission of proposed taxes, fees and charges to the National Treasury and the Commission on Revenue Allocation (CRA) ten months before commencement of a financial year. This process also applies to issuance of waivers and variations of levies. In addition, a new national property taxation legislation shall replace the outdated Rating Act and the Valuation for Rating Act. A national valuation plan shall be developed to facilitate preparation of valuation rolls, and a framework prepared outlining processes and procedures for payment of Contribution in Lieu of Rates. All Counties will become rating authorities, and all land shall be declared as rateable, with appropriate rating methods being applied. The Land Act, 2012 shall be amended so that Counties collect land rent directly, and land rent is to be aligned with economic realities. To support implementation of the Policy, a range of national-level legislative reforms has been proposed, some of which are already underway.

To achieve harmony, the two levels of Government will be sensitized on their gazetted respective regulatory functions over betting, casinos and other forms of gambling. The SBP shall be the primary business regulatory and licensing instrument, anchored in an Act of Parliament, and in County-specific legislation and policy. The Alcoholic Drinks Control Act, 2010 shall be amended to recognize County Governments' role in regulating alcoholic drinks. A national legislation shall be prepared as a contingency for Counties without their own alcoholic drinks control laws to permit enforcement activities. The Policy discourages imposition of cess except where it applies to agricultural produce (including livestock and fisheries), is done at source, and projected revenues exceed administration costs. Nevertheless, Counties intending to impose cess should develop supportive legislative frameworks, indicating that the levy is for infrastructure development, and the percentage of collections to be ploughed back into sectors from which it is generated. To improve licensing of outdoor

advertising, County Governments should distinguish between branding and mobile advertising -- branded vehicles should not be charged advertising fees in multiple Counties.

Enhancing OSR administration, governance, transparency and oversight

County Governments are required to develop revenue policies and legislation anchoring their levies, and each County is to develop a Tariffs and Pricing Policy within 12 months of this Policy's effectiveness. The National Government will provide technical assistance including in preparation of credible revenue forecasts, and Counties should take measures to improve efficiency and effectiveness of revenue personnel. The National Treasury will design a revenue collection and management system compatible with the IFMIS for use by all Counties. The system will provide uniform and real time revenue information to facilitate consolidation, analysis and reporting. Guidelines on application of the Standard Chart of Accounts will be issued by the National Treasury to ensure Counties comply with prescribed financial reporting standards.

The Policy guides County Governments on how to select the most appropriate organizational structure for revenue collection and management. To ensure effective and efficient revenue collection and management, the Counties are to designate Receivers of Revenue who shall be accountable to County Assemblies, and have independent accounting units as guided by the National Treasury. County internal audit departments and audit committees are to regularly review revenue collection and management procedures and systems, while revenue-related conflicts shall be resolved through intergovernmental bodies and institutions before resorting to the courts. The Counties should establish Municipal Boards and Town Committees where urban areas and cities meet legal thresholds.

To enhance compliance by rate payers and address enforcement difficulties, the Policy proposes several interventions. Firstly, County Governments should enact legislation to set out compliance obligations and powers, and the legislation can be based on the existing model, reviewed and updated through intergovernmental relations mechanisms. Secondly, to complement sanctions-based compliance mechanisms, County Governments should incentivize ratepayers by providing information on 'easy-to-pay-options'. Thirdly, measures requiring twinning of tax compliance with public services are to be entrenched in law e.g. tying issuance of the SBP to production by a business entity of a valid Tax Compliance Certificate, and awarding procurement tenders only to tax-compliant firms. Fourth, tax revenue databases of the two levels of Government shall be integrated to enhance compliance and monitor revenue enforcement personnel. Fifth, specific mechanisms shall be put in place to enable cooperation between the two levels of Government on enforcement of revenue raising measures. Sixth, it is suggested that the CRA considers enhancing the fiscal responsibility parameter within the revenue sharing formula that incentivizes improved OSR performance by Counties.

County Governments are to develop clear mechanisms for receiving feedback from the public and providing information on revenue raising measures. To enhance transparency, County Treasuries shall continuously review revenue collection performance vis-à-vis targets and report on progress. The National Treasury shall train staff in County Treasuries and revenue collecting departments, so as to harmonize operations of the two units. The Policy underscores the distinct but complementary roles of both arms of Government at the County level, where OSR matters are concerned. County Assemblies are encouraged to develop procedures on reviewing audited accounts on revenue, and to follow up on issues raised by the audit. The Assemblies shall also establish procedures on receiving, considering and determining petitions by the public on revenue collection and management. Parliament shall provide capacity building to County Assemblies to strengthen their oversight role.

Policy implementation

The Policy will be implemented through an intergovernmental institutional framework comprising: i) the Intergovernmental Budget and Economic Council; ii) a Steering Committee to make policy decisions regarding emergent issues impacting County OSR; iii) a Technical Committee overseeing capacity building to the Counties on policy and legal matters; and, iv) an Interagency Implementation Secretariat. The Policy's impact on the economy will be monitored through the National Integrated Monitoring and Evaluation System. Annual Policy implementation M&E reports will be prepared by the National Treasury jointly with relevant stakeholders. The Counties may review their domestication and implementation of the Policy, and every two years, the National Treasury will hold a conference on County OSR. The Policy will be operational for ten years, with a midterm review after five years.

TABLE OF CONTENTS

FOREWORD	i
ACKNOWLEDGEMENTS	iii
EXECUTIVE SUMMARY	v
ACRONYMS AND ABBREVIATIONS	xii
CHAPTER 1: INTRODUCTION	1
1.1 BACKGROUND	1
CHAPTER 2: SITUATION ANALYSIS	3
2.1 PRE-DEVOLUTION CONTEXT	3
2.2 COUNTY OWN-SOURCE REVENUE AFTER DEVOLUTION	3
2.2.1 Property related revenue	4
2.2.2 Entertainment tax	7
2.2.3 Business licensing	9
2.2.4 Liquor licensing fee	10
2.2.5 Cess	10
2.2.6 Other user fees and charges	12
2.2.7 Tourism-sector levies	13
2.2.8 Licensing of outdoor advertising	13
2.3 CHALLENGES OF REVENUE ADMINISTRATION AND MANAGEMENT	14
2.3.1 Absence of revenue policies and legislation	14
2.3.2 Illegal issuance of waivers and variations	15
2.3.3 Multiplicity of County fees and charges	15
2.3.4 Weak understanding of County revenue administration costs	15
2.3.5 Challenges related to financing of urban areas and cities	15
2.3.6 Human resources capacity and enforcement issues	16
2.3.7 Low automation and integration of revenue administration	16
2.3.8 Inappropriate institutional arrangements	17
2.3.9 Inconsistency in reporting of County revenue data	19
2.3.10 Weak capacity for revenue forecasting and analysis	19
2.3.11 Expenditure of local revenue at source	19
2.3.12 Lack of effective internal controls and audit mechanisms	19
2.3.13 Cash handling	19
2.3.14 Sharing of revenue from court fines	20
CHAPTER 3: RATIONALE AND OBJECTIVES	21
3.1 RATIONALE FOR THE POLICY	21
3.2 GOAL AND OBJECTIVES	21
3.3 STRATEGIES	21
CHAPTER 4: POLICY INTERVENTIONS	22
4.1 NATIONAL FRAMEWORK LEGISLATION	22
4.1.1 Regulating introduction of taxes, fees and charges including waivers and variations	22
4.1.2 Regulating property taxation, CILOR and land rent	23
4.1.3 Regulating entertainment	24
4.2 COUNTY GOVERNMENT LEGISLATION	24
4.2.1 Tariffs and Pricing Policy	25
4.3 IMPROVING REVENUE ADMINISTRATION	26
4.3.1 Efficiency and effectiveness of human resources	26
4.3.2 Improving revenue forecasts and incentivizing fiscal effort	26

4.3.3	The role of ICT and automation in enhancing revenue administration	27
4.3.4	Determining an appropriate structure for revenue administration	28
4.3.5	Recommendations for enhancement of specific County revenue streams	30
CHAPTER 5: GOVERNANCE, ACCOUNTABILITY AND OVERSIGHT		33
5.1	THE NEED FOR GOOD GOVERNANCE	33
5.2	ENHANCING GOVERNANCE IN REVENUE ADMINISTRATION	33
5.3	ENHANCING COMPLIANCE AND ENFORCEMENT	35
5.4	EFFECTIVE PUBLIC PARTICIPATION	36
5.5	PROMOTING TRANSPARENCY	36
5.6	THE ROLE OF THE NATIONAL AND THE COUNTY ASSEMBLIES	37
CHAPTER 6: POLICY IMPLEMENTATION		38
6.1	FRAMEWORK FOR MONITORING AND EVALUATION	38
6.2	FORMAT FOR PROGRESS REPORTS	38
6.3	FEEDBACK MECHANISMS AND STAKEHOLDER CONSULTATION	38
6.4	REVIEW TIMELINES	38

List of Tables

TABLE 1: COUNTY GOVERNMENTS' REVENUE SOURCES	1
TABLE 2: COUNTY GOVERNMENTS' OWN-SOURCE REVENUE CATEGORIES	2
TABLE 3: DELINEATION OF FUNCTIONS RELATING TO BETTING, CASINOS AND GAMBLING	8
TABLE 4: LEGAL ADMINISTRATIVE OPTIONS FOR COUNTY OSR COLLECTION AND MANAGEMENT	18
TABLE 5: RECOMMENDED REVENUE ADMINISTRATION STRUCTURES FOR COUNTIES	29
TABLE 6: FRAMEWORK FOR MONITORING AND EVALUATION	40

List of Figures

FIGURE 1: LOCAL REVENUE IN KENYA BEFORE AND AFTER DEVOLUTION	4
FIGURE 2: COUNTIES' GOVERNANCE AND REVENUE ADMINISTRATION STRUCTURE AND ROLES	35
FIGURE 3: INSTITUTIONAL FRAMEWORK FOR IMPLEMENTING THE POLICY	39

List of Annexes

ANNEX 1: LIST OF REVENUE STREAMS REPORTED BY COUNTY GOVERNMENTS	43
ANNEX 2: PROPOSED LEGISLATIVE REFORMS TO SUPPORT IMPLEMENTATION OF THE POLICY	44

Acronyms and abbreviations

AFAT	Area Fixed Asset Tax
AVM	Automated Valuation Model
BCLB	Betting Control and Licencing Board
CAMA	Computer Aided Mass Valuation
CARPS	Capacity Assessment and Rationalization of the Public Service
C-BROP	County Budget Review and Outlook Paper
CEC(M)	County Executive Committee (Member)
C-FSP	County Fiscal Strategy Paper
CILOR	Contributions in Lieu of Rates
CoB	Controller of Budget
CoG	Council of Governors
CPST	Center for Parliamentary Studies and Training
CRA	Commission on Revenue Allocation
CRF	County Revenue Fund (<i>account at the Central Bank of Kenya</i>)
ERP	Enterprise Resource Planning
GCCN	Government Common Core Network
GFS	Government Finance Statistics
IAWC	Interagency Working Committee on Enhancement of County Governments' OSR
IBEC	Intergovernmental Budget and Economic Council
ICPAK	Institute of Certified Public Accountants of Kenya
IFMIS	Integrated Financial Management Information System
IGRTC	Intergovernmental Relations Technical Committee
KeNHA	Kenya National Highways Authority
KESRA	Kenya School of Revenue Administration
KLGRP	Kenya Local Government Reform Programme
KNBS	Kenya National Bureau of Statistics
KRA	Kenya Revenue Authority
LAIFOMS	Local Authority Integrated Financial Operation Management System
LAs	Local Authorities (<i>Defunct</i>)
LATF	Local Authority Transfer Fund
LSK	Law Society of Kenya
MDAs	Ministries, Departments and Agencies
MoDAA	Ministry of Devolution and ASAL Areas
MoLG	Ministry of Local Government (<i>Defunct</i>)
MoL	Ministry of Land
NACADA	National Authority for the Campaign Against Alcohol and Drug Abuse
NLC	National Land Commission
OSR	Own-Source Revenue
PPRA	Public Procurement Regulatory Authority
SBP	Single Business Permit
SCoA	Standard Chart of Accounts
SRC	Salaries and Remuneration Commission
TA	Transition Authority (<i>Defunct</i>)
TCC	Tax Compliance Certificate
UACA	Urban Areas and Cities Act (<i>2011</i>)
USV	Unimproved Site Value

CHAPTER 1: INTRODUCTION

1.1 Background

The need for County Governments to have reliable revenue is a key principle of Kenya's devolution, contained in Article 175(b) of the Constitution. The 47 County Governments budget for devolved functions and generate revenue from local sources. The Constitution defines County Governments' funding sources to include: **i)** equitable share of at least 15 percent of most-recently audited revenue raised nationally; **ii)** additional conditional and unconditional grants from the National Government's share of revenue; **iii)** Equalization Fund based on half of one percent of revenue raised nationally; **iv)** local revenues in form of taxes, charges and fees; and, **v)** loans and grants.

This Policy focuses on local revenue or own-source revenue (OSR). The Constitution allows Counties to impose: property rates; entertainment taxes; charges for services they provide; and, any other tax or licensing fee authorized by an Act of Parliament. These OSR streams fall into three categories namely:

- a) **Taxes:** Compulsory government levies for which nothing is received directly in return. Taxes do not necessarily involve the use or derivation of direct benefits from services, regulation or goods. Rather, taxes are unrequited transfers intended primarily to generate revenue for the government. Examples are property rates and entertainment taxes.
- b) **User charges and fees:** Payments for publicly-provided services, or charge for using a public facility such as vehicle parking lot, market, health facility or park. User fees/charges may correspond to usage of services provided, or may be for the bulk or time-limited use of services such as water. The main economic rationale of user fees/charges is not to produce revenue but to promote economic efficiency. Well-designed user fees/charges achieve this goal by: **i)** providing different information to public-sector suppliers e.g. how much clients are willing to pay for particular services, the type of services to be supplied, the quantity and quality, and to whom; and, **ii)** ensuring that what the public sector supplies is valued at least at (marginal) cost by citizens.
- c) **Licenses:** Charges in respect of authorization granted to an entity to undertake a certain action and is mainly issued for regulatory purposes. Examples include business and outdoor advertising licenses.

In the first 4 years of devolution, OSR contributed 12 percent of Counties' total receipts; transfers from the National Government (i.e. equitable share and conditional allocations) contributed more than 88 percent. (Table 1). During this period OSR increased initially (by nearly 20 percent between FY 2013/14 and 2014/15) before contracting in the subsequent two years.

Table 1: County Governments' revenue sources

Source of revenue	2013/14	2014/15	2015/16	2016/17
<i>(Figures in Kshs millions unless indicated otherwise)</i>				
Transfers from National Treasury	187,239	225,650	264,468	280,300
Own Source Revenue	30,533	36,532	35,723	34,200
Transfers from Other Government Agencies	3,137	1,009	7,925	15,555
Proceeds from Domestic & Foreign Grants	8	256	2,182	4,674
Returned CRF Issues			534	1,229
Proceeds from Sale of Assets	7	11		4
Social Security Contributions		26		
Proceeds from Domestic Borrowings	1,856	298	862	
Proceeds from Foreign Borrowings		12		
Grants Received from other levels of government		36		

Reimbursements & Refunds	7	4	47	
Grand Total	222,788	264,825	311,740	335,963
<i>OSR as % of total receipts</i>	<i>13.7%</i>	<i>13.8%</i>	<i>11.5%</i>	<i>10.2%</i>
<i>OSR growth from previous year</i>		<i>19.6%</i>	<i>-2.2%</i>	<i>-4.3%</i>

Source of data: National Treasury, based on audited accounts (except for FY 2016/17, which is unaudited)

County Governments impose tens of user fees and charges, although 70 percent of collections comes from about 10 revenue streams (Table 2). 40 percent of Counties' OSR in FY 2016/17 was generated from three imposts namely: **i)** business licenses (14.8 percent); **ii)** property-related income i.e. "poll rates" and plot rents (14.1 percent); and, **iii)** vehicle parking (12.2 percent).

Table 2: County Governments' own-source revenue categories

OSR category	2013/14		2014/15		2015/16		2016/17	
	<i>Kshs M</i>	<i>%</i>	<i>Kshs M</i>	<i>%</i>	<i>Kshs M</i>	<i>%</i>	<i>Kshs M</i>	<i>%</i>
Business permits	364	1.2%	3,517	9.6%	4,299	12.0%	5,061	14.8%
Property-related revenue	3,805	12.5%	5,428	14.9%	6,203	17.4%	4,835	14.1%
Vehicle parking fees	303	1.0%	2,983	8.2%	3,851	10.8%	4,176	12.2%
Health facility operations/serv.	202	0.7%	2,382	6.5%	2,455	6.9%	3,775	11.0%
Natural resource revenue	1,520	5.0%	1,850	5.1%	1,711	4.8%	1,931	5.6%
Cesses	77	0.3%	976	2.7%	1,279	3.6%	1,213	3.5%
Market/trade centre fee	1,028	3.4%	1,002	2.7%	965	2.7%	1,045	3.1%
Housing	39	0.1%	809	2.2%	1,752	4.9%	983	2.9%
Other unclassified receipts	-	0.0%	1,834	5.0%	2,728	7.6%	887	2.6%
External services fees	21	0.1%	209	0.6%	23	0.1%	527	1.5%
All other OSR sources	23,175	75.9%	15,542	42.5%	10,456	29.3%	9,767	28.6%
Grand Total	30,533	100%	36,532	100%	35,723	100%	34,200	100%

Source of data: National Treasury, based on audited accounts (except for FY 2016/17, which is unaudited)

CHAPTER 2: SITUATION ANALYSIS

2.1 Pre-devolution context

At Independence, Kenya inherited a system of Local Authorities (LAs), whose basis was the Local Government Act (Cap. 265). LAs derived revenue-raising powers from several legal instruments including: **i)** the Local Government Act (Cap 265, sections 216-217) which empowered LAs to establish and maintain a General Rate Fund; **ii)** 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 authorities while the Valuation for Rating Act (Cap 266) provided for valuation of properties for the purpose of levying rates. The latter laid out procedures for preparing a valuation roll, which contains information on all rateable properties within a specific jurisdiction; **iii)** the Trade Licensing Act (Cap 497) which empowered LAs to impose business licenses; and, **iv)** the Local Government Act (section 222) which empowered LAs to borrow, including through issuance of stocks or bonds, although this facility was rarely used.

A series of reforms and Constitutional amendments between 1969 and 1989 led to removal of LAs' powers to the Central Government. Through the Transfer of Functions Act (1969), primary health, health services and other functions were removed from LAs, except in the seven municipalities. This eroded LAs' revenue base leading to income decline. The Transfer of Functions Act removed the right of municipalities to levy their most important revenue source, the Graduated Personal Tax (GPT), which was replaced with a grants system. In 1989, the specific grants were replaced with 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 abolished following introduction of the Local Authorities Transfer Fund (LATF). By this time, LAs were permitted a narrow range of local taxes, fees and charges, which undermined collections, and introduced wide variations in revenue generation potential between rural and urban authorities. Revenue administration under the LAs was undertaken by Finance Departments headed by Town Treasurers. The Treasurers reported to Town Clerks, who were accountable to Finance Committees comprising elected councilors or ward representatives.

Subsequently, LAs experienced persistent shortfalls in OSR collection, which caused deficits, encouraged borrowing and led to mounting debt. The LATF was designed to forestall a financial crisis among the Authorities, most of which ended up depending heavily on the Fund. LATF's objectives included assisting LAs to reduce their debt. The goal was to eliminate all debt arrears by 2009/10, but this was never attained. Until their dissolution in 2013, many Authorities could not remunerate their councilors and effectively finance service delivery. 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, LAs ineffectively utilized powers under section 17(2) of the Rating Act to enforce rates payments. Outstanding debt repayment remained significant, causing incoming County Governments to inherit considerable liabilities. An exercise to determine and audit liabilities (as well as assets) transferred from the defunct LAs is still ongoing, under the Intergovernmental Relations Technical Committee (IGRTC).

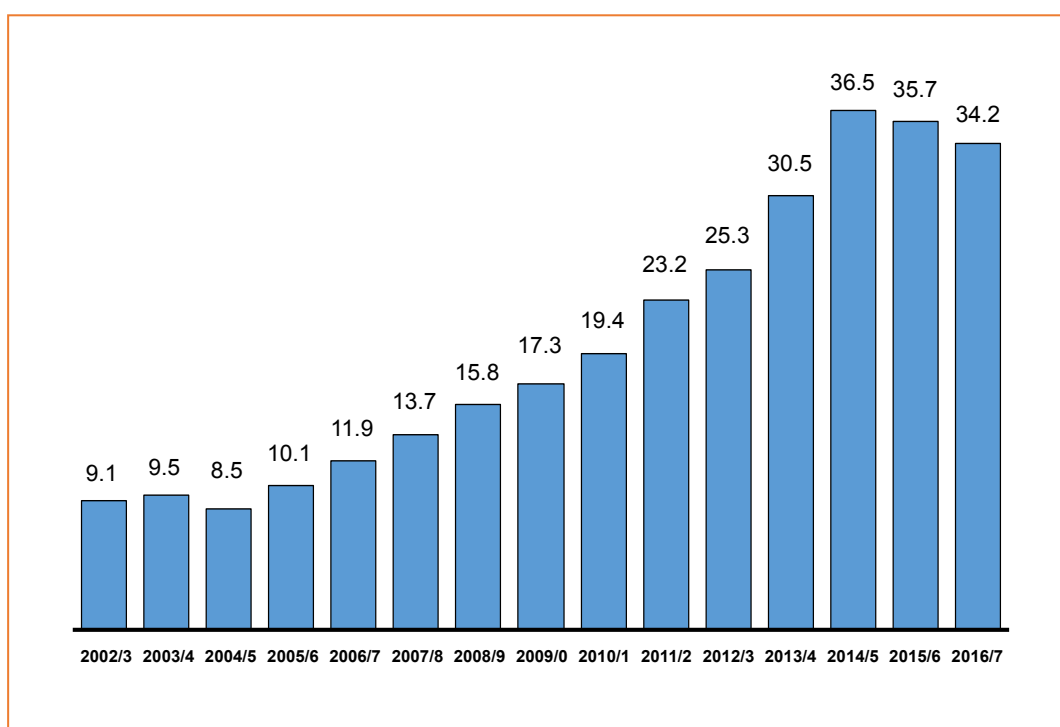
2.2 County own-source revenue after devolution

County Governments inherited all revenue streams previously administered by the defunct LAs. The Counties also inherited revenue administration procedures, guidelines and revenue collection personnel from the LAs. In the process, many inefficiencies were also inherited such as weaknesses in management of OSR -- difficulties with billing, laxity among revenue collectors and poor setting of annual revenue targets. Some Counties have made

progress in resolving these problems; others still struggle with technology and implementation of administrative guidelines on the payment of fees and charges, among other challenges.

County Governments have maintained the upward trajectory in aggregate OSR growth achieved by defunct LAs, but the pace is slower. (Figure 1). What is unclear is how much of the earlier growth in collections is attributable to an expansion in the base or improvements in operational efficiency; in many instances, growth in collections was achieved through increase in rates and introduction of new imposts. It is also unclear whether current collections are any indication of the underlying potential, since County Governments do not have credible estimates of their revenue potential from the various streams.

Figure 1: Local revenue in Kenya before and after devolution (Kshs billions)



Data sources: KNBS, LATF Reports, National Treasury, Controller of Budget

2.2.1 Property related revenue

Property rates

Property rates is a tax on the value of property (including land) and is usually assessed by a rating authority with help from a valuer. In Kenya, property rates is levied under the Valuation for Rating Act (Cap 266) of 1956 and the Rating Act (Cap 267) of 1963. The former guides preparation of the valuation roll. The latter identifies the rating authority and provides for imposition of rates and forms of rating that are applicable. To give effect to Article 209(3) of the Constitution, County Governments are required to enact property rating and valuation legislation. To date, less than ten Counties have done so; those that have not enacted new legislation rely on Cap 266 and Cap 267, which are not aligned to the Constitution. However, two important laws are in place that have implications for property taxation. These are:

- (a) *The Land Act (2012)*: This gives effect to Article 68 of the Constitution, to revise, consolidate and rationalize land laws, and provide for the administration and management of land and land based resources; and,
- (b) *The Land Registration Act (2012)*: This deals with registration of land titles, to give effect to the principles and objects of devolved government.

Valuation rolls should be prepared or updated every 10 years, but this has never been achieved. A valuation roll is a list of rateable properties showing the rateable owner(s) and their addresses, locations of land, tenure, acreage of property and assigned value in jurisdiction of the rating authority. The valuation roll forms the basis for assessment of property rates payable. The value assigned to a property determines the amount of rates to be paid by the owner. Rates are fixed by individual rating authorities (LAs or County Governments) and can vary depending on land use e.g. agricultural, residential, commercial and industrial use. Rating authorities can use a combination of valuation rolls and other forms of rates such as graduated or flat rates. Valuation rolls should be prepared every decade, and supplementary rolls more regularly e.g. in case of significant changes in ownership and land use. Nairobi County's valuation roll was last updated in 1982, Machakos in 1983 and Mombasa in 1991. Some Counties have recently updated their valuation rolls e.g. Kisumu (2008); Nyeri (2009); and Kiambu (2014). Widespread lack of updated valuation rolls is mainly due to the high cost involved in their preparation and implementation. The failure to update valuation rolls and enact property legislation means that Counties have no legal rating system within their jurisdictions. Most are operating under the rating systems inherited from LAs.

County Governments are operating multiple valuation rolls -- one for each former LA -- which are running concurrently with different tax rates assigned to them. This means that residents within a County could be subject to different rates. In most cases Counties are using expired rolls, in contravention of sections 3 and 4 of the Valuation for Rating Act. Where Counties have updated their valuation rolls, much information is missing from the rateable properties database. Where the valuation rolls are in use (which is primarily in urban areas) there is insufficient planning of market/trading centres, and development plans are outdated. Like the defunct LAs, County Governments rely on the Ministry of Lands (MoL) for valuation services. However, the Ministry is short of experienced valuers, and there have been delays in delivery of the service. Where private valuers have been engaged, concerns have emerged on quality of the rolls; according to MoL, some valuation rolls prepared by the private sector are faulty and cannot be implemented. Procurement of valuation services outside the public sector remains unregulated, and there are concerns about quality levels, evaluation during tendering and prohibitive fees charged by independent practitioners.

Most County Governments use unimproved site value (USV) form of rating for urban and developed areas, and flat rates or graduated rates for rural public land and gazetted forests. For agricultural freehold land located outside urban areas -- which constitutes the bulk of potentially rateable land -- flat rates or annual agricultural rental value rates are applicable. For gazetted forests, flat or graduated rates are used. Community land is typically not rated due to the subsistence nature of its usage and the low value structures found within such land.

Majority of Kenya's land is communally owned and therefore unregistered, which complicates property taxation. Only a few Counties notably Kiambu, Murang'a, Nyeri and Nairobi have had their land adjudicated and registered. Nearly 75 percent of Kenya's unregistered land is concentrated in ten Counties (i.e. Mandera, Wajir, Garissa, Kilifi, Tana River, Taita Taveta, Kwale, Samburu and Turkana). Such land ownership patterns have

adverse implications for levying of property rates and land-based revenue. In these regions, land ownership cannot be assigned to specific individuals, which means that assigning tax responsibility is impossible. This Policy includes recommendations for improvement of land registration and adjudication.

Where property rates is concerned, noncompliance is rampant and County Governments have not exploited legal provisions relating to enforcement. Enforcement is complicated by costly and lengthy litigation processes and sending of notices by post office, an outdated and impractical billing method considering the numerous vacant properties and absent owners. Furthermore, the Counties lack suitably-qualified personnel to successfully enforce compliance, as is done at the national level by the Kenya Revenue Authority (KRA).

The above factors have led to weak and inconsistent performance of property tax revenues. In 2004-2010, Kenya's property tax revenue averaged 0.15 percent of GDP, a poor comparison with the average for middle-income countries of 0.76 percent of GDP. With the onset of devolution, property revenue -- typically reported as poll rates and plot rents -- dropped sharply in FY 2013/14 before increasing in the next two years to levels not realized before, and falling again in FY 2016/17. As a proportion of total OSR, property revenue is currently approximately half its pre-devolution level, which might be attributed largely to disruptions during the transition to devolution. To make up for the shortfall in collections, many Counties have sharply increased their rates, which might also have affected compliance. In general, the deterioration in collection of property rates underscores the need for clear policy and legal frameworks accompanied with effective administrative structures.

Contribution in Lieu of Rates (CILOR)

Contribution in Lieu of Rates (CILOR) refers to annual payments by the Government to rating authorities in respect of Government land. CILOR's legal underpinnings are found in section 23(1) of the Rating Act (Cap 267) and the Valuation for Rating Act (Cap 266), which defines the basis for assessment of Government land for rates. The basis for CILOR's calculation is found in the Valuation for Rating (Public Land) Rules. Generally, the same tax rate (or rate struck) that is used for private land is applied to public land -- although for un-alienated public land in rural areas and gazetted forests, flat rates or graduated rates may be applied. Payments are on such dates and in such instalments as may be determined by the Minister.

CILOR is charged on the basis of a public land valuation roll comprising public land within the area of a local authority which would, if it were not public land be rateable property. Accordingly, the payment covers: i) gazetted forests; ii) un-alienated Government land i.e. where letters of allotment have been issued but no titles given within townships; iii) rural public land including Chief's offices and other administration centres; and, iv) other public land that is valued and used by the Government. According to the *Public Land Rules*, the public land valuation roll shall include land belonging to Kenya Railways, Kenya Posts and Telecommunication, Kenya Airways, Kenya Ports Authority and Kenya Airports Authority. However, the roll excludes land under museums, botanical gardens and arboreta, veterinary quarantine areas, state houses/presidential lodges, aerodromes, railway tracks, wharves/piers, roads/streets used by the public for vehicular traffic and parks.

Through a clear legal process, the defunct Local Authorities received CILOR from Central Government agencies for public land within their jurisdiction. Each calendar year, LAs presented CILOR claims to Ministry of Lands, accompanied with copies of valuation rolls relating to the Government land, relevant maps indicating the valued property

and a letter from the Ministry of Natural Resources (in the case of gazetted forest land). If satisfied, the Lands Secretary through the Chief Valuer audited the CILOR claims before advising the Ministry of Local Government (MoLG) to authorize the Ministry of Finance (National Treasury) to effect payments. It was not the practice for Government to pay accrued interest on outstanding CILOR, except when MoLG published an annual notice under the Valuation for Rating Act (Public Land) Rule No. 17, declaring the payments. The rule was however seldom invoked.

Since devolution, no County Government has received CILOR payments from the National Government. This is primarily because the legal basis for making CILOR claims is undermined by the widespread lack of up-to-date valuation rolls and legislation to support imposition of property rates. In addition, administrative guidelines on post-devolution CILOR claims processes have not been clarified and County administrations are unfamiliar with payment procedures, and attempts to lodge claims directly with Ministries, Departments and Agencies (MDAs) have not succeeded. Moreover, claims by some Counties for CILOR arrears have included accrued interest and yet, following the pre-devolution practice, this can only be done after invocation of Rule No. 17 as described above. This rule has not been invoked for a number of years and all payments made so far have been made on account.

Land rent

Land rent is collected on land owned by County Government in various markets and trading centres. Land rent is charged on annual basis. Most County Governments have not been able to optimize land rent, which has not been revised over time. Moreover, there remains lack of clarity concerning collection of land rent for County Governments. Whereas NLC under section 28(1) of the Land Act (2012) is mandated to collect land rent on rental properties and all payments on behalf of the County Governments, the County Governments are still collecting the same. Therefore, this Policy seeks to address issues of land rent by affirming the need for each level of Government to collect land rent due to it either directly or through appointed Receivers of Revenue.

2.2.2 Entertainment tax

Regulation of entertainment is a concurrent function. The Constitution assigns to County Governments powers to impose entertainment taxes and regulate public entertainment, including betting, casinos and other forms of gambling, as well as cinemas and video shows and hiring, among others activities. The Constitution also assigns to the National Government powers to regulate national betting, casinos and other forms of gambling. National-level enabling legislation includes the Entertainments Tax Act (Cap. 479) of 1950, and the Betting, Lotteries and Gaming Act (Cap 131) of 1966. The former legislation provides for the imposition of a tax in respect of all payments for admission into an entertainment -- an exhibition, performance or amusement. This encompasses theaters, movies, cultural and sporting events, nightclubs, casinos and racetracks. The latter legislation provides for the control and licensing of betting and gaming premises, imposition of taxes on betting, lotteries, gaming and prize competitions. It also establishes the Betting Control and Licensing Board (BCLB), which has considerable regulatory powers including issuance of licenses and permits.

Initially, concurrence of the function led to complications in licensing responsibilities between the two levels of Government. In 2014, Nairobi County Government enacted a Betting, Lotteries and Gaming Act establishing a Betting License and Regulation Board to license *all* gaming operators within the County. Gaming operators challenged the County legislation in court, arguing that they were already licensed by the national BCLB, and that the County legislation was in breach of the Constitution and in conflict with national legislation.

Suspending the County legislation, the court referred the matter to the defunct Transition Authority (TA) for mediated resolution within 90 days, and subsequent refiling in court.

Following mediation, stakeholders within the sector agreed on a framework for unbundling of functions, which has been gazetted. The mediation took place under an interagency technical committee comprising the TA, the Council of Governors (CoG), the Kenya Revenue Authority (KRA), National Treasury, the Commission on Revenue Allocation (CRA), the Ministry of Devolution and ASAL Areas (MoDAA), the Ministry of Interior and Coordination of National Government, and the Association of Gaming Operators of Kenya. There were initial concerns by the National Government that licensing of betting and gambling should not be decentralized, owing to potential risks of money laundering and insecurity. Ultimately, stakeholders agreed that the National Government remains in charge of licensing of public gaming *activities* while County Governments take responsibility for licensing of gaming *premises*. **Table 3** shows the delineation of functions which was gazetted in September 2017.

Table 3: Delineation of functions relating to betting, casinos and gambling

	National Government	County Governments
1	a) Policy formulation, legislation and development of standards and norms b) Regulation of the gaming industry c) Capacity building and technical assistance	a) Implementation of policy, standards and norms b) Periodic monitoring and evaluation of betting, lotteries and gaming c) Development and implementation of county legislation on betting and other forms of gambling
2	Licensing of public gaming (i.e. casinos)	a) Licensing of public gaming (casino) premises b) Enforcement of compliance (spot checks, daily supervision of casinos)
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	Licensing of on-course totalisators Licensing of off-course totalisators	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: Gazette Notice No. 8753 of September 8th, 2017

Note: Totalisators are computerized systems which run pari-mutuel betting, calculating payoff odds, displaying them and producing tickets based on incoming bets.

2.2.3 *Business licensing*

Business licensing is undertaken through the Single Business Permit, issued in respect of a class of business activities in lieu of separate licenses which could otherwise require to be issued in respect of each activity. SBP was introduced in 1998 by the Ministry of Local Government as part of revenue mobilization reforms under Kenya Local Government Reform Programme (KLGRP). The introduction was by a Local Government Act amendment through the 1998/99 Finance Act. The amendment enabled LAs to issue business permits to allow the conduct of business or trade within their jurisdictions. Introduction of the SBP consolidated local government revenue raising instruments pertaining to licensing and regulation of commercial enterprises. The regulatory framework for SBP is contained in the Local Government (Single Business Permit) Rules, 2008. The SBP has five objectives, which are to: i) simplify the local regulatory environment to encourage greater economic growth and employment; ii) reduce administration and compliance costs of regulating private sector activities; iii) generate consistent business related data for local level planning, regulatory and service delivery purposes; iv) enhance local government revenues so that local authorities can provide local service delivery; and, v) establish a stronger link between local government and the business community in order to improve government transparency, accountability and responsiveness.

Administration of the Single Business Permit is encountering a number of challenges. Most Counties have not enacted trade licensing legislation that should underpin the SBP; some have amended SBP fee schedules to enhance collections, thereby escalating the cost of doing business. Kenya's business environment and investment climate is still uncompetitive. This is worsened by unstructured engagement between County officials and business enterprises, and licensing overlaps caused by ineffective coordination between national business regulatory agencies (e.g. those imposing hotel license, music copyright, bed levy and other fees) and County departments enforcing SBP obligations. It is common for Counties to charge fire protection and other fees in addition to the SBP.

Implementation of the Single Business Permit is further hampered by incomplete information on eligible enterprises. In some cases, partial registers have been extracted from the Local Authority Integrated Financial Operations Management System (LAIFOMS), which constituted the core platform underpinning pre-devolved SBP management. A few Counties are implementing new transactional business licensing platforms, but many are still operating LAIFOMS, despite the system's outdated information. This constrains Counties' ability to determine SBP compliance levels and set realistic revenue targets. In addition, an appropriate balance has not been achieved between SBP's regulatory and revenue objectives. The latter objective requires that license fees be pegged at cost recovery levels, and application and approval processes be simplified. In general, a clear link is missing between SBP license payments and the quality of services provided by County Governments.

Administration of and compliance with the Single Business Permit is also experiencing challenges because of complexities within its fee structure. Some SBP fee categories have become redundant due to inactivity of economic subsectors whose importance has declined. Only a few Counties have revised segmentation within fee structure sub-categories to make them understood by businesses. Being a premises-based license, SBP is challenging for businesses with many outlets in one County. A pharmacy with six outlets maintains a similar number of SBPs, which complicates compliance especially in Counties with poor automation. Compliance is also difficult for centrally-managed businesses with a national branch network,

because of different tariffs across Counties. In this case, a business has to source all SBP-related invoices from different Counties in which it operates and forward these to its head office for processing and payment. This is administratively burdensome and complex.

Moreover, enforcement of the Single Business Permit is being subverted by litigation from professional organizations. SBP is intended to license all business or trade including professions and occupations within an authority's jurisdiction (*see section 163A of the Local Government Act*). The license applies to firms and/or individuals offering services (e.g. legal, financial, management, engineering, architecture, surveying, etc.) as well as private institutions (e.g. schools, health clinics, consulting offices of doctors, etc.). This was the case until in 2007, when the Law Society of Kenya (LSK) challenged the license in court, arguing that imposition of the business permit amounts to regulation of legal practitioners who are already licensed by the professional organization. The High Court restrained the City Council of Nairobi from "demanding, seeking or receiving applications for SBP" from the legal profession, advocates and LSK members. In implementing the ruling, MoLG stopped all other LAs from levying the SBP to LSK members. It also excluded professional engineers from the business license. Recently, the Institute of Certified Public Accountants of Kenya (ICPAK) has discouraged its members doing business within County Government jurisdictions from complying with the licensing requirement.

2.2.4 Liquor licensing fee

Until 2010, the legal basis for regulating the sale and supply of liquor was the 1957 Liquor licensing Act (Cap 121). Through the Act, the Minister of State for Provincial Administration and Internal Security had powers to declare specified areas as licensing areas, which determined liquor fee payable in the area. Provinces or districts were gazetted as licensing areas. For instance Nairobi was Nairobi licensing area, while Nyanza Province was gazetted as Siaya, Kisumu, South Nyanza and Kisii licensing areas.

In 2010, the Liquor Licensing Act was replaced with the Alcoholics Drinks Control Act No. 4, although this does not give to County Governments powers of enforcement. This Act established in each district an Alcoholic Drinks Regulation Committee, responsible for issuance of licenses for brewing, wholesale and retail of alcoholic drinks. The Act established the: i) National Authority for the Campaign Against Alcohol and Drug Abuse (NACADA) as the public body or department responsible for matters relating to alcoholic drinks; and, ii) Alcoholic Drinks Control Fund, consisting of such license and other fees as may be payable under the Act. License categories and fees applicable under each category were defined in the Alcoholic Drinks Control (Licensing) Regulations, 2010. Under the Act, enforcement of non-compliance with liquor licensing regulations is not controlled by County Governments which are constitutionally responsible for the function.

County Governments are expected to develop relevant liquor licensing legislation, but many have not done so. The legislation should provide for the licensing and control of production, distribution, sale and consumption of alcoholics drinks, as well as control of outdoor advertisements of alcoholic drinks and promotion of primary healthcare. Not all Counties have enacted required legislation. To guide this legislation process, the National Government through NACADA has developed a Model County Alcoholic Drinks Control Bill. The authority is also training County officials in enforcement matters.

2.2.5 Cess

Cess is a levy primarily on tradable agricultural produce imposed previously by Local Authorities on the basis of the Agriculture Act (Cap 318) and the Local Governments Act (Cap 265). Section 192(a) of the Agriculture Act empowered LAs to impose a cess on

any kind of agricultural produce after consultation with the Ministers responsible for Local Government and Agriculture. The Act also enabled LAs to enact by-laws requiring any person -- whether within or outside the area of jurisdiction of the authorities -- who buys or markets on behalf of a producer of agricultural produce on which cess is payable, and on which no cess has been paid, to deduct from the money payable to the seller an amount equal to cess payable on the produce, and to remit the amount to the authority to whom the cess is payable.

Cess was intended as an earmarked levy to support improvement of production and distribution of taxed agricultural produce. 80 percent of all cess collections was used in maintaining roads and other services related to sectors in which it was levied. The remaining 20 percent was credited to LAs' general account. In respect of tea and coffee sectors, 80 percent of cess collections was transmitted to the Kenya Roads Board (KRB) Fund.

Implementation of cess before devolution was supported by its incorporation in agricultural sector policies and legislation. The Kenya National Livestock Policy (2008) included provisions for LAs to plough back cess revenue towards development of livestock marketing infrastructure in order to improve local livestock market. Additional provisions were contained in the Kenya Meat Commission (Amendment) Act (1966), such as rates payable for livestock cess, payment and collection procedures and processes for recovery of cess as a civil debt due from persons liable to pay.

In the post-devolution period, cess collection is not guided by any policy, legal and regulatory frameworks. The constitution does not explicitly define cess among main tax categories that County Governments may impose. In addition, the Agriculture Act on which basis cess was previously imposed has been repealed by the Agriculture Fisheries and Food Authority (AFFA) Act (2013), which consolidates laws on regulation and promotion of agriculture. Moreover, the High Court has prohibited County Governments from levying agricultural produce cess or related tax until they enact appropriate revenue laws. In the period before devolution, some LAs were similarly restrained from imposing cess, mainly for want of necessary legislation.

Administration of cess by County Governments is surrounded by numerous challenges and ambiguities. These include: i) the indiscriminate list of commodities for which cess payment is now required, including manufactured goods in transit through and/or across County boundaries; ii) collection of cess both at source (e.g. at farm gate in the case of agricultural produce and at production point in the case of manufactured goods) and at point of exit from the County; and, iii) levying of cess on natural products and/or extractives (e.g. sand, building stones and timber) that should ideally be charged under legal provisions for royalties. Apart from these problems, it is not clear how the Counties compute payable cess, identify commodities to be levied or determine where collections are to be made. Under LAs, the practice was to levy cess on volume or value traded. In either case, a flat, proportionate or graduated rate was applied at the LA's discretion. While this is still the practice today, there is no clarity on how different Counties determine applicable cess rates.

The 'barrier' method of cess administration disrupts free flow of goods between Counties, and may also contribute to high administration and overall economic costs. The practice by Counties -- like the defunct LAs -- of stationing revenue clerks on barricades along transportation routes leads to unnecessary delays. Farmers and produce transporters are held up at the roadblocks negotiating and seeking clearance. Not only does this practice lead to multiple cess levies along trading routes; it also presents an opportunity for rent seeking behavior from County officials. In addition, the barrier method is likely to escalate administration and enforcement costs as opposed to if the Counties adopted automated

solutions to collect the cess at source. In general, the methods by which Counties are administering cess are likely to offend Article 209(5) of the Constitution, which requires that County fees and charges should not disrupt economic activities. In particular, cess collection across County borders means that final consumers are likely to suffer higher commodity prices, despite the fact that producers are the ones liable to make payments. Research has established that the average produce cess is higher than other market charges, and has a significant positive effect on distribution costs -- a one percent increase in cess raises average distribution costs by 0.8 percent.

Cess accounts for a rather small proportion of County Governments' own-source revenue. In FY 2016/17, collections by Counties amounted to Kshs. 1.2 billion, equivalent to 3.5 percent of aggregate OSR. In FY 2015/16, Kshs. 1.3 billion was collected, which equaled 3.6 percent of total OSR. (This excluded Kshs. 106.8 million in coffee cess collected by KRB that was subsequently released to 30 Counties from which it was generated). In general, low cess collections may be indicative of leakages or poor compliance, especially given the levy's weak connection with specific services. It may also signify negative yields resulting from high administration costs. 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 and titanium). Thus, it is not clear the extent to which the low cess collections can support infrastructure development.

2.2.6 Other user fees and charges

County Governments are imposing user fees and charges primarily to raise revenue, without anchorage on policy and legislation or links with service provision. The fees and charges are entrenched in Counties' legal systems through annual Finance Acts passed by respective County Assemblies. Lack of clear policies and legislation is a disincentive to compliance by citizens. Compliance is also a problem where fees and charges are not commensurate with services, like where water charges are levied without guarantee of uninterrupted supply of clean water; or parking fees in the absence of clearly designated or secure parking spaces. As mentioned earlier, the main rationale for user fees and charges is not to generate revenue but encourage efficient use of resources. Properly designed user charges and fees also provide information on citizens' willingness to pay for services.

There is concern that administration costs of some fees may outweigh revenues, and that other charges exceed service provision costs. Fiscal policy aims to minimize administration costs so as to ensure positive yields. County Governments inherited more than 32,000 employees from defunct LAs, many of them attached to the revenue function. Subsequently, Counties have recruited additional revenue staff. Based on consultations as part of preparation of this Policy, only a few Counties understand the recurrent cost implications of administering their fees and charges. A better understanding can inform OSR revenue strategies, such as whether it makes economic sense to introduce new fees (or carry on with existing ones) if projected receipts do not balance underlying costs. The exception would be regulatory fees such as liquor licensing, or administrative charges like for building plan approvals. Other concerns are County charges which exceed service provision costs, or the imposition of fees where no services are provided.

Levies by some County Governments are inhibiting international protocols and agreements, particularly those intended to ease international trade. Mombasa County Government had proposed to impose a transport infrastructure development levy per container (ranging from USD 40–90) on shipping lines. These proposals are contained in the Mombasa County Port Authority Bill, 2014, and the Mombasa County Finance Bill, 2016. By raising the operational cost of cargo transport, such a levy can affect trade at Mombasa port and along the

northern corridor as exporters and importers seek alternative routes. The levy can jeopardize Kenya's trading position and erode the country's competitiveness. Moreover, the levy amounts to usurpation of the National Government's function in relation to regulation of international and national shipping. A number of frontier Counties including Busia and Migori are charging transit trucks a parking levy at gates leading to one-stop border post customs control zones. Like the port levy above, such charges can discourage international traders from Kenyan transport corridors.

No County Government has developed a Tariffs and Pricing Policy to guide imposition of fees and charges. A legal requirement under section 120 of the County Governments Act, 2012, the Tariffs and Pricing Policy should articulate the rationale for application of tariffs, fees, levies or charges by a County Government and how these are linked with service provision. (*See section 4.2.1 for more details*). Absence of a Tariffs and Pricing Policy may imply that determination by Counties of fees and charges -- including the amount paid by different categories of citizen groups -- is being done without objective considerations. Setting rates using objective criteria will improve predictability and stability of the rates across all Counties, in addition to enhancing efficiency in revenue administration.

2.2.7 Tourism-sector levies

Tourism traverses geographic boundaries, and its integral role in the economy as an 'invisible export' requires intergovernmental cooperation, including in setting of fees and charges. The concurrent nature of tourism is reflected in the Fourth Schedule of the Constitution: The National Government is responsible for tourism policy and development, which includes regulation of all tourism activities and services, a role currently being performed by the Tourism Regulatory Authority, as per the Tourism Act, 2011. County Governments on the other hand, have been assigned responsibility for trade development and regulation including "local tourism", a function which is yet to be unbundled.

The proliferation of tourism sector levies at the County level points to lack of clear national regulations and the fact that constitutional function assignments have not been unbundled. In addition to normal levies on all business (e.g. SBP) the Counties are imposing numerous other charges on hotels, lodges and restaurants such as health certificates and clearances, medical certificates for food handlers and fire safety. One County introduced a bed levy chargeable regardless of occupancy, while another is imposing a pool levy on hotels with swimming facilities. Such proliferation of levies is likely to have negative incentives, both for large rated hotels (which already pay higher income and property taxes) and smaller operators (whose sustainability is threatened). While the National Tourism Blueprint 2030, outlines ways of managing the sector -- product, marketing, investment promotion and infrastructure strategies -- there is need for national regulations to form the reference point by which Counties are to develop tourism products and impose levies.

2.2.8 Licensing of outdoor advertising

Outdoor advertising contributes significantly to the creation of vibrant industries and a competitive economy. However, outdoor advertising requirements of industry should be balanced against the need to protect public spaces and enhance their character and appearance, and ensure that public safety is not prejudiced. This is the rationale for outdoor advertising controls, which is achieved primarily through licensing.

Before devolution, the defunct LAs had significant regulatory powers over control of outdoor advertising. The LAs had powers to regulate: i) the display of adverts and advertising; ii) use and passage of advertising vans, sandwich boards, lanterns, flags, screens or other moveable advertising devices; iii) distribution of handbills in or along public place;

and, iv) street decorations. Underpinning the regulatory powers was the Local Government Act, Cap. 265 (section 162). Currently, the power to control outdoor advertising is assigned to County Governments in accordance with the Forth Schedule of the Constitution. A legislative framework proposed by the Senate (i.e. the County Outdoor Advertising Control Bill, 2015) has not yet been enacted. Only a few Counties have prepared policies and or legislation on outdoor advertising and signage, covering licensing objectives, framework for regulations and standards, general design considerations and guidelines for license application and approvals.

Licensing of outdoor advertising in Kenya is generally perceived by the private sector as “burdensome”. Before devolution, many licenses imposed by LAs (e.g. branding, banners, signage on bus shelters and company premises as well as billboards) were perceived by private sector to be “burdensome”, “annoying” and having “extremely high impact” on trade. In 2007, a review of business licenses and fees recommended the immediate elimination of all LA advertising licenses (with the exception of billboard licenses) and their replacement with “standards to achieve law and order contained in a business licensing code under the Local Government Act”. The review proposed that LAs be prohibited from publishing any outdoor advertisement-related by-laws outside the recommended code. An earlier review, in 2006, had recommended that LAs should continue charging for outdoor advertisement among other fees and charges for services consumed directly by traders as long as the fees and charges are “not tethered” to the Single Business Permit (SBP).

There have been disputes between the two levels of Government on who should control outdoor advertising and how. In 2014, attempts by the Kenya National Highways Authority (KeNHA) to charge owners of billboards erected along national roads culminated in a legal challenge by Nairobi County Government. KeNHA argued that lack of proper management of billboard placement may lead to them being poorly erected and their collapse, which could cause accidents and highway closures; hence the need for National Government’s intervention through imposition of a road reserve space rent or lease charge. The County Government argued that KeNHA’s intervention would violate the Constitution, cause confusion in the industry and undermine the county’s outdoor advertising licensing revenue.

2.3 Challenges of revenue administration and management

2.3.1 Absence of revenue policies and legislation

Most County Governments are yet to enact or operationalize required legislation to underpin revenue-raising measures. Many Counties maintain fees and charges by the defunct LAs, which were regulated through by-laws that are now irrelevant. Others are mobilizing revenue using outdated policies and guidelines developed by the LAs. Through annual Finance Acts, some Counties have promulgated fee regimes inherited from LAs. These are further indications that majority of Counties lack principle legal frameworks to support revenue collection and management. The laws are required to support revenue administration, property rating, trade licensing and public participation. County Executives are expected to initiate draft revenue laws and forward them to County Assemblies for consideration and legislation. Upon assent by the Governor, the bills become law. Stakeholder engagement and public participation are important steps in this process.

The practice by the National Government offers guidance on how County Governments should deal with revenue legislation. At the National level, the annual Finance Act does not impose taxes, fees and charges; it merely alters the amount or rate of a tax or fee by amending the clause in the principal law that dictates the rate. Thus, the national Finance Act operates like an annual Statute Amendment (Miscellaneous) Act. This approach is consistent with

accepted revenue-raising practice, whereby sector-specific legislation imposes taxes, fees and charges and provides for easier financial regulation of each sector.

Lack of clear policy and legal frameworks is undermining revenue optimization by County Governments. There is currently no overarching law at the national level that guides Counties in their imposition of property rates. Outdated property legislation and valuation rolls imply low coverage and base of properties, which undermines property-related revenue. Less than 10 Counties have enacted Rating and/or Valuation for Rating Acts or updated their valuation rolls. Absence of the legislation also implies that Counties are not entrenched as rating authorities. Further, the absence of an integrated database among Counties and between the two levels of Governments means that sharing of information is not possible, which compromises enforcement.

2.3.2 Illegal issuance of waivers and variations

To encourage voluntary compliance, County Governments are offering waivers to ratepayers, but most of these have weak legal basis. According to Article 210 of the Constitution, no tax or licensing fee may be imposed, waived or varied except as provided by legislation. This refers also to waivers on penalties, interest and fines. Even where legislation permits the waiver of a tax or licensing fee, the constitution requires: i) maintenance of a public record of each waiver together with reasons; and, ii) a report to the Auditor-General. Moreover, State including County officials are not supposed to benefit from tax or fee waivers. To remedy this, some of the County Governments have inserted waiver clauses in their Rating and/or Valuation for Rating Acts, but this does not meet the constitutional requirement.

2.3.3 Multiplicity of County fees and charges

Citizens and businesses are adversely affected by the haphazard manner in which County Governments are levying user fees and charges. The Counties have created multiple regulations, which they use as “tax handles”, compelling citizens and businesses to pay for numerous licenses and permits. Transportation of agricultural produce and minerals by road attracts multiple cess charges across County boundaries to market points. There have been numerous complaints about such practices, some ending up in court. Multiple fees and charges are caused by lack of clarity in the process relating to introduction of levies, limited consultation and public participation, and the continuing duplication of functions between the two levels of Government. By charging multiple fees and charges, County Governments are in contravention of Article 209(5) of the Constitution. The practice also escalates the cost of doing business besides causing a high tax burden on both the public and businesses.

2.3.4 Weak understanding of County revenue administration costs

There is no clear understanding of County Governments’ revenue collection costs, or the efficiency of their revenue administration systems. As previously mentioned, such an understanding would help Counties to ascertain the economic rationale of their revenue collection activities and improve efficiency of administration. (*See section 2.2.6*). Attempts by the National Treasury to develop this understanding are so far unsuccessful, because of limitations in financial reporting formats. Efforts to obtain updated information on personnel numbers within County revenue departments are equally unsuccessful. In general, Counties should be concerned about the sustainability of some of their revenue streams vis-à-vis the collection and administration costs.

2.3.5 Challenges related to financing of urban areas and cities

To defray service provision costs, urban areas are expected to retain revenue from rates, fees and charges, but no County Government has implemented this requirement. The

PFM Act (2012) anticipates that urban areas and cities shall be allocated funds in proportion to the relative per capita revenue generated from the built-up locations, but this has not been achieved. Not all Counties have operationalized provisions in the Urban Areas and Cities Act (2011) requiring establishment of municipal boards and town committees. Instead, most Counties distribute budgetary resources among sub-counties or wards using formulas which ignore the fact that majority of OSR is generated from urban areas and cities. Consequently, insufficient resources are being re-invested in the towns, whose future potential to generate more revenue is likely to be undermined.

2.3.6 Human resources capacity and enforcement issues

Majority of County Government revenue administrators lack basic skills for the function, a key factor behind poor enforcement strategies. As mentioned earlier, majority of County revenue personnel were inherited from defunct LAs, and many lower cadre revenue clerks and collectors were ancillary personnel under the authorities. These personnel have scant knowledge of revenue laws. This skills and knowledge deficit comes to bear in all revenue-related operations, but most dramatically where collection and enforcement are concerned. Efforts to collect County revenue and enforce provisions of Finance Acts are often confrontational, involving brute force, arrests, street chases and riots. Some Counties have tried to mitigate these weaknesses through redeployment, additional recruitments or outsourcing revenue administration. However, these efforts are impeded by institutional constraints such as:

- slow integration of staff inherited from the LAs and those from devolved former ministries;
- disparities in earnings between the different personnel cadres (in general, defunct LA personnel earn more);
- inadequate incentives to attract professionals with necessary competencies;
- widespread accountability challenges as reflected in the Auditor-General's reports; and,
- ambiguity of roles and responsibilities within County revenue departments and lack of clarity in reporting structures.

2.3.7 Low automation and integration of revenue administration

Adoption by Counties of ICT systems is below par, and manual revenue collection is prevalent with its inherent risks of abuse and rent seeking. Generally, progress has been slow towards automation and integration. Even Counties with more advanced ICT systems have not fully deployed them towards revenue collection and management. Unstable Internet connectivity and power supply interruptions are key challenges. Network infrastructure is critical for effective deployment of Integrated Revenue Management Information System (IRMIS). To address the power challenge, the National Government has been rolling out electricity connection through the national grid to most parts of the country.

Revenue collection and management systems currently in use by County Governments can be clustered into four categories. Firstly, a number of Counties are using ICT infrastructures handed to them by defunct LAs, predominantly the Local Authorities Integrated Financial and Operations Management System (LAIFOMS). Secondly, the Integrated Financial Management Information System (IFMIS) revenue module, which is mainly used for reporting. This module is yet to be fully rolled out because major customization is needed to align it to Counties' OSR collection and management needs. Thirdly, many Counties have developed (or are developing) customized revenue management systems through private developers. For the most part, these systems are not based on the Standard Chart of Accounts (SCoA) and are incompatible with IFMIS. Fourth, some Counties

are procuring stand-alone receipting systems instead of investing in complete Enterprise Resource Planning (ERP) solutions.

Efforts to standardize revenue collection systems across all Counties -- a desirable outcome with numerous benefits -- have been unsuccessful. For effective revenue management across the Counties, there is need for a standardized ICT based system that integrates 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 limit achievement of this objective. The challenges include:

- (a) The fees payable for costs relating to system acquisition and licenses is exorbitant.
- (b) Owing to capacity constraints, there is no systematic and consistent use of the system -- often, the system is abandoned immediately after roll out.
- (c) Counties that have developed (or are developing) customized revenue management systems through private developers are not aligned to Standard Chart of Accounts (SCoA) resulting to conformity challenges.
- (d) Some County Governments have developed segmented and silo-like revenue administration systems, which creates a problem of integration.
- (e) Most Counties do not have Wide Area Network (WAN) which is necessary to connect all revenue collection points, including in sub-Counties. LAIFOMS, which some Counties are currently using, can only operate as a standalone system. The system is therefore not effective in a WAN setting.

2.3.8 Inappropriate institutional arrangements

Some revenue collection structures adopted by County Governments have undermined control by the Treasury, leading to poor coordination of the function. While some Counties use revenue units located within their Treasury departments, others have outsourced collection of specific revenue streams to private firms. Revenue collection in some Counties has been decentralized to respective departments (e.g. where the health department is directly responsible for collection of health facility user fees) with little reporting to the County Executive Committee Member for Finance. In other Counties, the revenue function falls not under the Treasury, but in other departments such as the office of the County Secretary contrary to provisions of the PFM Act (2012). The impact of such arrangements has been loss of control by County Treasuries of the revenue collection function. The approach has also led to weak coordination of revenue collection thereby creating room for illegal spending of revenue at source.

County Governments are permitted four administrative arrangements for revenue collection and management, but there are no guidelines on how to select the most suitable. According to the PFM Act (2012), the four options are: i) internal revenue administration, which is currently in use by most Counties; ii) establishment of an autonomous revenue authority (or County corporation); iii) contracting the KRA; or, iv) contracting a private firm or other agent. Each option has its strengths, and the Counties have a responsibility to identify the administrative arrangement through which revenue can be enhanced. (*Table 4*). There are however no guidelines to the Counties on how to determine the most appropriate administrative arrangement for revenue collection and management, given their context. The PFM Act also authorizes the CEC Member of Finance to: i) mobilize resources for funding the County's budgetary requirements and put in place mechanisms to raise revenue and resources (Section 104(d)); and, ii) designate Receivers of Revenue (Section 157).

Table 4: Legal administrative options for County OSR collection and management

Option	Pros	Cons
Internal revenue administration departments	<ul style="list-style-type: none"> • Does not require enactment of any enabling legislation • Enables County Governments to remain fully in control of the revenue function, and thus retain fiscal autonomy 	<ul style="list-style-type: none"> • If not well implemented, this option is prone to interference and capture by politicians • Unless standard formats are prescribed, this option presents a risk of losing uniformity in reporting, which can complicate cross County comparisons
Autonomous County Revenue Authority / Corporation	<ul style="list-style-type: none"> • Autonomy allows for greater focus on revenue administration • Benefits from available guidelines in the PFM Act and the PFM (County Government) Regulations on establishment of County corporations • If well structured, can eliminate conflict of interest between revenue policy formulation and implementation 	<ul style="list-style-type: none"> • Considering the fact that an authority or corporation comes with fixed costs, this option may disadvantage smaller Counties with low OSR potential -- if fixed costs are high, Counties may be forced to recover the expenses e.g. by increasing taxes, fees and charges • Requires enactment of a County enabling legislation
Contracting KRA	<ul style="list-style-type: none"> • This option conforms with the PFM Act which allows Counties to contract KRA as the principal collector of Government revenue • KRA's low revenue collection agency fee (currently below 2%) implies significant savings for Counties • Counties stand to benefit from KRA's expertise, systems and greater accountability • Can enhance compliance since KRA is better equipped legally and financially to undertake enforcement, if authorized through a legislative amendment • Allows specialization of personnel, and may permit more sophisticated technology • Permits information exchange as well as opportunities for capacity building from KRA • KRA's expected presence in all 47 Counties enables better coordination 	<ul style="list-style-type: none"> • Conceals responsibility for tax being levied • In the event of litigation by revenue payers, risks of County Governments may shift to KRA (<i>This could be mitigated through legislation assigning KRA only revenue collection responsibilities, while Counties deal with disputes</i>) • As County Governments remain in charge of enforcement, there is likelihood of disharmony with KRA as a contracted revenue collector (<i>This could be mitigated by amending relevant legislation</i>) • Possible loss of jobs for County revenue officials (<i>County personnel could be engaged in related activities e.g. billing</i>) • In the event that KRA is overwhelmed by its core mandate, focus may shift away from collection of County revenue
Contracting private firms and other agents	<ul style="list-style-type: none"> • County could potentially benefit from specialization and expertise of contracted firms • County may avoid major new investments in revenue administration infrastructure • County officials may enjoy reduced span of control especially staff and also dealing with employees relations 	<ul style="list-style-type: none"> • Could potentially be expensive to Counties • The third party risks become County risks • Difficult to justify economically, as projected benefits would need to significantly exceed potential costs • This option presupposes weak internal County capacity, but it requires strong managerial systems (to supervise the private agent) and procurement systems (to ensure value for money)

Source: IAWC

2.3.9 Inconsistency in reporting of County revenue data

County Governments' OSR data as reported in their financial statements are not reconciled with balances shown in the Integrated Financial Management Information System (IFMIS). The reason for this is that a number of Counties do not post all their OSR receipts on IFMIS. In addition, whereas the National Treasury has issued a Financial Statements template to be used by all County Governments in reporting their OSR, many Counties have not adhered to this template. As a result, it is challenging to directly compare performance across Counties and over time in terms of the different revenue streams.

2.3.10 Weak capacity for revenue forecasting and analysis

County Governments are not meeting their revenue targets, in part because the targets are unrealistic. According to the Controller of Budget (CoB), Counties' collections in FY 2016/17 was 54 percent of their aggregate projections, representing a drop from the performance of 69.3 percent in FY 2015/16. Nineteen Counties realized less than half of their FY 2016/17 target, again a deterioration compared with FY 2015/16, when thirteen Counties failed to do so. Such underperformance can be attributed to lack of capacity to prepare credible revenue projections. In making credible projections, the Counties should refer to the macroeconomic environment, previous year's performance and status of the tax base. Revenue projections form part of Counties' expected resources, thus failure to realize the projections implies budget deficits. Most Counties do not include detailed revenue forecasts in their County Budget Review and Outlook Papers (CBROPs) in line with the PFM Act, 2012.

2.3.11 Expenditure of local revenue at source

The practice by County Governments of operating multiple revenue collection accounts is a major cause of leakage, including collections being spent at source. 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 PFM Act provides guidance on the operations of this account. The aim is to ensure that any withdrawals from this account are done in compliance with the Constitution. Both the Auditor-General and the CoB have reported on Counties failing to disclose all their commercial bank accounts, and spending collected revenue at source, primarily due to lack of supervision and oversight into operations of the accounts. This challenge is also well documented in the *2015 County Revenue Baseline Study*.

2.3.12 Lack of effective internal controls and audit mechanisms

Lack of effective internal controls and audit mechanisms by County Governments contributes to loss of revenue. Examples of gaps in internal controls and audit processes include: postponed banking of collected revenues; late bank reconciliations; non-rotation of staff in revenue departments as well as allocation of duties among staff in ways that do not enable checks and balances; and, production by revenue officers of duplicate accountable documents such as receipt books. These gaps undermine Counties' revenue enhancement efforts. Many of these issues arise due to unqualified personnel and lack of integrity. There is also lack of effective internal audit as per section 155 of PFM Act; most Counties have internal audit departments but lack the oversight having not fully functional internal audit committees. Some Counties do not have independent audit committees.

2.3.13 Cash handling

Nearly 80 percent of revenue collectors are being paid in cash on a daily basis, a situation which presents obvious risks in terms of accountability. This is according to the *2015 County Revenue Baseline Study*. Revenue most likely to be collected in cash includes cess,

parking fees and market charges. Whereas some of the activities forming the basis for these collections may warrant the need for daily cash collections, this model of revenue management is risky and prone to leakage.

2.3.14 Sharing of revenue from court fines

A pre-devolution arrangement with the Judiciary whereby Local Authorities received a share of revenue from court fines is no longer constitutional. Section 157 of the Local Government Act, Cap 265, permitted LAs to enter into agreements with the Judiciary whereby Municipalities and City Councils could -- subject to the consent of the Minister -- erect and maintain courthouses and employ court staff, while the Judiciary supplied magistrates. Based on the agreements, the LAs reimbursed the Government magistrates' employment costs in exchange for a share of fines imposed on by-law violators appearing before the Courts. Offenses and penalties arising out of violations of the various by-laws were defined in the Local Government Act. This arrangement was nullified in November 2014, when the Chief Justice recalled all judicial staff previously assigned to Municipal and City Courts. According to the Chief Justice, the repeal of the Local Government Act, Cap 265 by the County Government Act, 2012 invalidated these courts. Moreover, the current legal regime requires that all revenues collected by the Judiciary are deposited into the Consolidated Fund.

The Judiciary has initiated consultations with County Governments aimed at overseeing transition from municipal and city courts to ordinary courts dealing with County matters. Under these consultations, the two parties have agreed to partner in the establishment of rules and procedures to be applied in enforcing County legislation, including those relating to collection and enforcement of OSR. Cases carried over from defunct municipal courts shall be handled by a newly designated registrar, and specific magistrates will be identified to deal with matters arising out of County legislation. Whereas the Judiciary will waive court fees payable by County Governments, all revenue shall be collected by the Judiciary and remitted to the Exchequer as required by the Constitution.

CHAPTER 3: RATIONALE AND OBJECTIVES

3.1 Rationale for the Policy

This Policy has been triggered by five main concerns. The concerns are:

- the low levels of Counties' OSR and its diminishing share vis-à-vis total resources;
- the way in which Counties plan and budget for local revenue;
- legal questions relating to some revenue-raising measures;
- the short- and long-term fiscal and macroeconomic ramifications of the measures; and,
- utilization of collections as well as reporting and accounting procedures.

Underlying the above concerns is the question about how each County can optimize its OSR within the existing rules of Public Finance Management (PFM).

3.2 Goal and objectives

The goal of the Policy is to propose a standardized institutional, policy and legal framework for own source revenue raising measures and enforcement that would be applicable to all County Governments. Below are the Policy's specific objectives:

1. To broaden County Governments' revenue bases, and,
2. To enhance County Governments' revenue administrative capacity

3.3 Strategies

The above goal and objectives will be achieved through the following strategies:

1. Identifying opportunities of optimizing counties' OSR potential;
2. Strengthening legal and institutional frameworks for county OSR; and,
3. Improving Counties' capacity for revenue collection and administration

CHAPTER 4: POLICY INTERVENTIONS

4.1 *National Framework Legislation*

4.1.1 *Regulating introduction of taxes, fees and charges including waivers and variations*

Regulating the introduction of taxes, fees and charges by County Governments, including waivers and variations, will improve policy coordination countrywide. The regulatory process prescribed here aims to address challenges related to County Governments' revenue-raising measures including multiplicity of fees and charges and inefficient revenue administration. The regulatory process is guided by the following principles:

- (a) County revenue raising measures should be aligned to the national tax policy/strategy;
- (b) Neither the National nor the County Governments may impose a tax, fee or charge on activities falling under the jurisdiction of another level of Government;
- (c) County taxes, fees and charges should be levied at the source or destination of transportation of goods in question (including within the same County);
- (d) In introducing any new taxes, fees or charges, a County Government shall consider its internal administrative capacity in order to ensure effective and efficient collection, and guard against introduction of disguised taxes in the form of user charges; and,
- (e) A request for assignment/imposition of new fees may be initiated by the National Government or a County Government. According to Article 209 of the Constitution, Parliament can authorize Counties to impose an additional tax, which means that a new County tax can be initiated by the National Government (i.e. as well as through County legislation).

New taxes, fees and charges by County Governments shall be introduced after review and ratification through a process to be prescribed in law. Where a County proposes to introduce a new tax, fee or charge which has not previously been imposed, the following legal process shall be applicable:

- (a) The County shall submit to the National Treasury and the CRA any tax, fee, charge proposals ten months prior to commencement of the financial year.
- (b) The proposed tax measure should have been included as a policy strategy in the most-recent County Fiscal Strategy Paper (CFSP).
- (c) The proposal shall include reasons for the new revenue measure; tax base or economic activity or income subject to the new tax, fee or charge; the statutory taxpayer; the rate structure; and, tax relief measures and exemptions to protect certain classes of taxpayers.
- (d) The proposal shall also include:
 - procedures for collection and administration, the collection agency, person or entity responsible for remitting the tax and timing of payments;

- costs and methods for administration and enforcing compliance, as well as proposed penalty provisions, an assessment of taxpayers' compliance burden and procedures for taxpayer assistance and resolving taxpayer complaints;
- estimated revenue collection per quarter and per annum;
- indication of the likely economic impact and tax burden on residents and businesses as well as risk of tax burden shifting; and,
- proof that other Counties likely to be affected by the new tax, fee or charge were consulted in respect of fiscal competition.

Issuance by County Governments of waivers and variations of taxes, fees and charges shall be in accordance with a process to be prescribed in law. Regulation of waivers and variations is pursuant to section 159 of the PFM Act (2012), which expects the CEC member for Finance to develop a known and predictable criteria to guide issuance of waivers and variations of taxes, fees and charges, including penalties and interest. The prescribed process shall include a proposal submitted by the CEC Member for Finance containing the request for waiver or variation and indicating: i) reasons or policy objectives of such a waiver/variation; ii) category of tax payers to benefit from such waiver/variation; iii) impact of the waiver/variation on revenue collection; and, iv) likely economic impact of the waiver/variation as well as potential shifts in tax burden and benefits as per section 132 (3)(c,e) of the PFM Act (2012). In order not to discourage compliance, the Counties shall not issue waivers and variations to the same category of rate payers in a financial year following a similar waiver in the preceding year.

4.1.2 Regulating property taxation, CILOR and land rent

There will be new national legislation on property taxation to replace the outdated Rating Act and the Valuation for Rating Act. Below are reasons for enacting this legislation at the national level:

- It is time consuming and cumbersome for each County Government to prepare and enact valuation and rating legislation, especially considering that the small pool of valuation professionals is already overstretched. Development of this legal framework at the national level will ensure that within a reasonable timeframe, all Counties have necessary legal authority to impose and collect property rates;
- A national legislation will ensure uniformity in underlying property valuation and rating with respect to the tax base, waivers, exemptions, deductions, and payment periods, without taking away County Governments' ability to determine their own rates; and,
- Legislation at the national level will enable the National Treasury to put in place regulations to ensure that Article 209(5) of the Constitution is not offended with respect to protecting national economic policies and economic activities across County boundaries. This will be achieved by defining boundaries on the basis of valuation and providing mechanisms for effective engagement of stakeholders, some of who reside outside the County.

The national legislation will contain all integral property rates elements but not administrative ones. The national legislation shall set the legal foundation of a reformed rating and valuation system with inbuilt key policy decisions. The legislation shall contain elements on property discovery and tax base coverage, valuation and assessment and establishment of appropriate tax rates. Under the proposed legislation, it is recommended that provisionally, Kenya retains unimproved site value (USV) form of rating for large urban areas and/or a quantum capital value based on amount of development at a specified price. In the medium to long term, the Counties should move progressively towards capital value form of

rating. Rural land should be valued according to a simplified area based approach. This will ensure an element of buoyancy in revenue from property rates. It is also recommended that the total area of County Governments be declared as rating areas, and that maximum and minimum property rates be prescribed so as to ensure that property taxation does not prejudice national economic policies contrary to Article 209(5) of the Constitution. In future, self-declaration of property value should be considered as an option for capital improved value. Administrative procedures such as billing, collection, enforcement and remedies will not be contained in the national level legislation, as these provisions will be anchored in County-specific legislation.

A national valuation plan shall be developed to provide a road map and timelines for preparation of County valuation rolls. The plan is to be developed by MoL jointly with the National Land Commission (NLC) and County Governments. To deal with the high cost of updating the valuation rolls, Counties may zone rural and urban areas within their respective jurisdictions, and charge a flat rate for each zone as a short term measure.

A framework shall be developed outlining processes and procedures for payment of Contribution in Lieu of Rates. As part of this framework, it is recommended that outstanding CILOR before March 4th, 2013 be addressed within the IGRTC framework that deals with identification, verification and validation of assets and liabilities of the defunct LAs. As a basis for payment of CILOR, the Counties should update valuation rolls and invoice the National Government. The National Treasury jointly with MoL will develop mechanisms for making the CILOR payments, including how the necessary budgetary allocations are to be handled. In case of undetermined public land the NLC in consultation with the MoL shall determine payment modalities. Details on CILOR exemptions shall be provided for in the national legislation on property rates.

4.1.3 Regulating entertainment

It is recommended that entertainment industry stakeholders comply with the delineation of functions which has been gazetted, so as to eliminate conflicts of licensing roles between the two levels of Government. As mentioned earlier, the functions for each level of Government have been gazetted. This clarifies exclusive and concurrent mandates of the National and the County Governments in regulation of activities related to betting and gaming. (*Table 3*). In taxing entertainment, National Government has a role under the Fourth Schedule for regulating and licensing betting, casinos and other forms of gambling. The scope for County Governments in entertainment taxation is restricted to County casinos and lotteries. What is now required is enforcement of the gazetted functions, as well as sensitization and capacity building initiatives to enable County Governments effectively undertake their mandates, while also enhancing revenue. In addition, the Entertainment Tax Act (Cap 479) needs to be aligned with the Constitution.

4.2 County Government Legislation

County Governments are required to develop principal revenue legislation and policies on which to anchor their taxes, fees and charges. This is in line with Article 210(1) of the Constitution and section 132 of the PFM Act (2012). The County legislation should cover property rates, revenue administration, business and trade licensing and entertainment. The Commission on Revenue Allocation (CRA) in conjunction with the Kenya Law Reform Commission (KLRC) and the Council of Governors (CoG) have developed a County Model Revenue Legislation Handbook containing model laws on property rates, trade licenses, revenue administration and finance law. As part of this Policy's implementation plan (*see chapter 6*), technical assistance will be provided to Counties needing assistance in developing or customizing their revenue legislation.

4.2.1 Tariffs and Pricing Policy

Each County Government is required to develop a Tariffs and Pricing Policy within 12 months of this Policy's effectiveness, justifying the rationale of levying fees and charges.

As mentioned earlier, section 120 of the County Governments Act, 2012 provides that a County Government or any agency delivering services in the County shall adopt and implement a Tariffs and Pricing Policy for provision of public services. Moreover, section 107 (2)(g) of the PFM Act requires that there should be reasonable predictability with respect to County tax rates. The Tariffs and Pricing Policy provides a rationale for levying fees and charges, as well as a basis for setting fee/charge levels. It also provides citizens with information in understanding and interpreting the taxes, fees and charges they pay and the services that they should expect from the County in return. By developing a Tariffs and Pricing Policy, a County will ensure that:

- its taxes, fees and charges comply with all prevailing legislation;
- public services are financially sustainable, affordable and equitable;
- the needs of economically vulnerable groups -- the poor, aged and people living with disabilities -- are taken into consideration; and,
- there is consistency in how tariffs are applied throughout the County.

General principles

Guiding principles for development of Tariffs and Pricing Policies are contained in section 120 of the County Governments Act, 2012. A County's Tariffs and Pricing Policy shall define a minimum amount of basic services including water, sewerage and sanitation and refuse collection. Consumption below this amount shall not attract any user fee or charge. Consumption of services above the defined minimum level shall be subject to payment using a stepped structure in which charges increase progressively with consumption levels. The Tariffs and Pricing Policy should contain: measures to keep tariffs affordable; how tariffs will be determined and reviewed, including mechanisms for public consultations; the need to ensure that tariffs for services are sufficient to cover initial capital expenditure of the service as well as operation and maintenance, including externalities; and, the need to promote local and economic competitiveness and development. It is recommended that Counties should develop their Tariffs and Pricing Policies so as to achieve equity, proportionality and financial sustainability. Sustainability also means that fees and charges must be collected, and Counties should adopt efficient credit control and debt collection systems to ensure full recovery of fees and charges. It is expected that these principles will guide County revenue administrators (in determining equity or reasonableness of user fees and charges), courts (in cases of arbitration) and service delivery agencies such as Municipal Boards (in settling and implementing rates and debt collection policies).

The tariff determination process

Counties may set their tariffs to recover the full (or part of the) cost of services being provided, or bring about a surplus that can be utilized to subsidize other services. This calls for an annual review of tariffs i.e. during budget preparation. Proposed tariffs will be presented to the public for consultations and resolution, which will be publicly displayed in a notice by the County Secretary. A proposed tariff will only take effect if no objection is lodged within the period stated in the notice. Otherwise, the County Government will be required to consider every objection before confirming, amending, or withdrawing the proposal, followed by a fresh notice as prescribed in the County Governments Act, 2012. As mentioned earlier, the Counties are expected to identify all costs involved in providing a

service, such as bulk purchase costs (in the case of water); cost of distribution including losses attributed to wastage (e.g. in the case of water); depreciation expenses (in case of assets); and, maintenance of infrastructure and other fixed asset costs. The cost of free services offered to the poor as well as essential services will also be determined, alongside administration and service costs, including:

- a) service charges levied by other departments such as finance, human resources and legal services;
- b) reasonable general overheads e.g. costs associated with the office of the County manager;
- c) adequate contributions to the provisions for debts and obsolescence of stock; and,
- d) all other ordinary operating expenses associated with the service concerned including, in the case of an electricity service, the cost of providing street lighting in a County area.

4.3 Improving revenue administration

4.3.1 Efficiency and effectiveness of human resources

County Governments should take deliberate measures to improve efficiency and effectiveness of personnel involved in the revenue function. Each County's revenue department shall review and evaluate its workload and competency needs, before assessing existing staff involved in revenue collection and administration to identify gaps in skills, numbers and training needs. Based on this, an appropriate training programme shall be designed and delivered. Where recruitment is necessary, new personnel should be trained on core revenue management aspects such as planning, collection, inspection, accounting, reporting and legal enforcement. Further, each County shall develop: i) a Scheme of Service for the revenue function, indicating qualifications to be possessed by all personnel; and, ii) a competitive salary and incentive system to retain staff. For purposes of continuous training, Counties are encouraged to partner with the Kenya School of Revenue Administration (KESRA). The large numbers of under-qualified casual employees currently involved in County revenue collection should be absorbed within or without the department and allocated duties that fit their qualifications.

4.3.2 Improving revenue forecasts and incentivizing fiscal effort

The National Government will support County Governments in enhancing their capacity to prepare credible revenue forecasts. This support will focus on: i) revenue forecasting and analysis as well as impact and tax burden assessment for purposes of introducing or waiving taxes; and, ii) generating comprehensive data that is needed to support more accurate revenue forecasting. County Governments' annual estimates of revenue (accompanying the budget) shall be supplemented with a statement explaining the basis for the estimates. The statement shall provide for each category of tax, fee or charge: i) the previous years' collection; ii) a description of the base; iii) the applicable rate; iv) total projected collections; v) assumptions made; and, vi) reasons for previous year's performance for major revenue streams. In addition, details of revenue projections by stream shall be included in County Budget Review and Outlook Papers (CBROPs). In an effort to incentivize fiscal effort, the CRA is already implementing the fiscal responsibility criteria contained in the second-generation revenue sharing formula. This approach, which captures improvements in Counties' OSR per capita, is consistent with Article 203(e) of the Constitution according to which determination of equitable shares should consider Counties' fiscal capacity and efficiency, and incentivize optimization of local revenue raising.

4.3.3 The role of ICT and automation in enhancing revenue administration

The National Treasury shall design and prescribe a standardized revenue collection and management system for use by County Governments. This is pursuant to: i) Article 190(2) of the Constitution, which requires County Governments to use financial management systems that comply with any requirements prescribed by a national legislation; and, ii) section 12(1)(e) of the PFM Act (2012), which requires the National Treasury to design and prescribe an efficient financial management system for both levels of Government. These requirements connote standardization of ICT-based systems used by the Counties, which involves integration and automation. Integration aims to facilitate monitoring, financial control and oversight by the National Treasury including by enabling comparison across Counties. Automation aims to eliminate handling of cash by County officials, which contributes to revenue leakages. As already explained, a standardized revenue collection and management systems will ensure uniformity in reporting by Counties, besides saving them costs associated with purchase of independent systems. For these reasons, the National Treasury shall develop a revenue collection and management system that meets the prescribed standards for use by the Counties.

The prescribed standardized revenue collection and management system for use by County Governments shall permit seamless integration with the IFMIS. This means that the design and structure of the system will be based on the Government Standard Chart of Accounts (SCOA), which is already being revised. It also means that an improved standard revenue reporting template will need to be developed for use by all the Counties, to enable comparative analysis. In general, the prescribed standardized system must at the minimum support the following 12 core processes:

- (a) Revenue sources management, which includes 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, which includes invoicing (or billing) and receipting;
- (e) Receiving and processing payments through multiple e-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 or the clustering of customers into unique segments based on predefined parameters;
- (j) Work flow management;
- (k) Reporting and auditing (as per County and National requirements); and,
- (l) Integration with IFMIS and other existing technologies

The success of the system designed will depend on its ability to overcome connectivity challenges. In this context, the Counties are encouraged to diversify service delivery channels for example through use of mobile digital technology. The Government through the ICT

Authority in collaboration with private Internet Service Providers (ISPs) proposes to extend connectivity to sub-county and ward levels, especially in geographically expansive Counties.

4.3.4 Determining an appropriate structure for revenue administration

Guidance is hereby provided to County Governments that might assist their selection of the most appropriate organizational structure for revenue collection and management.

As mentioned earlier, the existing legal framework permits four structures for revenue collection and management at the County level, namely: i) establishment of internal revenue administration departments; ii) establishment of autonomous County revenue authorities/corporation; iii) contracting the KRA; or, iv) contracting private firms and other agents. However, no guidance has previously been provided to the Counties on how they might determine the most appropriate structure. To address this gap, an effort is made here to categorize the 47 Counties using two currently available metrics: i) per capita OSR collection in FY 2014/15 (mainly property rates, land rent and single business permit); and, ii) personnel emoluments as a rudimentary proxy for cost of revenue collection. Accordingly, each County is mapped to one of the legally permitted revenue collection and management structures. (*Table 5*). It must be emphasized that the guidance provided here is not binding, and individual Counties are encouraged to undertake more detailed analysis using current and more precise data so as to arrive at the most suitable structure.

Table 5: Recommended revenue administration structures for Counties

Structure	County Governments	Rationale
Establishment of internal revenue administration departments	Tana River, Lamu, West Pokot, Mandera, Nandi, Kitui, Siaya, Garissa, Bomet, Wajir, Homa Bay, Migori, Nyamira, Kirinyaga, Marsabit, Makueni, Nyandarua, Elgeyo Marakwet, Trans Nzoia, Kilifi, Vihiga, Turkana, Kwale, Kericho, Baringo, Busia, Murang'a, Tharaka Nithi	<ul style="list-style-type: none"> Where revenue is still relatively low (probably with no predominant revenue streams) and where economic justification is low for investment in advanced and costly revenue administration systems This is the structure currently being used in most County Governments
Establishment of autonomous County revenue authorities / corporation	Embu, Uasin Gishu, Laikipia, Kajiado, Isiolo, Samburu, Taita Taveta	<ul style="list-style-type: none"> Counties with potentially significant revenue, requiring only modestly complex administration (including, due to narrow concentration of the most important revenue streams e.g. park entry fees). Annual expenses of such authorities / corporations should not exceed 2% of estimated revenue in each financial year Laikipia County has already established a County Revenue Board, which is responsible for collecting and receiving all revenue, administration and enforcement, assessment and accounting, provision of advice to the CEC on all revenue matters, preparation of annual reports, and payment of all revenue into CRF. The Board's funds and assets consist of not more than 2% of estimated revenue to be collected each financial year
Contracting the Kenya Revenue Authority (KRA)	Nairobi, Mombasa, Kiambu, Narok, Nakuru, Kisumu, Machakos, Nyeri	<ul style="list-style-type: none"> It would be easier for KRA to collect revenue from more urbanized Counties with large formal sectors; this would allow KRA to fully apply its professional skills, personnel and technical resources Counties with relatively high revenue (including future capacity) but in which revenue collection is potentially both costly and complex (including, due to several important revenue streams) For a brief period, KRA collected local revenue for the defunct City Council of Nairobi, but the arrangement was prematurely terminated Kiambu County already has an MoU with KRA to collect property rates, land rent and SBP Park entry fees, the largest revenue stream in Narok County is currently being collected by KAPS, a private firm
Contracting private firms and other agents	Kakamega, Kisii, Bungoma, Meru	<ul style="list-style-type: none"> By contracting private firms, these Counties could benefit from professionalized revenue administration and reduced costs, although with progressively enhanced revenue collection, contracting KRA could also be a medium-term option

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

4.3.5 Recommendations for enhancement of specific County revenue streams

Below are specific policy recommendations for the enhancement of different County revenue streams:

Revenue stream	Specific policy recommendations
Property-related revenue	<ul style="list-style-type: none"> • Develop a national integrated land registry that links the 58 County land registries • Digitize land titles and register untitled parcels • Develop a comprehensive national cadaster, to be regularly updated to include buildings and physical improvements • Introduce incentives that encourage registration of properties including agricultural land by reducing registration, survey and legal fees. Consideration could be given to make registration compulsory irrespective of the legal status (including informal settlements) • Introduce measures to audit new valuation rolls prepared by County Governments with oversight by the NLC in consultation with MoL • Ensure that all titled land is rateable in any form of rating that is appropriate for local economic status • In each County, all land parcels should be declared as rateable, with an appropriate form of rating being applied to each parcel • Agricultural rental value form of rating needs to be updated and provision made for reviews and/or indexing in response to evolving use of rural land e.g. for tourism and ecotourism and conservancy • Regularly update development plans, base maps and cadastral and geo-spatial plans to ensure that all rateable properties are captured • Trading/market centres need to be planned, surveyed and registered as a matter of urgency so as to have them be rated. For other communal land outside trading/market centres, other forms of rating can be applied • For quality assurance purposes, MoL, the Public Procurement Regulatory Authority (PPRA) and County Governments should develop standard evaluation criteria for use in engaging professionals to prepare valuation rolls • Oversight role by MoL should be anchored in law as a measure to ensure quality assurance through an appointed committee • Development of an appropriate fiscal cadaster based on the land cadaster but supplemented with detailed technical data on buildings, value zones, property values, and taxation records • Issuance of a valuation manual with detailed instructions for: single market valuation; using mass valuation instruments; defining value zones, and guiding revaluation of Area Fixed Asset Tax (AFAT) unit taxes. Additionally, migrating land subject to rent (leaseholds) to either AFAT or value fixed tax (to mitigate low tax collection on leases which are charged per m² with no charge for improvements). • Adoption of Computer Aided Mass Valuation system (CAMA) or Automated Valuation Models (AVMs), which centralizes procedures and utilizes modern instruments like the digitized land records and the GIS mapping, supplemented with technical details from owners. CAMA models are well regulated and can handle information from computerized land cadasters and the GIS. CAMAs use the same information as single property valuation and can handle and combine various valuation methodologies, including market value, cost-based, and 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.

Revenue stream	Specific policy recommendations
	<ul style="list-style-type: none"> The Land Act, 2012 should be amended so that land rent is collected directly by County Governments, not the NLC. This will increase efficiency in revenue administration as all the revenues due to Counties would be collected in one stop shop. There is also need to revise land rents to increase the revenue collected.
Business licensing	<ul style="list-style-type: none"> The Single Business Permit shall be maintained as the primary instrument for regulating and licensing businesses. This requirement shall be anchored in an Act of Parliament. The SBP shall be anchored in County-specific trade licensing legislation and policy. In the event of any exception to this requirement (e.g. where a County intends to introduce a business license outside the SBP regime) then the procedure provided in this Policy for introduction of new taxes, fees or charges shall apply. Implementation of the SBP shall be as set out in a Schedule, which County Governments are required to comply with. The Cabinet Secretary/National Treasury shall, in consultation with all relevant stakeholders, amend the Schedule through a gazette notice. Counties should update information on enterprises eligible for business licensing by encouraging online registration for and renewal of business permits, as this will reduce registration time and increase efficiency in administration. Furthermore, the National Treasury jointly with the Attorney-General will appeal the court judgment exempting certain professionals and their associations from the SBP, which will also be prorated. It should be noted that the SBP is distinct from the liquor license.
Liquor licensing	<ul style="list-style-type: none"> There is need to amend the Alcoholic Drinks Control Act, 2010 to recognize County Governments' role in regulating alcoholic drinks, including sale. It is also proposed that a national legislation be prepared as a contingency for Counties which have not yet enacted their own alcoholic drinks control laws. The proposed national legislation will enable Counties to undertake enforcement activities.
Agricultural produce cess	<ul style="list-style-type: none"> County Governments wishing to impose cess should develop supportive legislative frameworks. The legislative frameworks should clearly indicate that cess is meant for infrastructure development, and the percentage of cess collections to be ploughed back into sector(s) from which it is generated. In general, this Policy discourages the imposition of cess except where its imposition: i) is applicable only to agricultural produce (including livestock and fisheries); ii) is done at source; and, iii) projected revenues exceed administration costs.
Tourism-related charges	<ul style="list-style-type: none"> There is need for an initiative within the tourism sector, bringing together County Governments and other stakeholders to: i) define the parameters and scope of 'local tourism' as envisaged in the Fourth Schedule of the Constitution; and, ii) formulate clear regulations covering development of products by Counties (i.e. uniformity, norms and standards across Kenya and the EAC region as well benchmarks with leading destinations around the world) as well as guidance on imposition of fees and charges within the sector.
Outdoor advertising	<ul style="list-style-type: none"> Fees and charges levied by the Counties should not contravene Article 209(5) of the Constitution especially in mobile advertising. There is need to differentiate between branding and mobile advertising. For instance, branded vehicles should not be charged advertising fees in more

Revenue stream	Specific policy recommendations
	<p>than one county for delivery. This should be treated differently with a trader doing business in more than one county with a branded vehicle. This would ensure that there is no multiplicity and duplication of charges.</p>
<p>Revenue from court fines</p>	<ul style="list-style-type: none"> • The fact that revenue from court fines is not shareable with County Governments should not disincentive enforcement activities. This is because: i) compliance by payers of County taxes, fees and charges has the potential of generating comparatively higher revenues; and, ii) failure by the Counties to enforce OSR compliance on account of their inability to benefit from court fines could be detrimental.

CHAPTER 5: GOVERNANCE, ACCOUNTABILITY AND OVERSIGHT

5.1 The need for good governance

The process of County revenue collection and management should reflect transparency, public participation, accountability and good governance. The Constitution outlines national values and principles of governance e.g. rule of law, public participation, good governance, transparency, inclusiveness, accountability, integrity and sustainable development. The Constitution also requires all State Organs as well as State and public officers to observe national values and principles in the formulation and implementation of public policy decisions. These national values and principles are also underscored in the PFM Act (2012), which establishes relevant institutions and assigns them responsibilities. Adherence to these values will result in: better understanding of revenue raising measures by ratepayers; reduced revenue leakages; improved control through better recording and reporting and voluntary compliance leading to increased OSR collection by Counties; and, more resources to the Counties to fund their priority projects and programmes.

Realization of good governance requires clarification of roles of both levels of Government, including offices mandated with revenue collection and management. Clarity of roles will help to eliminate multiplicity of fees and charges by both levels of Government as well as duplication of effort in County departments involved in revenue collection and administration. Further, clarification of roles will deter arbitrary application of revenue policies and abuse of executive powers. 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 assign regulatory and revenue raising responsibilities.

To promote accountability, County Governments should develop and issue guidelines on revenue collection enforcement measures that are consistent with existing legal frameworks. Whenever there is a breach of these guidelines by offices mandated with revenue collection and management responsibility, County Governments should impose administrative sanctions. In cases of serious and persistent breach of these guidelines, including failure to comply with Article 207 of the Constitution and section 109 of the PFM Act, 2012 the relevant State and public officers shall notify the National Treasury and provisions of Article 225 of the Constitution shall apply. Further, County Governments shall seek to educate and inform taxpayers of their tax obligation to enhance compliance. (*Section 5.3 contains further provisions for enhancing compliance and enforcement*).

To achieve transparency, County Governments are required to involve the public in planning and oversight of revenue collection and management. Counties are also required to provide adequate feedback mechanisms once members of the public raise issues of concern. Information should be provided to the public in easily accessible media and through multiple channels. Further, Counties are required to disclose information and hold specific offices responsible for reporting within set timeliness to achieve transparency.

5.2 Enhancing governance in revenue administration

County Governments are required to designate Receivers of Revenue who shall be accountable to County Assemblies to ensure effective and efficient revenue collection and management. Section 104(d) of the PFM Act, 2012 authorises County Treasuries to mobilise resources for funding the Counties' budgetary requirements, and to institute mechanisms to raise the necessary resources. Further, section 157 of the Act authorises the CEC Member for Finance to designate Receivers of County Revenue. A Receiver of Revenue may be

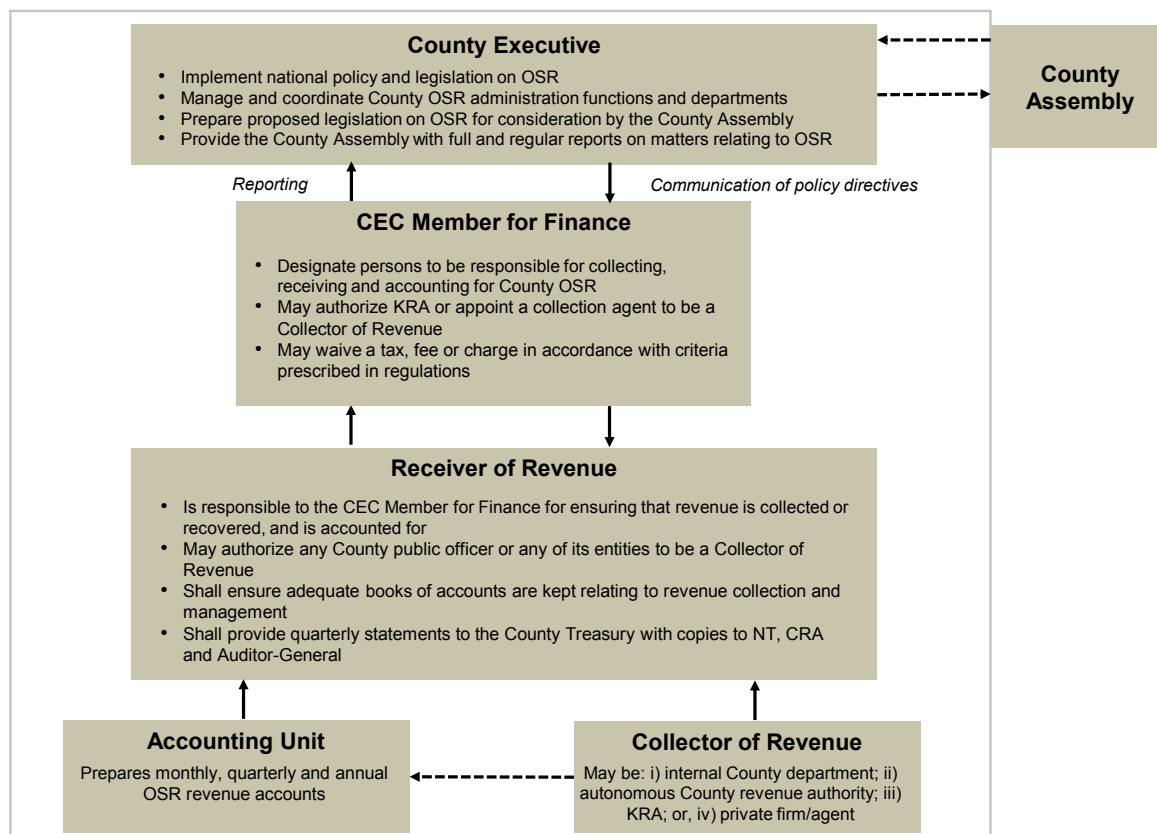
responsible for more than one revenue stream. In order to achieve uniformity, the National Treasury in consultation with the CRA and the CoB shall issue guidelines on duties of Receivers of Revenue. Each County shall determine revenue streams to be administered under Article 209(3) of the Constitution. In addition, each revenue stream shall be supported by a primary County legislation, which should be aligned to the national policy and legislation. 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 earlier (*See section 4.3.2*).

For efficient functioning, the designated Receiver of Revenue is expected to have a fully-fledged accounting unit according to guidelines issued by the National Treasury. Pursuant to Section 148(5) of the PFM Act, 2012, the proposed accounting unit may, in order to promote efficient use of the County resources, adopt, subject to approval by the County Assembly, a centralized financial management service. Responsibilities of the accounting unit will include preparation of monthly, quarterly and annual accounts. The Receiver of Revenue will have a cash office to oversee day-to-day revenue collection, transmission of collections to the CRF, bank reconciliation and support other related functions. The Receiver of Revenue may appoint collectors of revenue, who will report to the accounting unit. A detailed structure of County Governments' revenue administration together with key roles is shown in *Figure 2*.

County Governments' revenue collection and management procedures and systems shall be regularly reviewed by internal audit departments and audit committees. This is in accordance with provisions of PFM Act, 2012. The Auditor-General shall audit all County Government revenues. In addition, the CRA shall, when appropriate, define and enhance the revenue sources of the County Governments in accordance with Article 216(3)(b) of the Constitution.

In resolving revenue-related conflict, County Governments should take advantage of intergovernmental bodies and institutions as a first priority before resorting to the courts. In the event of disputes or lack of clarity on matters touching on revenue collection and management, the Counties are particularly encouraged to consult the Intergovernmental entities as established by relevant laws.

Figure 2: Counties' governance and revenue administration structure and roles



County Governments are required to establish Municipal Boards and Town Committees where urban areas and cities meet thresholds provided for in the Urban Areas and Cities Act. As already discussed, urban areas and cities are economic growth centres, and if not adequately financed, achievement of national economic policy objectives may be jeopardized. An Act of Parliament shall compel the creation of the required urban and city structures. The Act of Parliament will also require County Governments to adequately resource the urban areas and cities through the financing framework provided for in the PFM Act (2012). Further, to incentivize better revenue collection and management by urban areas and cities, the National Government may provide a conditional or unconditional grant to the Counties.

5.3 Enhancing compliance and enforcement

County Governments should enact legislation to set out compliance obligations and powers in a County (Revenue Administration) Act, and the legislation can be based on the existing model, reviewed and updated through intergovernmental relations mechanisms. Alternatively, such legislation could be enacted by Parliament for exercise at County level, to ensure consistency in treatment of tax/fee/charge administration, compliance and enforcement countrywide. Below are additional recommendations for enhancement of compliance by rate payers, and addressing enforcement challenges:

- To complement sanctions-based compliance mechanisms, **incentivize ratepayers by providing information** on easy-to-pay-options such as mobile money, credit and debit cards, revenue collection agents and bank transfers. In addition, the easy-to-pay-options shall provide ratepayers with information on clear payment due dates along with adequate time within which to pay and the possibility of paying in instalments.
- Use of **alternative arbitration mechanisms to resolve tax-related disputes** between tax collection authorities and taxpayers. Alternative arbitration mechanisms

will ensure that the powers of the tax collection authority to enforce compliance are applied fairly to facilitate the collection of outstanding dues.

- (c) Entrench in law measures that require **twinning of tax compliance with certain County Government services**. Examples include tying issuance of the SBP to production by a business entity of a valid Tax Compliance Certificate (TCC); or, awarding procurement tenders only to firms with valid TCCs.
- (d) Integrate the National Government and the County Governments' tax revenue databases to enhance compliance and also monitor State officials enforcing revenue raising measures. Further to Article 189 of the Constitution, specific mechanisms shall be put in place to enable **cooperation between the two levels of Government on enforcement** of revenue raising measures is contemplated.
- (e) Regular accounting by County Governments to rate payers especially to **demonstrate linkage between revenue collected and public services delivered** to the lowest level of administration. Improvement in service delivery would act as an incentive to the taxpayers to comply.
- (f) Inclusion in County Governments' performance management contracts of aspects of compliance with existing OSR legislation. In addition, the Counties could put in place **appraisal performance systems with incentives to revenue administrators** for good performance.
- (g) Enhancement of the fiscal responsibility parameter within the **revenue sharing formula that incentivizes improved OSR performance** -- collection and management -- by County Governments.
- (h) Implementation by the National Government of **conditional or unconditional allocations intended to incentivize good OSR collection and management practices** by County Governments. This is consistent with Article 202(2) of the Constitution.
- (i) All revenue raising legislation should contain enforcement clauses empowering the Counties to charge and collect fines and penalties.

5.4 Effective public participation

Counties shall develop mechanisms for receiving public feedback and providing information on preparation of revenue raising measures. Provision of information to the public will enable their active and effective participation in the formulation and monitoring of County revenue-raising measures, create awareness, enhance ownership and minimize resistance to imposition of taxes, fees and charges, thereby improving compliance. Thus, the Counties should provide structures for public participation in the preparation of revenue raising measure under existing legislation. This should be done in accordance with the *County Public Participation Guidelines, 2016* and County public participation laws.

5.5 Promoting transparency

Below are recommended strategies for enhancing transparency where County Governments' own-source revenue is concerned:

- a) County Treasuries shall **continuously review the performance of revenue collection vis-à-vis targets** and shall include a status report in the Quarterly and Annual reports which shall be published in various media.
- b) The standardised ICT-based system to be prescribed shall **provide real time revenue information** in a consistent manner to enable consolidation and analysis, as well as

periodic reports for use by the National Treasury, the CoB, the CRA and the Office of the Auditor General, and also easily accessible by the general public.

- c) County Governments shall **report on OSR in accordance with section 163 - 166 of the PFM Act (2012) and the PFM (County Governments) Regulations (2015)**. As mentioned earlier, the National Treasury shall issue guidelines on application of the SCoA to ensure all Counties comply with financial reporting standards prescribed by Public Sector Accounting Standards Board (PSASB).
- d) County Treasuries shall **prepare consolidated annual revenue accounts and submit them to the Auditor-General** for audit as per the PFM Act, 2012 and the Public Audit Act, 2015; and,
- e) The National Treasury shall **build capacity of both County Treasuries and revenue collecting departments**, so as to harmonize operations of the two units.

5.6 The role of the National and the County Assemblies

County Assemblies have an important oversight role on revenue collection and management matters, in addition to their legislative mandate. Some Counties have not enacted revenue collection and administration laws, due largely to lack of a clear understanding of complementary roles of the Executive and the Assembly. Some Assemblies have passed revenue-related legislative proposals with no inputs from Executives. Instances abound where Executives prepared revenue forecasts which were later adjusted by Assemblies. These situations have triggered conflicts, which delay enactment of legislations. Both Executives and Assemblies should play distinct but complementary roles where OSR is concerned; Executives are responsible for execution, while Assemblies are responsible for legislation and oversight. Assemblies should develop procedures for reviewing audited revenue accounts and follow up on audit queries. Assemblies should also establish rules on receiving, considering and determining petitions by the public on revenue collection and management. Parliament through the Center for Parliamentary Studies and Training (CPST) shall provide capacity building to County Assemblies to strengthen their oversight role. To support implementation of the Policy, a range of national-level legislative reforms has been proposed, where the National Assembly's role is critical. *Annex 2* contains key legislative reforms, some of which are already underway.

CHAPTER 6: POLICY IMPLEMENTATION

6.1 Framework for Monitoring and Evaluation

The Policy will be implemented through an intergovernmental institutional framework that will also undertake Monitoring and Evaluation (M&E). The institutional framework is contained in *Figure 3*, which shows key implementing agencies whose roles are summarized below:

- ***Intergovernmental Budget and Economic Council:*** IBEC's role in the context of this Policy is as laid out in the PFM Act, 2012.
- ***Steering Committee:*** Chaired by the Cabinet Secretary/National Treasury and Planning, this Committee will: i) strategically lead and oversee implementation of the OSR Policy and Legal Framework; and, ii) make policy decisions regarding emergent issues impacting County OSR. The Steering Committee will meet at least twice a year.
- ***Technical Committee:*** Chaired by the Principal Secretary/National Treasury, this Committee will: i) review and make recommendations on issues pertaining to County OSR; ii) oversee capacity building support to the Counties policy and legal matters; iii) oversee procurement and engagement of TA; and, iv) supervise activities of the Interagency Implementation Secretariat. The Technical Committee will meet at least four times a year.
- ***Interagency Implementation Secretariat:*** The Secretariat will recruit and manage activities of all TA activities.

The M&E framework is contained in Table 6, which reflects the Policy's objectives, strategies, activities, outputs, output indicators, actors, cost and timeframe for implementation. The Policy's broader impact on the overall economy System will be monitored within the context of the National Integrated Monitoring and Evaluation System (NIMES).

6.2 Format for progress reports

Annual M&E reports on implementation of the Policy will be prepared by the National Treasury. The National Treasury will also commission a midterm evaluation, to be conducted by an independent agency to measure outcomes and impacts of the Policy and inform its review. All M&E studies will be undertaken jointly with relevant stakeholders. County Governments may undertake periodic review on their domestication and implementation of the Policy.

6.3 Feedback mechanisms and stakeholder consultation

Every two years, the National Treasury will hold a County own source revenue conference. The purpose of the conference is to monitor progress in implementation of the Policy and receive feedback from County Governments and other stakeholders.

6.4 Review timelines

The Policy will be operational for a period of ten years and will be subjected to a midterm review after five years.

Figure 3: Institutional framework for implementing the Policy

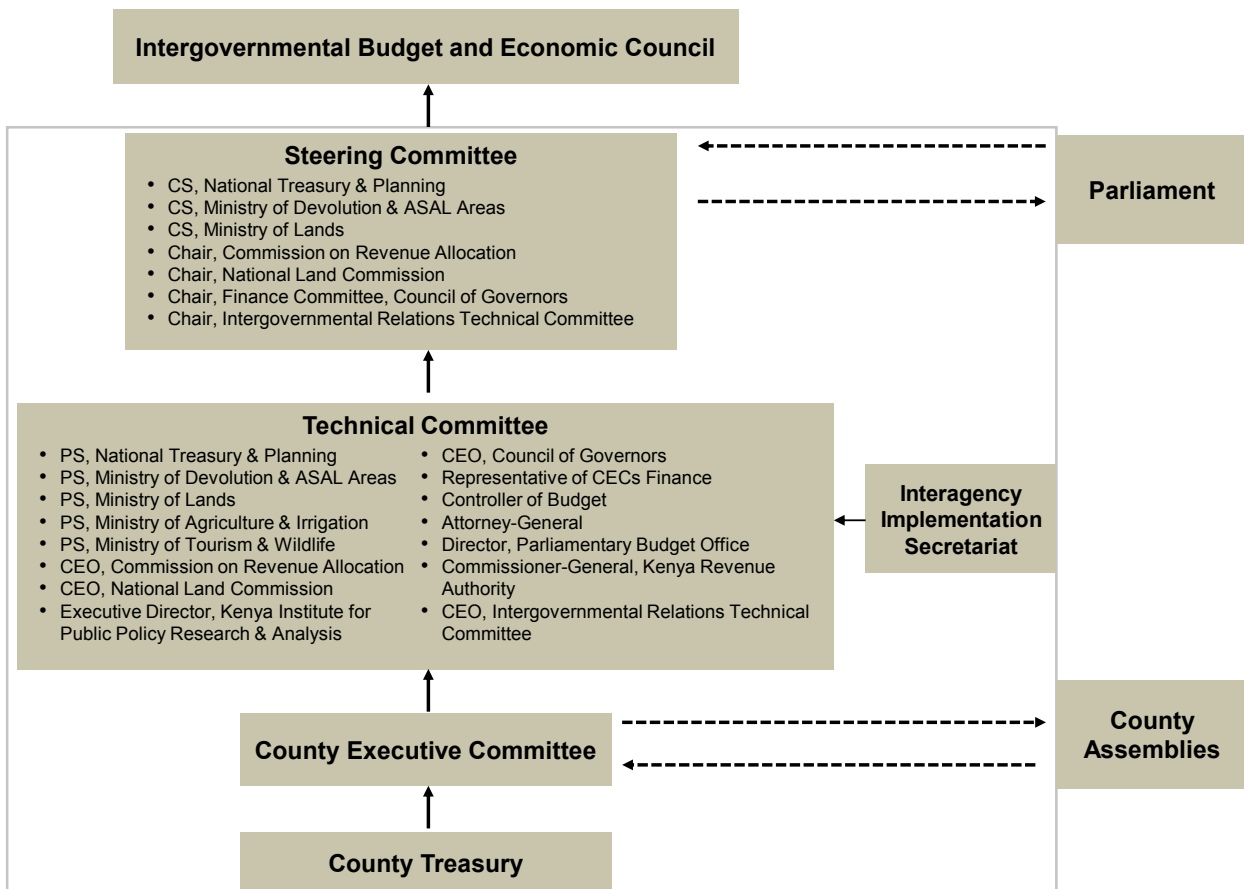


Table 6: Framework for Monitoring and Evaluation

Strategies	Activities	Output	Output indicators	Lead actors	Cost	Timeframe
OBJECTIVE 1: TO BROADEN COUNTY GOVERNMENTS' TAX BASES						
Identify opportunities for optimizing Counties' OSR potential	Recruit TA to collect and collate data to facilitate computation of County revenue potential	Counties' revenue potential is established	Revenue potential of all Counties determined	IAIS	To be determined (TBD)	Within 1 year
	Recruit TA to undertake macroeconomic modelling to simulate County revenue potential	Counties have adopted appropriate revenue forecasting mechanisms / tools	No of Counties with appropriate revenue forecasting tools <i>(50% within year 2 and 100% in year 3)</i>	NT	TBD	Within 1 year
	Conduct expert and peer review of the model			NT		Within 1 year
	Publish data on County revenue potential arising from the simulation in model	Recruit TA to support Counties in revenue forecasting	NT / CRA / KNBS	NT	TBD	Within 2 years
	Recruit TA to support Counties in revenue forecasting					NT
		Training of County officials			NT	TBD
OBJECTIVE 2: TO ENHANCE COUNTY GOVERNMENTS' REVENUE ADMINISTRATIVE CAPACITY						
Strengthen legal and institutional framework for County OSR	Constitute an Interagency Working Committee to draft National Framework Legislation (NFL) to regulate process of introducing, varying and waiving County taxes, fees and charges	National Framework Legislation to regulate imposition of County taxes, fees and charges is in place	A National Framework Legislation is enacted by Parliament to regulate the process of introduction of taxes, fees and charges, as well as issuance of waivers and variations	NT	TBD	Within 1 year
	Research and drafting of the NFL					
	Conduct expert and peer review of the NFL	Cabinet approval of the NFL Submission of the draft NFL to Parliament	IAWC	IAWC	TBD	Within 1 year
	Cabinet approval of the NFL Submission of the draft NFL to Parliament					

Strategies	Activities	Output	Output indicators	Lead actors	Cost	Timeframe
Improve Counties' capacity for revenue collection and administration	Recruit TA to support Counties in development of principal laws to anchor their revenue measures	Counties enact principal laws to anchor their revenue measures in line with Article	No of laws enacted by Counties to guide property rates, entertainment, revenue administration and trade licensing;	IAIS	TBD	Within 2 years
	Research and drafting of relevant laws			IAIS	TBD	
	Conduct expert and peer review of drafted laws			IAIS	TBD	
	Approval of principal revenue laws by County Executive Committees and County Assemblies			Counties	TBD	
	Recruit TA to support Counties in the development of Tariffs and Pricing Policy	Counties have approved a Tariffs and Pricing Policy	No of Counties with a Tariffs and Pricing Policy	CRA	TBD	Within 1 year
	Counties prepare draft Tariffs and Pricing Policy			CEC Finance	TBD	
	Draft Tariffs and Pricing Policy is subjected to expert and public consultation			CEC Finance	TBD	
	Tariffs and Pricing Policy is approved by CEC	Communities' awareness of their role as well as opportunities to hold government to account on revenue matters	% of people in communities who have participated in and contributed to discussions on revenue matters	CEC	TBD	50% within 1 years; 100% by year 3
	Policy is submitted to County Assemblies for approval			CEC Finance	TBD	
	Recruit TA to develop programmes and material for civic engagement	Mount civic engagement forums (through public fora and media)	Communities have established appropriate institutional arrangement for revenue collection and	IAIS / MoDAA / NT / CRA	TBD	All Counties within 1 years
Recruit TA to develop guidelines on standardized organizational structure for collection and management of revenue	MoDAA / County Governments					
Issue guidelines on the organizational			NT			Within 1 year
			NT			

Strategies	Activities	Output	Output indicators	Lead actors	Cost	Timeframe
	structure for revenue collection and management of revenue	management and staffed with adequate and skilled personnel	and management of revenue that meet prescribed standards			
	County Executives develop standardized structures for revenue collection and management			CEC Finance	TBD	
	Subject the standardized structure to stakeholder validation			CEC Finance	TBD	
	County Public Service Boards approve the standardized structure			CPSB	TBD	
	Provide capacity building support to Counties in revenue collection and management, including policy on County OSR and related legislation			NT	TBD	
	Recruit TA to develop guidelines on the County standardized ICT-based system for revenue collection and management		Guidelines on the standards of ICT based revenue collection and management system for use by Counties are gazetted	IAIS / NT	TBD	Within 1 year
	Issuance of guidelines by the National Treasury	Counties have adopted a standardized ICT based system of collecting and managing revenue	No of Counties using a standardized ICT based system for collecting and managing revenue	NT	TBD	
	Capacity building on use of the system		% of land titles that are digitized	NT	TBD	
			% of County registries that are linked to the national land registry		TBD	

Annex 1: List of revenue streams reported by County Governments

A. OWN-SOURCE REVENUE STREAMS

1. Administrative services fees & charges
2. Advertisement fees
3. Agriculture
4. Application fees
5. Betting control
6. Business permits
7. Cesses
8. Natural resources, exploitation, environment & conservancy
9. Cultural & social services
10. AIA from devolved ministries
11. Donations
12. Extension of users
13. External services fees
14. Feeding program
15. Fines, penalties & forfeitures
16. Fund raising events
17. Housing
18. Impounding fees
19. Income from County entities
20. Infrastructure assets
21. Interest received
22. Lease / rental of County properties
23. Liquor licence fee
24. Livestock
25. Market & trade centre fee
26. Other education-related revenues
27. Other health & sanitation fees
28. Other local levies
29. Other miscellaneous revenues
30. Other property income
31. Other receipts not classified elsewhere
32. Other revenues from financial assets
33. Plan approval fees
34. Plot rents, rents & poll rates
35. Profits & dividends
36. Public health facility operations & services
37. Public works and roads
38. Receipts from incidental sales by non-market establishments
39. Receipts from mortgage account
40. Receipts from sale of incidental goods
41. Receipts from sales by non-market establishments
42. Receipts from voluntary transfers other than grants
43. Sale of tender documents
44. Sales of agricultural goods
45. Sales of County assets
46. Sales of market establishments
47. School fees
48. Sewerage administration
49. Slaughter houses administration
50. Social premises use charges
51. Sub County veterinary services
52. System required revenue accounts
53. Technical services fees
54. Trade & industry
55. Transfers from County entities
56. Transfers from reserve funds
57. Vehicle parking fees
58. Water supply administration
59. Weight & measures

B. PROCEEDS FROM SALE OF ASSETS

60. Disposal and sales of non-produced assets
61. Receipts from sale of: i) certified seeds and breeding stock; ii) buildings and inventories; iii) stocks and commodities; iv) strategic reserves stocks; v) vehicles and transport equipment; vi) plant machinery and equipment
62. Reimbursements (e.g. from insurance companies)

Source: Consolidated Financial Statements of County Governments

Annex 2: Proposed legislative reforms to support implementation of the Policy

Revenue stream	Current legal framework	Current context, and summary of proposed reforms	Time specification
Property-related revenue	<ul style="list-style-type: none"> Land Act, 2012 	To be amended so that: i) land rent is collected directly by County Governments, not the National Land Commission (NLC); and, ii) land rents can be updated in tune with current economic realities	Three months
	<ul style="list-style-type: none"> Rating Act (Cap. 267) Valuation for Rating Act (Cap 266) 	To be replaced with new national property tax legislation containing integral property rates elements. (Administrative elements are to be defined in County-specific legislation). The proposed new legislation will also outline a suitable method for compensating Counties for GoK-owned land as well as exemptions say, where land is used for military purposes, aerodromes, etc.	One year
Entertainment tax	<ul style="list-style-type: none"> Entertainments Tax Act (Cap. 479) of 1950 Betting, Lotteries and Gaming Act (Cap. 131) of 1966 	Both legal frameworks to be amended to: i) align it with the Constitution; ii) reflect Gazette Notice No. 8753 on delineation of regulatory and licensing functions relating to betting, casinos and other forms of gambling; and, iii) reflect regulation of other forms of entertainment e.g. theaters, movies, cultural and sporting events, nightclubs and racetracks	Six months
Business licensing	<ul style="list-style-type: none"> Trade Licensing Act (Cap. 497) 	To be amended to: i) empower County Governments to impose business licenses; and, ii) have the licenses run for 12 months from the time it is issued i.e. instead of current calendar-year approach	Six months
	<ul style="list-style-type: none"> Local Government Act (Cap. 265, Revised 2010) 	As this is the legal framework through which SBP was introduced (via 1998/99 Finance Act), it now needs replacement. Also, the SBP Schedule that is contained in the Act needs to be revised to reflect today's dynamic business environment	One year
User fees, charges and licenses	<ul style="list-style-type: none"> There is currently no coherent legal framework with country-wide application 	An omnibus legal framework to be developed regulating all County user fees, charges and licenses	Two years
Liquor licensing	<ul style="list-style-type: none"> Alcoholic Drinks Control Act, 2010 	To be amended to recognize County Governments' role in regulating alcoholic drinks, including sale	Three months
	<ul style="list-style-type: none"> Alcoholic Drinks Control (Licensing) Regulations, 2010 	To be amended to re-define license categories and fees applicable under each category	Three months
		New legislation to be prepared as a contingency for Counties which have not yet enacted their own alcoholic drinks control laws	Six months

Revenue stream	Current legal framework	Current context, and summary of proposed reforms	Time specification
Agricultural produce cess	<ul style="list-style-type: none"> There is currently no legal framework following repeal of the Agriculture Act (Cap 318), which contained the legal basis for cess 	There is need for a more detailed assessment of cess, as a basis for developing a suitable legal framework for it. Based on this assessment, there may be need to amend the Agriculture Fisheries and Food Authority (AFFA) Act (2013) and the Kenya Meat Commission Act (Cap 363) of 1990 to: i) strengthen the legal basis for cess; and, ii) in the case of the latter clarify the level of Government responsible for imposition of cess on the sale/slaughter of stock, or on any class or classes of slaughter stock	One year
Tourism-related charges	<ul style="list-style-type: none"> Tourism Act, 2011 	To be amend to align it with the Constitution (after unbundling tourism sector functions which is to be done). In addition, clear regulations to be formulated covering development of products by Counties (i.e. uniformity, norms and standards across Kenya and the EAC region as well benchmarks with leading destinations around the world) as well as guidance on imposition of fees and charges within the sector.	Three months
Outdoor advertising	<ul style="list-style-type: none"> There is currently no coherent legal framework following repeal of the Local Government Act 	There is need for Senate to advance to conclusion the earlier proposed County Outdoor Advertising Control Bill, 2015, which lapsed	One year
Revenue from court fines	<ul style="list-style-type: none"> There is currently no coherent legal framework following repeal of the Local Government Act 	It is expected that ongoing consultations between the Judiciary and the Council of Governors will culminate in a new legal framework containing among other provisions: i) A framework for transition of municipal/city courts to ordinary courts dealing with County matters; ii) rules and procedures to be applied in enforcing County legislation, including those on OSR; and, iii) a legal basis for waiving court fees payable by County Governments	One year
Revenues from (and funding for) urban areas	<ul style="list-style-type: none"> Urban Areas and Cities Act, 2011 	To be amended to enhance sustainability of funding for cities and towns, including through: i) directing that a portion of urban revenues -- specifically property rates -- be ring-fenced and retained in urban areas; ii) creation of a conditional grant to County Governments to supplement funding of urban areas	Three months

Source: IAWC