Paper laid by Sen. Billow Kerrow on 9/6/2016

REPUBLIC OF KENYA

HARAMBEE

PARLIAMENT

THE SENATE

ELEVENTH PARLIAMENT – FOURTH SESSION

REPORT OF THE SENATE STANDING COMMITTEE ON FINANCE, COMMERCE & BUDGET ON THE PETITION BY HON. DANIEL C. CHITWAH, SPEAKER OF THE VIHIGA COUNTY ASSEMBLY, CONCERNING TAXATION OF ALLOWANCES AND OTHER BENEFITS PAID TO MEMBERS AND STAFF OF THE COUNTY ASSEMBLY

Approved
Speaker
9/6/16

Rt. Hon. Speaker
You may approve for tabling.
09/06/16

PARLIAMENT BUILDINGS
NAIROBI

JUNE 2016

PREFACE

Mr. Speaker Sir, on behalf of the Members of the Finance, Commerce and Budget Committee and as required under the Senate Standing Orders, I hereby present to this House, the Committee's Report on the petition by Hon. Daniel C. Chitwah, Speaker of the Vihiga County Assembly, concerning taxation of allowances and other benefits paid to members and staff of the County Assembly, that was presented to the Senate by Sen. Kembi-Gitura, Deputy Speaker of the Senate.

In their petition, the petitioner states that in June 2015, the county assembly received a demand from the Kenya Revenue Authority (KRA) for payment of tax arrears for the years 2013 to 2015 on allowances and other benefits paid to Members and staff of the Assembly. The petition was then tabled in the Senate on 5th November, 2015 and thereafter, committed to the Standing Committee on Finance, Commerce and Budget for consideration and determination.

Mr. Speaker Sir, it is significant to mention that the purpose of the approval of this report is to protect and enhance the process of enacting legislations in the County Governments and set the benchmarks for developing a shared vision in the management of public finance.

COMMITTEE RECOMMENDATIONS

The committee having considered the matters raised in the petition recommends as follows:

i. That KRA should issue a circular to all county governments to advise them on how to collect taxes.

ii. That the County Assembly engage with KRA to devise modalities of settling the tax liability and explore the possibility of requesting a waiver on the accrued interest and penalties, if such a waiver exists and is admissible.

iii. That the imprest surrender system of the County Assembly be streamlined.

Mr. Speaker Sir,

The Standing Committee on Finance, Commerce and Budget is established pursuant to Standing Order No. 208 and is mandated, to investigate, inquire into and report on all matters relating to coordination, control and monitoring of the county budgets and to:

a) *Discuss and review the estimates of County governments and make recommendations to the Senate;*
b) *Examine the Medium term Budget Policy Statement presented to the Senate;*
c) *Examine and report on the Budget allocated to constitutional commissions and independent offices;*
d) *Examine bills related to the Counties;*
e) *Examine the Budget, including the Division of Revenue Bill; and*
f) *Examine and consider all matters related to resolutions and Bills for appropriations, share of national revenue amongst the counties and all matters concerning the National Budget, including public finance, monetary policies and public debt, trading activities and commerce, tourism, investment and divestitures policies, planning and development policy.*

Mr. Speaker Sir,

The Committee on Finance, Commerce and Budget was constituted by the House on Thursday 13th March 2014 during the Second Session of the Eleventh (11th) Parliament and as currently constituted, comprises the following members:

1. The Hon. Sen. Billow Kerrow, MBS, MP. -Chairperson
2. The Hon. Sen. Peter Ole Mositet, MP. -Vice-Chairperson
3. The Hon. Sen. G. G. Kariuki, EGH, MP.
4. The Hon. Sen. Moses Wetang'ula, EGH, MP.
5. The Hon. Sen. Beatrice Elachi, CBS, MP.
6. The Hon. Sen. (Dr.) Wilfred Machage, MGH, MP.
7. The Hon. Sen. Mutahi Kagwe, EGH, MP.
8. The Hon. Sen. (Dr.) Boni Khalwale, MBS, MP.
9. The Hon. Sen. (Prof.) Peter Anyang' Nyong'o, EGH, MP.
10. The Hon. Sen. Mutula Kilonzo Junior, MP.
11. The Hon. Sen. (Prof.) John Lonyangapuo, CBS, MP.
12. The Hon. Sen. Aaron Kipkirui Cheruiyot, MP.
13. The Hon. Sen. (Dr.) Zipporah Kittony, MBS, OGW, MP.
14. The Hon. Sen. Catherine Mukite Nabwala, MP.
15. The Hon. Sen. Paul Njoroge Ben, MP.
16. The Hon. Sen. (Dr.) Agnes Zani, MP.

PRAYERS OF THE PETITIONER FROM VIHIGA COUNTY ASSEMBLY

Pursuant to provisions Article 119 of the Constitution of Kenya and part XXIV of the Senate Standing Orders, the petitioners sought answers to the following prayers -

(a) The Senate committee on Finance, Commerce and Budget committee do summon the Commissioner General of KRA to substantiate the blatant violation of the law and discrimination against Western region county assemblies and the matters herein raised in the petition.

(b) The senate to implore KRA to refund any monies paid by the Vihiga County Assembly since this has negatively affected the operations of the Assembly.

(c) The Senate Committee on Finance, Commerce and Budget do determine why there is no uniform application of Income Tax laws to other counties and the National Assembly.

(d) The committee to determine whether these deductions by KRA contravene the financial ceilings set by the Commission on Revenue Allocation to the County Assembly and hence compromising the County Assembly's ability to effectively carryout their mandate.

Committee sittings

In deliberating on issues concerning taxation of allowances and other benefits paid to members and staff of the County Assembly of Vihiga, the committee held a total of two (2) sittings and received both oral and written submissions from the Kenya Revenue Authority (KRA).

Committee General Recommendations

The committee having considered the matters raised in the petition recommends as follows:

i. That KRA should issue a circular to all county governments to advise them on how to collect taxes.

ii. That the County Assembly engage with KRA to devise modalities of settling the tax liability and explore the possibility of requesting a waiver on the accrued interest and penalties, if such a waiver exists and is admissible.

iii. That the imprest surrender system of the County Assembly be streamlined.

ACKNOWLEDGEMENT

Mr. Speaker Sir,

The Committee is grateful to the Kenya Revenue Authority who appeared before the Committee to share on their role as far as the issues concerning taxation of allowances and other benefits paid to members and staff of the County Assembly of Vihiga is concerned.

The Committee is also particularly grateful to the Offices of the Speaker, the Clerk of Senate for the support received as it discharged its mandate. The Committee also wishes to thank the Senators who participated in the process of ensuring that the Committee completes its report.

Mr. Speaker Sir,
On behalf of the committee, and pursuant to standing order 227(2), it is therefore my pleasant and honourable duty to present and lay on the table of the house the report of the Finance, Commerce and Budget Committee concerning the Petition on taxation of allowances and other benefits paid to members and staff of the County Assembly of Vihiga.

SIGNED: ....

SENATOR BILLOW KERROW, MBS, MP.

(Chairperson, Standing Committee on Finance Commerce and Budget)

Date: 8th June 2016
....

III. INTRODUCTION

REVIEW OF THE PETITION TO THE SENATE OF THE REPUBLIC OF KENYA IN THE MATTER OF VIHIGA COUNTY ASSEMBLY

3.1 Brief on the Vihiga County Assembly Petition

The Constitution under Articles 37 and 119 grants every Kenyan a right to petition Parliament to consider any matter within its authority, including enacting, amending or repealing any legislation. The Petition to Parliament (procedure) Act No. 22 of 2012 makes provision for the procedure for the exercise of the right pursuant to those Articles. The Act also defines the format of petitions to be addressed to the Senate or National Assembly.

The Petitioners allege that-

a) That, in June 2015, the county assembly received a demand from the Kenya Revenue Authority (KRA) for payment of tax arrears for the years 2013 to 2015 on allowances and other benefits paid to Members and staff of the Assembly;

b) That, the county assembly is engaging with the KRA to reach settlement on the matter;

c) That, in the meantime, the KRA has proceeded to order the freezing of the bank accounts of the said county assembly, and this has hampered the county assembly from discharging its constitutional mandate; and

d) That the actions of KRA in demanding payment of taxes on allowances are not being applied uniformly across all counties, and are unduly targeted at county assemblies from the Western region of Kenya.

II. HIGHLIGHTS ON THE ISSUES PETITIONED

1.1.2 Prayers of the Petitioners

(a) The Senate committee on Finance, Commerce and Budget committee do summon the Commissioner General of KRA to substantiate the blatant violation of the law and discrimination against Western region county assemblies and the matters herein raised in the petition.

(b) The senate to implore KRA to refund any monies paid by the Vihiga County Assembly since this has negatively affected the operations of the Assembly.

(c) The Senate Committee on Finance, Commerce and Budget do determine why there is no uniform application of Income Tax laws to other counties and the National Assembly.

(d) The committee to determine whether these deductions by KRA contravene the financial ceilings set by the Commission on Revenue Allocation to the County Assembly and hence compromising the County Assembly's ability to effectively carryout their mandate.

II.SUBMISION FROM PARTIES

In establishing facts, the committee invited and met with the commissioner of Domestic Taxes, KRA Ms. Alice Owuor.

Submission by the KRA

The Committee invited the Commissioner General of KRA and requested to be represented by the Commissioner Domestic Taxes who appeared before the committee on 24th November, 2015 to give a presentation on behalf of KRA with regard to the contents of the petition before the committee.

1. **The committee wanted to know the demand by KRA on Vihiga County for tax arrears of 2013 and 2015 and allowances paid by the assembly.**
   The KRA informed the committee that when counties were formed, they had to take them through tax education and sensitization to help them understand how to manage the payroll taxes. At some point there were still low levels of compliance and thus KRA decided to prepare a work program for all 47 counties for them to do a quick audit on the payroll. Out of the 47 counties, they've completed audits for 37 counties across the country.

   Vihiga County had several issues on taxing of benefits i.e. fringe benefit tax and sitting allowances among all other benefits that are supposed to be taxed. After the audit, the county objected but unfortunately the objection was late according to the timeline provided by the law. They were guided on how to go about submitting a late objection but did not respond to that.

2. **The order by KRA to freeze the bank account of the Vihiga County Assembly.**
   The KRA responded that, they had not taken any action against the bank accounts of the county assembly. However, they give taxpayers a deadline by notifying them on the possible actions KRA would take if they don't comply with the guidelines given.

3. **Allegations of not applying the action uniformly.**

   KRA responded that they had audited 37 counties so far and had done that fairly and uniformly across the region and had not targeted the Western region only as the petitioner had put it.

4. **Performance of revenues**

   KRA informed the committee that as counties were established, the amount of taxes they used to collect, particularly Pay As You Earn remittance, was about 474 million Kenya Shillings per month. As counties employed more staff and became more sensitized on the correct way to tax salaries and allowances, PAYE increased to 1.6 billion Kenya Shillings per month. They only had challenges in the last 3 months as counties have not been receiving money in good time thus creating a challenge for them to pay their taxes.

   KRA has appointed counties as withholding agents for withholding VAT e.g. when they pay their suppliers, they withhold 6% and remit the rest to KRA. The KRA stated that in terms of general compliance from counties, the response has been good.

5. **Policy measures or arrangements put in place to improve revenue collection.**

   KRA informed the committee that they have undertaken the prospect revenue mobilization for respective county governments as provided for under the Public Finance Management Act 2012 (section 160). A letter was sent to each county governor with a view of obtaining their buy-in and indications so far point to a general consensus by the counties to partner with KRA.

1.1.3 Key issues to be addressed in the petition

The Kenya Revenue Authority, in a letter dated 4th June, 2015 to Vihiga County Assembly Clerk presented a brief on audit findings and demand for tax. It highlighted three key areas of coverage (PAYE, Fringe Benefits and Withholding Tax).

1. PAYE (ALLOWANCES AND BENEFITS)

The audit realized that the County Assembly paid various allowances to MCAs and staff that were not subjected to tax (Sections 5(2)(a), 5(2)(a)(iii), 5(2)(b) and 3(2)(a)(ii) of ITA). These Sections defines gains or benefits in respect of employment to cover wages, salaries, leave pay, overtime, bonus, subsistence, etc. and taxation thereof. The audit also noted that some direct benefits to the Speaker and Clerk (paying rent to Speaker's residence and vehicle allocation to Speaker and Clerk) were not subjected to PAYE. Section 5(2B)(a)(iii) provides for taxation of the same. Therefore the tax liability amounts to Ksh. 9.36 million, Ksh. 49.847 million and Ksh. 9.61 million in 2013, 2014 and 2015 respectively. The cumulative amount is **Ksh. 68.824 million**

2. FRINGE BENEFITS

The audit noted that MCAs were enjoying mortgage and car loans at 3% which is lower than the market interest and there was no evidence that the fringe benefits tax was withheld and paid (Section 12B of ITA and Public Notices of 2013 and 2014). This resulted to Ksh. 2.1 million and Ksh. 0.983 million for 2014 and 2015 respectively. The total amount is **Ksh. 3.084 million.**

3. WITHHOLDING INCOME TAX

The County Assembly engaged professionals for legal and consultancy services and did not withhold tax in accordance with Section 35 of ITA whose rates are provided under the Third Schedule. The tax liability inclusive of interest and penalty is Ksh. 54,000, Ksh. 218,056 and Ksh. 2,543 in 2013, 2014 and 2015 respectively. The total tax liability is Kshs. 274,600.

ON OVERALL TAX LIABILITY – inclusive of interest and penalty (2013 – 2015)

PAYE (Allowances and benefits)	- Kshs. 68.824 million
Fringe Benefits	- Kshs. 3.084 million
Withholding Tax	- Kshs. 274,600
Total	**= Kshs. 72.184 million**.

COMMITTEE RESPONSE TO PRAYERS OF THE PETITIONERS

(a) The Senate committee on Finance, Commerce and Budget committee do summon the Commissioner General of KRA to substantiate the blatant violation of the law and discrimination against Western region county assemblies and the matters herein raised in the petition.

The Committee invited the Kenya Revenue Authority and herein attached is the response from the Kenya Revenue authority *(Annexe II)* that responds to all issues you have highlighted in the petition.

(b) The senate to implore KRA to refund any monies paid by the Vihiga County Assembly since this has negatively affected the operations of the Assembly.

The Committee met with KRA and it was directed to look into the accounts and should there be any refund to be done, it should be done accordingly.

(c) The Senate Committee on Finance, Commerce and Budget do determine why there is no uniform application of Income Tax laws to other counties and the National Assembly.

The Committee conferred with KRA on the issue of uniformity in the application of Income Tax Laws. KRA's response is attached as *Annex II.* KRA further informed the committee that one of the principles of taxation is that tax liability is to individuals and not groupings as alleged in the petition.

(d) The committee to determine whether these deductions by KRA contravened the financial ceilings set by the Commission on Revenue Allocation to the County Assembly and hence compromising the County Assembly's ability to effectively carryout their mandate.

The Committee was able to look into the matter and it was apparent that every institution must plan and budget with an eye on their liabilities of which taxes are inclusive.

COMMITTEE OBSERVATIONS

The committee having considered the matters raised in the petition observes as follows:

i. That, there was an assertion that there were consultations with KRA headquarters and a revelation that per diem is an expense and not income. The Committee noted that there was no evidence available to that effect and that some allowances are indeed income.

ii. The Committee noted that section 4 and 5 of the Income Tax Act, provides that income upon which tax is chargeable in respect to employment and services rendered include; wages, leave pay, bonus, travelling, entertainment and subsistence; the commissioner may however exclude certain aspects of subsistence, travelling and entertainment incomes if they are reimbursements.

    In this case per diem falls under reimbursement expenses and it is therefore not taxable and there's a circular to that exception. Fringe benefit is taxable and withholding tax of 5% - 10% is a duty that the assembly is supposed to withhold if they have engaged consultants for professional services. The Committee noted that the Salaries and Remuneration Commission had not communicated to any Assembly that per diem and other allowances cannot be taxed.

iii. The Committee observed that the main issue raised in the petition relates to non-payment of PAYE on rent and motor vehicle benefits accruing to the Speaker and Clerk of the County Assembly. Consequently the County Assembly owes Kenya Revenue Authority (KRA) Kshs. 68.824 million inclusive of penalties and interest.

iv. The Committee noted that the Income Tax Act (Section 84) provides for a mechanism of objection to a tax assessment within 30 days from the date of service of notice. The Committee observed that whereas the service notice was received on 5th June, 2015, the objection from the Assembly was done on 25th September, 2015 and received in KRA on 28th September, 2015. Further, the objection failed to address the tax assessment of 4th June, 2015.

v. The Committee observed that there was no evidence of violation of any law in regard to the three named Counties.

vi. The Committee further observed that Vihiga County Assembly engaged consultants but did not withhold the tax in accordance to section 37 of the Income Tax Act thus not observing the law and the only query they can therefore raise is the taxation of their per diem.

Rt-Hon Speaker, this is endorsed for your Approval and Tabling
28/04/16.

REPUBLIC OF KENYA

HARAMBEE

PARLIAMENT

THE SENATE

ELEVENTH PARLIAMENT – FOURTH SESSION

REPORT OF THE SENATE STANDING COMMITTEE ON FINANCE, COMMERCE & BUDGET ON THE PETITION DAVID O. GESICHO, CONCERNING A PROPOSED FORMULA FOR DIVISION AND ALLOCATION OF REVENUE TOWARDS REALIZATION OF THE SUSTAINABLE DEVELOPMENT GOALS (SDGs)

Approved

Speaker

PARLIAMENT BUILDINGS
NAIROBI

28 APRIL 2016

PREFACE

Mr. Speaker Sir, on behalf of the Members of the Finance, Commerce and Budget Committee and as required under the Senate Standing Orders, I hereby present to this House, the Committee's Report on the petition by David O. Gesicho, concerning a proposed formula for division and allocation of revenue towards realization of the Sustainable Development Goals (SDGs), that was presented to the Senate by Sen. Ekwee Ethuro, Speaker of the Senate.

The petition was brought to the attention of the Senate by Mr. David O. Gesicho who is a citizen of Kenya and resident of Kakamega County. The petition was tabled in the Senate on 18th February, 2016 and thereafter, committed to the Standing Committee on Finance, Commerce and Budget for consideration and determination.

Mr. Speaker Sir, it is significant to mention that the subject matter of the petitioners report touches at the core of the role of the Senate. The Senate is charged with determining the criteria of allocating money between the forty-seven county governments. This function of the Senate is enshrined in Article 217 (1) of the Constitution, which provides that once every five years, the Senate shall by resolution, determine the basis for allocating among the counties the share of national revenue that is annually allocated to the county level of government.

Mr. Speaker Sir, it is significant to note that the matters raised in this petition are timely as the Senate will this year pass a resolution on the Second Generation Revenue Sharing Formula, which will be used to share revenue among counties for the financial years 2016/2017, 2017/2018 and 2018/19. The Petitioner thus provided the Committee with an opportunity to engage further with critical matters that should be considered in designing a framework for sharing revenue.

Mr. Speaker Sir,

The Standing Committee on Finance, Commerce and Budget is established pursuant to Standing Order No. 208 and is mandated, to investigate, inquire into and report on all matters relating to coordination, control and monitoring of the county budgets and to:

1. *Discuss and review the estimates of County governments and make recommendations to the Senate;*
2. *Examine the Medium term Budget Policy Statement presented to the Senate;*
3. *Examine and report on the Budget allocated to constitutional commissions and independent offices;*
4. *Examine bills related to the Counties;*
5. *Examine the Budget, including the Division of Revenue Bill; and*
6. *Examine and consider all matters related to resolutions and Bills for appropriations, share of national revenue amongst the counties and all matters concerning the National Budget, including public finance, monetary policies and public debt, trading activities and commerce, tourism, investment and divestitures policies, planning and development policy.*

Mr. Speaker Sir,

The Committee on Finance, Commerce and Budget was constituted by the House on Thursday 13th March 2014 during the Second Session of the Eleventh (11th) Parliament and as currently constituted, comprises the following members:

1.	The Hon. Sen. Billow Kerrow, MBS, MP.	-Chairperson
2.	The Hon. Sen. Peter Ole Mositet, MP.	-Vice-Chairperson
3.	The Hon. Sen. G. G. Kariuki, EGH, MP.	
4.	The Hon. Sen. Moses Wetang'ula, EGH, MP.	
5.	The Hon. Sen. Beatrice Elachi, CBS, MP.	
6.	The Hon. Sen. Mutahi Kagwe, EGH, MP.	

7. The Hon. Sen. (Dr.) Boni Khalwale, MBS, MP.
8. The Hon. Sen. (Prof.) Peter Anyang' Nyong'o, EGH, MP.
9. The Hon. Sen. (Dr.) Zipporah Kittony, MBS, OGW, MP.
10. The Hon. Sen. Aaron Kipkirui Cheruiyot, MP.
11. The Hon. Sen. Catherine Mukite Nabwala, MP.
12. The Hon. Sen. Mutula Kilonzo Junior, MP.
13. The Hon. Sen. (Prof.) John Lonyangapuo, CBS, MP.
14. The Hon. Sen. Paul Njoroge Ben, MP.
15. The Hon. Sen. (Dr.) Wilfred Machage, MGH, MP.
16. The Hon. Sen. (Dr.) Agnes Zani, MP.

I. PRAYERS OF THE PETITIONER

Pursuant to provisions Article 119 of the Constitution of Kenya and part XXIV of the Senate Standing Orders, the petitioner sought answers to the following prayers.

That Parliament -

(1) Introduces legislation for enactment by August 2016 that will provide for a minimum allocation of fifteen percent (15%) of the National Annual Budget to the Health Sector in belatedly implementing in the Republic of Kenya, the Recommendations of the OAU/AU Abuja Declaration (2001) on HIV/AIDS, Tuberculosis and other related infectious diseases;

(2) Introduces legislation for enactment by August 2016 that will provide for a minimum allocation of ten percent (10%) of the National Annual Budget to the Agriculture Sector in belatedly implementing in the Republic of Kenya the recommendations of the Maputo Declaration (2003) on Agriculture and Food Security in Africa;

(3) Does all that is within its mandate and authority including amendment of the Kenya Constitution 2010 to allow for the relevant legislation to be enacted; and if such constitutional amendment requires a referendum, to initiate the process that will lead to the holding a plebiscite;

(4) Irrespective of the declarations, commitments, pledges, undertakings and resolutions of the African Union, on its own motion takes steps to legislate by August 2016 for the provision of a minimum national annual budgetary allocation of fifteen percent (15%) of the National Budget to the health sector and twenty percent (20%) to the agriculture sector including water, irrigation and rural development;

(5) Puts in place by August 2016, legislation to provide for to provide for a national annual deficit of not greater than five percent (5%) of the Gross Domestic Product;

(6) Develops and puts in place legislation to ensure that National and County Governments' budgets collectively comply with the requirement of 15% of the national budget allocation to the health sector and 20% of the national budget allocation to the agriculture sector including water, irrigation and rural development; for example for the county government budgets, this may translate to about 43% of the county budgets being allocated to the agriculture sector, water, irrigation and rural development and about 32% of the county budgets being allocated to the health sector, with the assumption that the two sectors will take up a combined 75% of county budgets leaving 25% of the budget for other devolved functions. This significant percentage allocation for the two critical sectors of health and agriculture would inform the need for conditional allocations;

(7) Takes measures to amend sub article 203(3) of the Constitution to provide for the equitable share of the revenue raised nationally that is allocated to county governments to be not less than C percent (C%) in the formula such as –

$$CR+\{(c/100) \times NR\} = \{[(A+H)/100] \times NB\} + ODS - NHA + CAE$$

Therefore $C = (\{\{[(A+H)/100] \times NB\} + ODS - NHA + CAE\} / NR\} \times 100$

Where:

C is the county government equitable share percentage of the revenue raised nationally.

NR is the most recent audited accounts of the national revenue locally received as approved by the National Assembly;

CR is the county revenue received locally as approved the county assemblies;

NB is the National Budget Estimates;

A is the percentage of the current national budget allocated to the agriculture sector, water and irrigation and rural development;

H is the percentage of the current national budget allocated to the health sector;

ODS is the estimates in the current National Budget for the other devolved sectors;

NHA is the estimates in the current national budget for functions of agriculture and health sectors and of the other devolved that are coordinated by the national government;

CAE is the estimates in the current county budget for the county assemblies and county executives.

(8) Prepares subsequent Division of Revenue Bills from the financial year 2016/17 being cognizant of the provisions of Article 203 (1) of the Constitution and of the renewed vigor in improving the health, nutrition, economic and social well being of the citizens of the Republic of Kenya by use of a formula such as –

$C = [[\{(A+H)/100 \times NB\} + ODS+CAE-NHA-CR]/NR] \times 100$

And where $A+H \geq 35$

And the alphabet letters representation are as indicated in (vii) in coming up with the percentage of revenue raised nationally that is due to county governments.

(9) Prepares subsequent County Allocation of Revenue Bills i.e. from the financial year 2016/17 being cognizant of the provision of Article 203 (1) of the Constitution and of the renewed vigor in improving the health, nutrition, and economic and social well being of the citizens of the Republic of Kenya.

(10) Introduces legislation for enactment that will provide for a paradigm shift from economic development of the Republic of Kenya to human development of the citizens of the Republic of Kenya by placing a minimum percentage of the national budget that will be allocated to the critical sectors involved in basic human development.

The proposed legislation should provide for a minimum percentage allocation of the national budget such as –

Food (Agriculture), water, Sanitation & Irrigation	20%
Health	15%
Education/Knowledge	20%
Shelter	10%
Security	10%
Total	75%

And the sectors that have been devolved getting the allocations conditionally to the counties.

Committee sittings

In deliberating on issues on the proposed formula for division and allocation of revenue towards realization of the Sustainable Development Goals (SDGs), the committee held a total of one (1) sitting and received both oral and written submissions from the petitioner and the Commission on Revenue Allocation (CRA).

Committee General Recommendations

The committee having considered the matters in the petition recommends that;

The Committee recommends that whereas it is important to allocate more resources to county governments and in particular towards the improvement of the Human Development Index in Kenya, this does not require further legislation as proposed by the Petitioner. Sufficient legislation and guiding Regulations are already in place that can be used to achieve this objective. It is further not practical to ring fence 75 percent of the total budget to county governments as proposed in the Petitioners Prayers. The work of achieving the Sustainable Development Goals is a progressive process and is the reason attainment of its targets have been given by the United Nations as 2030.

ACKNOWLEDGEMENT

Mr. Speaker Sir,

The Committee is grateful to the Petitioner and the Commission on Revenue Allocation who appeared before the Committee to discuss the matters raised in the petition and deliberate on matters relating to the framework for sharing revenue among the county governments.

The Committee is also particularly grateful to the Offices of the Speaker, the Clerk of Senate for the support received as it discharged its mandate. The Committee also wishes to thank the Senators who participated in the process to ensuring that the Committee completes its report and also the Senators from Wajir County who attended the Committees Sittings.

Mr. Speaker Sir,

On behalf of the committee, and pursuant to standing order 203(6), It is therefore my pleasant and honourable duty to present and lay on the table of the house the report of the Finance, Commerce and Budget Committee regarding the Petition by David O. Gesicho, concerning a proposed formula for division and allocation of revenue towards realization of the Sustainable Development Goals (SDGs).

THE HON. SENATOR BILLOW KERROW, MP

CHAIRMAN, FINANCE, COMMERCE AND BUDGET COMMITTEE

Date: April, 2016

II. INTRODUCTION

REVIEW OF THE PETITION

2.1 Brief on the Petition

1. The Constitution under Articles 37 and 119 grants every Kenyan a right to petition Parliament to consider any matter within its authority, including enacting, amending or repealing any legislation. The Petition to Parliament (procedure) Act No. 22 of 2012 makes provision for the procedure for the exercise of the right pursuant to those Articles. The Act also defines the format of petitions to be addressed to the Senate or National Assembly.

2. This petition has been presented by David O. Gesicho, a citizen of Kenya and also a resident of Kakamega County.

3. The petition was approved for presentation to the Senate House on 16th February, 2016 and subsequently committed to the Senate Standing Committee on Finance, Commerce and Budget.

4. The following are summary of the key issues that the petition draws to the attention of the Senate:

    (a) That, since independence, Kenya has struggled to tackle hunger, poverty, ignorance and disease, challenges which are still with us 52 years after independence;

    (b) That, Kenya has also made commitments under various international instruments such as to allocate at least 15% and 10% of the national annual budget to health and agriculture, respectively. These commitments are, however, yet to be implemented therefore forestalling the potential contributions of the two sectors to the economy and the society;

(c) That the United Nation adopted 17 Sustainable Development Goals last year (See petition) for the listing) and subsequently committed to the agenda to achieve and attain the objectives and outcomes of those goals by 2030;

(d) That, Kenya may not attain the SDGs with the current formula for division and allocation of national revenue, which underfunds critical sectors such as health and agriculture, both at the two levels of government, and instead prioritizes or is in favour of other sectors such as infrastructure development and national security;

(e) Proposes a formula to be used in arriving or allocating share of national revenue to counties. The formula which is as a result of work - out of two equations (see page 6 of the Petition) together with the definition of the various variables are as provided below:

$$C = \frac{\left(\left(\frac{(A+H)}{100} * NB\right)\right) + ODS - NHA - CR \div CAE}{NR} * 100$$

Where:

(a) C - Is the County Government equitable share percentage of the revenue raised nationally;

(b) NR - Is the most recent Audited Accounts of National Revenue Received as approved by the National Assembly;

(c) CR- Is the County Revenue Received locally as approved by the County Assemblies and National Assembly;

(d) NB - Is the current National Budget Estimates;

(e) A - Is the percentage of the current National Budget allocated to the Agriculture Sector, Water and Irrigation and Rural Development;

(f) H - Is the percentage of the current National Budget allocated to the health sector;

(g) ODS - Is the Estimates in the current National Budget for the Other Devolved Sectors;

(h) NHA - Is the Estimates in the current National Budget for functions of Agriculture and Health Sectors and of the other Devolved Sectors that are coordinated by the National Government; and,

(i) CAE - Is the Estimates in the current County Budget for the County Assemblies and County Executives.

(f) That, the tax revenue base is currently at about 18.4 percent of the GDP and projected to gradually reflect 20.8 percent by 2015/16 and 21.8 percent in the medium term. In addition, the petitioner observes that the annual deficit is estimated at 8.7 percent of GDP in the FY 2015/16 or kshs 567 billion. And that based on the European Union Maastricht Treaty a deficit is considered as excessive budget deficit when in excess of 3 percent of GDP, and thus a need to legislate at not more than 5 percent of GDP.

(g) That the Petitioner has also once petitioned the president of the Republic of Kenya with a view to have the matters as contained in the petition addressed but has since received no response or feedback. Further, the Petitioner also indicates the issues raised are also not before any court of law or a constitutional or legal body.

2.2 Prayers of the Petitioners

The petitioners' prayer was that the Senate of the Republic of Kenya intervenes and: -

(a) Introduces legislation for enactment by August 2016 that will provide for a minimum allocation of fifteen percent (15%) of the National Annual Budget to the Health Sector in belatedly implementing in the Republic of Kenya, the Recommendations of the OAU/AU Abuja Declaration (2001) on HIV/ AIDS, Tuberculosis and other related infectious diseases;

(b) Introduces legislation for enactment by August 2016 that will provide for a minimum allocation of ten percent (10%) of the National Annual Budget to the Agriculture Sector in belatedly implementing in the Republic of Kenya the Recommendations of the Maputo Declaration (2003) on Agriculture and Food Security in Africa;

(a) Does all that is within its mandate and authority including amendment of the Kenya Constitution 2010 to allow for the relevant legislation to be enacted; and if such a Constitutional Amendment requires a referendum, to initiate the process that will lead to the holding a plebiscite;

(b) Irrespective of the Declarations, Commitments, Pledges, Undertakings and Resolutions of the African Union, on its own Motion takes steps to legislate by August 2016 for the provision of a minimum National Annual Budgetary Allocation of fifteen percent (15%) of the National Budget to the Health Sector and twenty percent (20%) to the Agriculture Sector including Water and Irrigation and Rural Development.

(c) Puts in place by August 2016, legislation to provide for a National Annual Deficit of not greater than five percent (5%) of the Gross Domestic Product.

(d) Develops and puts in place legislation to ensure that National and County Governments' Budgets collectively comply with the requirement of 15% of the National Budget Allocation to the Health

Sector and 20% of the National Budget Allocation to the Agriculture Sector including Water and Irrigation and Rural Development; for example for the county government budgets, this may translate to about 43%of the county budgets being allocated to the Agriculture Sector, Water and Irrigation and Rural Development and about 32% of the county budgets being allocated to the Health Sector when the assumption is that the Agriculture and Health Sectors combined will take up 75% of the county budgets while the other devolved functions are taking up the remaining 25%. Thus the need for legislation for the two critical sectors of Health and Agriculture (including Water and Irrigation) to get Conditional Allocations.

(e) Takes measures to amend sub article 203(3) of the Constitution of Kenya to provide for the equitable share of the revenue raised nationally that is allocated to county governments to be not less than C percent (C%) in the formula i.e where C is as shown below:

$$C = \frac{\left(\left(\frac{(A+H)}{100} * NB\right)\right) + ODS - NHA - CR \div CAE}{NR} * 100$$

(f) Prepares subsequent Division of Revenue Bills from the financial year 2016/2017 being cognizant of the provisions of Article 203 (1) of the Constitution of Kenya and of the renewed vigour in improving the health, nutrition and economic and social well being of the citizens of the Republic of Kenya by use of a formula such as:

$$C = \frac{\left(\left(\frac{(A+H)}{100} * NB\right)\right) + ODS \div CAE - NHA - CR}{NR} * 100$$

And where $A+H \geq 35$

And the Alphabet letters representation are as indicated in (vii) in coming up with the percentage of the revenue raised nationally that is due to County Governments

(g) Prepares subsequent County Allocation of Revenue Bills i.e. from the financial year 2016/2017 being cognizant of the provisions of Article 203 (1) of the Constitution of Kenya and of the renewed vigour in improving the health, nutrition and economic well being of the citizens of the Republic of Kenya.

(h) Introduces legislation for enactment that will provide for a paradigm shift from Economic Development of the Republic of Kenya to Human Development of the citizens of the Republic of Kenya by placing a minimum percentage of the national budget that will be allocated to the critical sectors involved in basic human development.

The proposed legislation should provide for a minimum percentage allocation of the National Budget such as:-

Food (Agriculture), Water, Sanitation & Irrigation	20
Health	15
Education/ Knowledge	20
Shelter	10
Security	10
Total	75

And the sectors that have been devolved getting the allocations conditionally to the counties.

III. SUBMISION FROM PARTIES

In establishing facts, the committee invited and met with the Petitioner and the Commission on Revenue Allocation.

3.1 Submission by the petitioner

The petitioner appeared before the committee on 22nd March, 2016 to make his presentation with regard to the contents of his petition before the committee.

The Petitoner informed the committee as follows –

1. That the focus of his petiton was to revise the formula for sharing reveue between the forty-seven counties so as to incerease allocations to the sectors of health and agriculture in the counties.
2. He further highligthted that the empahsis of his formula was on ensuring county governments addressed basic needs so as to stimualte economic development.
3. He emphasisied that in order to achieve human development n counties, it was critical that at least 45%of national revenue should be allocated to county governments.

3.2 Submissions by Commission on Revenue Allocation

CRA made reference to the Petitioner's prayers and advised as follows:

A. International Conventions

1. On international commitment to allocate at least 15% and 10% of the national annual budget to health and agriculture respectively, as noted by the petitioner, Kenya falls substantially below the target.
2. Nonetheless, both Vision 2030 and the Medium Term Plan have identified health and agriculture as key priority sectors. It is on this basis that the national government has allocated additional resources

to these sectors as conditional allocations to county governments. This include the following conditional allocations:

a. Ksh. 4.5 billion for purchase of medical equipment in all the 47 counties
b. Ksh. 3.6 billion to level 5 hospitals
c. Ksh. 4.3 Billion for free maternal health care services
d. Ksh. 900 Million for forgone user fees and
e. The National Government has continued to provide seed and fertilizer subsidies and through the National Irrigation Board, the government is also working with the development partners on irrigation schemes such as the Galana.

3. Kenya is not food scarce. The problem the country is experiencing is poor marketing logistics in the agricultural sector, which create superficial shortages and low returns to farmers. Whereas food is rotting in one part of the country or animals dying one part of the country, another segment of the population have no access to either. The problem that needs to be urgently addressed is the poor management of Institutions in agricultural sector.

4. Whilst it is important that the country becomes food secure, the country needs to move from subsistence agriculture to mechanized agriculture. For Kenya to realize its dream of attaining an industrializing country status by 2030, the trade and manufacturing sectors need to contribute substantially above the agricultural contribution to GDP. The current huge public investments on infrastructure and security are therefore a step in the right direction to attract both domestic and foreign investments.

5. Health, education, shelter, security, water, and sanitation define basic human needs. Investments in these sectors require huge capital outlays. The government has highly subsidized activities in this sector with tax revenues collected from other sectors. Whilst it is important to increase allocations to these sectors, there is need to strike a

balance with other lead sectors to ensure the country develops. As much as the end is important, the means to that end is equally important.

6. Increased allocation to infrastructure and national security indirectly also benefit agriculture and health. Infrastructural development and national security are prerequisites to any meaningful development in a country. We need good infrastructure (both roads, water and electricity) to enjoy good health care and thrive agricultural activities

B. Revenue Sharing Formula

7. The Constitution in Article 203(2) provides that the equitable share of revenue raised nationally that is allocated to county governments be not less than fifteen percent of the most recent audited accounts of revenue received and approved by the National Assembly. The current allocation to county governments of Ksh. 259,775 million is equivalent to 33.4 percent of the shareable revenue for financial year 2012/13 and 20.8% of the projected revenues for 2015/16 amounting to Ksh1,254 million

8. The sharing of revenue between the national and county governments is further guided by the provision of Article 203(1) which provides for among others; that provision must be made in respect of the public debt and other national obligation.

9. In accordance with the principal of *funds follow functions,* county governments have been given, with some exceptions, resources attached to the functions transferred to them. There is no difference between the proposal by the petitioner on resources due to county governments and what the CRA has recommended as a basis for sharing of revenue between the two levels of government.

10. The percentage allocated to county governments (what the petitioner calls C) above the minimum 15% is always a subject of negotiation. However the prays of the petitioner if granted, will constrain the operations of the national government.

For example, the petitioners' final prayer on health of 15% and Agriculture of 20% if executed based on the shareable revenue for 2013/14 of Ksh 935,653 Million amounts to Ksh. 327,479 million against a CRA recommendation of Ksh. 110,711 to the two sectors. If we add the other recommendations as specified by the Petitioner to this allocation for health and agriculture, the equitable share allocation to county governments for financial year 2016/17 will amount to Ksh 548,533 million. This is equivalent to 58.6 percent of the shareable revenue.

11. County governments have resources at their discretion. How they choose to allocate resources among competing priorities various from county to county and this is the essence of devolution. County plans and budgets are subjected to public participation. Therefore, it is the people who choose what their priorities are. Overall, the PFM Act 2012 and attendant regulations provides for broad fiscal prudence measures to includes limit on how much resources can be spent on development and remuneration

C. Budget Deficit

12. The National budget deficit for 2015/16 is projected at Ksh. 570.2 billion. This is equivalent to 42 percent of our total revenue and 8.7 percent of GDP. This budget deficit ad indeed the public debt is high by international standards. However, the national treasury has put in place austerity measures to curb none essential expenditures. In the Medium term, the National Treasury has targeted to reduce the deficit to 5% of GDP. As a commitment towards this goal, the overall,

national budget for 2016/17 is less than that of 2015/16. There is no need for further legislation on the budget deficit.

D. CRA Advisory

13. Based on the forgoing analysis, whereas it is important to allocate more resources to county governments and in particular towards the improvement of the human development index in Kenya, this does not require legislations. It is also not practical to ring fence 75 percent of the total budget to county governments based on the Petitioners Prayers. Once adequate infrastructure is in place, and the country is secure, the country will progressively achieve the sustainable development goals.

IV. COMMITTEE OBSERVATIONS AND RECOMMENDATIONS

Committee Observations

a) International Commitments on sectoral budget allocations

Indeed Kenya has committed itself to various regional or continental declarations to either allocate certain threshold /percentage of its budgetary resource towards specific sectors or gradually scale up such allocations to agreed levels. Examples of such commitments include the Abuja Delaration and the Maputo Declaration as well as the the MDGs now replaced by SDGS. In the case of Abuja Declaration AU head of states pledged and set targets to support the health sector by allocating atleast 15% of annual national budget which was also to be supported further by an increase of official development assistance to developing countries. On the other hand, the Maputo Declaration was similarly a pledge at the Africa Union Summit in Maputo, Mozambique, to allocate atleast 10 perecent of the national budget to agriculture with aview to achieve atleast 6 percent annual agricultural growth. These two declarations were informed by the need to reverse decades of under investment in these sectors to improve the respective countries' economic and social profile including reducing high poverty rates.

However,while progress in terms of gradual increase in allocations is realised in most countries, the full actualization of these commitments and promises depend on various factors and realities such as limited resource base, donor commitments as well as the priorities put forward by national blue print plans and political considerations. For instance, only 20 percent of the countries (Kenya excluded) committed to Maputo Declations indicated fulfillment by end of 2014 and many countries also reported to have missed targets on the Abuja Declaration commitments primarily due to missing funding targets. These international commitments and targets non-the- less provide important and useful guide posts in resource allocation.

In light of the various factors at play and the absence of legal instruments to compel allocations towards a certain threshold, the current sectoral allocations are based on negotiations through a ceiling approach premised upon legislative consideration and approval.

b) Division of Revenue and County share allocation

That sharing of nationally raised revenue is underpinned by various Articles in the Constitition that inform the frameworks to be used for sharing revenue both vertically (between the two levels) and horizontally (among the 47 county governmts) . These provisions in the Constitution are however not a static/or pre - determined framework in resource sharing, allowing instead for a periodic review of an approved basis that is arrived at through negotiation and compromise between key actors including the public.

However , the Petitioner proposes to amend the constitution to provide for a formula incorporating several parameters (see item 'e' of the Prayers). The formula suggests a resulting percentage (denoted as "C") which will be the county government equitable share percentage of the nationally raised revenue. Further, the proposal doesn't indicate or demonstrate how the criteria mentioned under Article 203 (1) will be taken into account since there is no pıovision in the petition addressing the same. Some of those criteria include taking into account allocations such as national interest and provisions in respect of public debt and national obligations, among others.

c) Macro Economic Indicators and Fiscal Responsibility Principles

According to the 2016 Budget Policy Statement, total expenditure is set to decline from 28.3 percent of GDP in 2016/17 to 26.0 percent of GDP in 2018/19. The implication of this would be to reduce the overall deficit, inclusive of grants, from 6.8 percent of GDP in 2016/17 to 4.1 percent of GDP in 2018/19.

On legislation provisions, The PFM Act, 2012 and Regulations provide for sufficient details with regards to adherence to fiscal reponsibility principles including the level of debt threshold (50 percent on Gross Domestic Product. In addition, EAC Monetary Union Protocol on macroeconomic convergence criteria provides that members undertake to attain a ceiling of fiscal deficit including grants of 3% of GDP and a ceiling on public debt to GDP ratio of 50%, among others.

Committee Recommendations

The committee having considered the matters in the petition recommends as follows:

a) In view of the mandate of CRA has to recommend the vertical and horizontal division of nationally raised revenue, and further that in the process making its recommendations the Commission is required to engage key actors and the public;CRA should take note of the matters raised in the petition for use in its subsequent engagements on the matter of divison of revenue.

b) On the prayer relating to amending the Constitution, the Committee draws the attention of the Petitioner to the provisions of Chapter 16 of the Constitution stipulating the processes and procedures involved in amending the Constitution. Similarly, the Petitioner may wish to engage with one of the various ongoing initiatives of amending the Constitution by various actors by presenting his recommendations.

c) PFM regulations gazetted by the Cabinet Secretary provide for provisions on fiscal prudence and further provide sufficient details on fiscal responsibility principles as well as financial objectives which are provided in the medium term Budget Policy Statement and submitted to Parliament for scrutiny and approval.

d) Based on the forgoing analysis, the Committee recommends that whereas it is important to allocate more resources to county governments and in particular towards the improvement of the Human Development Index in Kenya, this does not require further legislation as proposed by the Petitioner. Sufficient legislation and guiding Regulations are already in place that can be used to achieve this objective. It is further not practical to ring fence 75 percent of the total budget to county governments as proposed in the Petitioners Prayers. The work of achieving the Sustainable Development Goals is a progressive process and

is the reason attainment of its targets have been given by the United Nations as 2030.

ANNEXES

i. **Annex 1:** Petition Concerning a Proposed Formula for Division and Allocation of Revenue Towards Realization of The Sustainable Development Goals (SDGs)

ii. **Annex 2:** Submission by the Commission on Revenue Allocation

iii. **Annex 3:** Minutes