



UNIVERSITY OF NAIROBI

**EVALUATING THE EFFICACY OF ALTERNATIVE DISPUTE RESOLUTION IN TAX
DISPUTES IN KENYA**

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**A PROJECT PAPER SUBMITTED IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS OF MASTER OF LAWS, SCHOOL OF LAW. UNIVERSITY OF
NAIROBI.**

DECLARATION

I do declare that, save for information sources of which have been duly acknowledge, this research project is my original work and has not been submitted to other institution of higher learning for any academic purposes.

Signature

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This research project has been submitted for examination with my approval as the University Supervisor.

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DR. KARIUKI MUIGUA

DEDICATION

To my parents, sisters and wife for being on my side all through my academic journey

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First and most of all I would like to thank Dr. Kariuki Muigua my supervisor for his expertise, assistance, guidance and patience throughout the process of writing this thesis.

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ABBREVIATION AND ACRONYMS

ADR- Alternative Dispute Resolution.

HMRC- Her Majesty's Revenue and Customs.

KRA -Kenya Revenue Authority.

TAA -Tax Administration Act.

TATA -Tax Appeal Tribunal Act.

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CHAPTER ONE

1.1 Introduction and Background to the study

1.1.1. Introduction

After the promulgation of Constitution of Kenya 2010, Alternative Dispute Resolution (ADR) mechanisms have gained greater acceptance in Kenyan legal landscape.¹ In the past, Kenya Revenue Authority (KRA) tax dispute resolution has hindered growth owing to inordinate delay and procedural complexities. Prolonged litigation in tax disputes and time it takes to resolve dispute with KRA has created a perception that the dispute mechanism is unfavourable to tax payers. The Constitution has enshrined the principle of equity in taxation. Every citizen must pay their fair share of taxes. This provided for under Article 201 (a) (I) “The burden of taxation must be shared fairly.”² The issue of tax dispute is of importance as a sizeable amount of revenues may be locked up in dispute. If the dispute is resolved amicably, the revenue that was locked up could have a significant impact in the Kenyan economy. It is against this backdrop that the research aim to examine the current alternative dispute mechanisms used by KRA to solve tax dispute in Kenya.

There is no doubt that disputes are bound to happen and indeed exist between the taxpayers, market stakeholders and KRA. A quick and effective dispensation of these disputes ensures a healthy environment for business and market growth through maximization of profits and mended healthy working relationships, as well as high yields in taxes.³

ADR enhances access to justice and contributes to respect for the Rule of Law, which is an essential precondition for development.⁴ The Constitution of Kenya, 2010 provide that the court shall give effect to application of ADR mechanisms to solve disputes. Litigants to tax disputes are encouraged to engage in ADR process. The Tax Appeal Tribunal Act (TATA) encourages parties who wish to

¹ Constitution of Kenya Article 159

² Constitution of Kenya Article 201

³ Muigua K, ‘Avoiding Litigation through the Employment of Alternative Dispute Resolution,’ pp 6-7, a Paper presented at the In-House Legal Counsel, Marcus Evans Conference at the Tribe Village Market Hotel, Kenya on 8th & 9th March, 2012, available at <http://www.chuitech.com/kmco/attachments/article/101/Avoiding.pdf>, (accessed on 10/05/2014).

⁴ *Ibid*, p7, see also Rukwaro G.K., ‘The Rule of Law and Development,’ in Y. Vyaset al (eds), *Law and Development in the Third World*, University of Nairobi, 1994; & Whitford W.C., “The Rule of Law: New Reflections on an Old Doctrine,” *East African Journal of Peace and Human Rights* Vol. 6(2), pp. 159-161.

settle a tax dispute through ADR in the Tax Appeal Tribunal.⁵

1.1.2 Background of the study

KRA has come up with mechanisms to attain high tax revenue due to increased public expenditure. A significant portion of 2017/2018 budget is expected to be financed from the tax revenue.⁶ The demand for high tax revenue is as a result of blotted government recurrent expenditure. KRA have been forced to come up with diligent enforcement and compliance mechanisms or policies to avoid tax loophole.⁷

Tax payers on the other hand have come up with strategies to reduce tax compliance. This is as a result of taxpayers' awareness of their rights and obligations in relation to lodging objections to tax assessments that they consider in contravention of tax laws or unfair.⁸ Tax payers are demanding tax refunds from KRA with same magnitude as KRA demand taxes due from them. Thus, there has been an increase in complex tax disputes between tax authority and tax payers.

The current regulatory framework governing tax disputes has come up with mechanisms through which dissatisfied tax payers who are issued with tax assessments by commissioner of tax can seek redress.⁹ When the commissioner receives the objection in writing, he may deal with the objection in three ways: Amend the assessment to allow the objection in whole, amend the assessment to partially allow the objection or reject the objection in whole. The commissioner has the option to escalate the dispute to arbitration bodies set up to resolve tax disputes.¹⁰ ADR process is voluntary and may be initiated by either the commissioner or tax payer. Where an individual is dissatisfied by an appealable decision they may appeal to the TAT in accordance to the provisions of TATA, even further to the High Court and Court of Appeal respectively.¹¹ In June 2015, KRA incorporated

⁵ Section 28

⁶ John Kinuthia and Jason Lakin, Ph.D. Kenya: Analysis of the 2017/18 National Budget Estimates, June 2017

⁷ Linda Muthoni, "Amend tax disputes resolution process" Capital news, 8/11/2011, available at <http://www.capitalfm.co.ke/eblog/2011/06/08/amend-tax-disputes-resolution-process/> (accessed 13/12/2016)

⁸ Simon James and Clinton Alley, "Tax Compliance, Self-Assessment and Tax Administration" (1999) 2(2).

⁹ Section 51(1) TPA.

¹⁰ Section 52 TPA.

¹¹ Section 52(1) TPA

Alternative Dispute Resolution processes in order to solve numerous tax disputes. ADR offer several channels that enable tax payers interact with KRA without resorting to litigation.

Social justice demands that every person be treated equally before the law.¹² Statutory and administrative tax complexities result in tax disputes.¹³ Taxation forms an important relationship between a tax payer and the government. Thus, equality in resolving disputes plays a significant role from a social justice perspective.¹⁴ While there exists comprehensive tax disputes resolution mechanisms in Kenya, it is not clear whether tax payers who are in disputes with KRA can equally access internal ADR mechanisms to resolve tax disputes. It is against this backdrop that the study seeks to critically analyze the efficacy of current ADR mechanisms in resolving tax disputes.

In our society, disputes are common features that define us.¹⁵ Therefore, tax disputes are common and familiar to the modern tax system in the world. Tax disputes occur when tax payers disagree with tax administrators in respect to tax payer entitlement or tax liability.¹⁶ In addition, tax liability and tax dispute may arise at any stage after disagreement between tax payers and the tax administrator.¹⁷

In appreciating the importance of tax disputes there are advanced opinions by scholars to this effect; Trans-nam and Walpole argue that unlike most civil or commercial disputes, tax disputes involve two parties, an administrative agency and an individual tax payer or small business.¹⁸ The two parties are unevenly positioned with respect to each party ability to influence the law after the court or tribunal judgment has been handed down.¹⁹ In addition, in tax disputes there is a reversal onus once they are considered by the tribunal.

In Kenya, tax disputes may arise for various reasons; issuance of additional assessments, an

¹² Ibid.

¹³ Simon James and Clinton Alley, "Tax Compliance, Self-Assessment and Tax Administration" (1999) 2(2), *Journal of Finance and Management in Public Services*.

¹⁴ Frank Gilders, John Taylor, Michael Walpole, Mark Burton and Tony Ciro, *Understanding Taxation Law 2016* (LexisNexis Butterworths, 2015) 1091.

¹⁵ Pope and Margaret McKerchar, "Understanding Tax Morale and Its Effect on Individual Taxpayer Compliance", (2011) 5 *British Tax Review* 587, 589.

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ Binh Tran-Nam and Michael Walpole, "Independent Tax Dispute Resolution and Social Justice in Australia" (2012) *Law Journal* 470.

¹⁹ Ibid.

inclusion of any amount, the exclusion of any amount or decision by the commissioner and interpretation of facts involved in any dispute, or law applicable.²⁰ When dispute arise, a disputant has the right of objections and appeals or litigation in a judicial process.²¹

As earlier noted, ADR process is voluntary and discussions may be initiated by either the commissioner or the tax payer.²² When discussions are initiated by the commissioner: the commissioner notifies the Tax payer of intention to engage ADR mechanism accompanied by settlement proposal if any. The tax payer notifies the commissioner of his acceptance together with response to proposals copied to Corporate Tax Dispute Resolution (CTDR). CTDR appoints a facilitator or facilitation panel and communicates to parties. The alternative dispute resolution mechanism applicable is facilitated mediation. The facilitator calls for the first ADR meeting and subsequently calls for commencement of substantive hearing. After hearing, parties may have reached agreement and therefore give effect to the agreement terms by signing. If no agreement is reached, parties are free to exercise their statutory rights by approaching the court.²³

When the process is initiated by a tax payer; the tax payer notifies commissioner of intention to engage ADR accompanied by settlement proposal if any. The commissioner notifies the tax payer of his acceptance together with response to proposals copied to CTDR. CTDR appoints a facilitator or facilitation panel and communicates to parties. The facilitator calls for the first ADR meeting and subsequently calls for commencement of substantive hearing. After hearing, parties may have reached agreement and therefore give effect to the agreement terms by signing. If no agreement is reached, parties are free to exercise their statutory rights by approaching the court.²⁴

Ordinarily KRA would ask for a settlement proposal where the taxpayer initiates the process, and of which is facilitated by the head of Corporate Tax Dispute Resolution Division. The tax agency being open to the ADR process and having its officials finance the process wholesomely makes the process vulnerable to biasness. The question of if the Tribunal has the authority to consider appeal

²⁰ Section 2 & 50 TPA.

²¹ Section 51(1) of the TPA.

²² Ibid.

²³ Section 52 TPA.

²⁴ Section 53 &54 TPA.

papers filed out of time, and whether procedural technicalities are considered sufficient for the Tribunal to strike out a *bona fide* appeal is as well imminent. More importantly, what process governs the alternative dispute resolution mechanism for settlement of tax disputes and their efficacy are among the legal gaps that seek to be investigated.

The research will make reference to United Kingdom as an ideal state that has put in place different dispute resolution mechanisms to address tax disputes. In United Kingdom, Her Majesty's Revenue and Customs (HMRC) provide that traditional tax disputes are settled either through litigation or out of court settlement between parties.²⁵ United Kingdom has a similar model of resolving tax disputes. HMRC play a role in resolving tax disputes. A facilitator is appointed from within HMRC who carry out inquiry and speak to both parties to the dispute.²⁶ The facilitator assists the tax payer and HMRC to come to an agreement. The difference between the UK model is that the facilitator is appointed from HMRC staff who is accredited by Centre for Effective Dispute Resolution (CEDR) who act as a mediator. Basically, the UK model falls under mediation. This model is appealing because it safeguards the independence of the process.²⁷

In United Kingdom, HMRC has approved a guide for resolving disputes through ADR. The following are approved methods;

Facilitative mediation

A trained and accredited mediator brings the parties together in an effort to reach settlement. The mediator does not offer an opinion of the merits of the arguments advanced during discussion. The facilitator may or may not be a specialist in the subject matter.²⁸

Evaluative mediation

An accredited mediator brings the parties together and provides his or her view of the matter as a specialist in the subject matter of dispute. The mediator offers opinion on the merits of arguments

²⁵ Code of governance for resolving tax disputes, Her Majesty Revenue & Customs (HMRC), United Kingdom.

²⁶ Ibid.

²⁷ Ibid.

²⁸ HM Revenue and Customs, Resolving Tax Disputes: Practical Guidance for HMRC Staff on the use of Alternative Dispute Resolution in Large or Complex Cases (April 2012) 4.

advanced during discussion.²⁹

Non-binding neutral evaluation

A third party who is an expert provides a non-binding opinion. This method is applicable in cases that are not related to tax issues but determination of issues may have tax consequences.³⁰

HMRC has concluded that the tax dispute resolution model has been successful. Therefore, the average time taken to resolve dispute has been reduced and disputes involved have been successfully resolved.³¹

There are recent trends by states to move towards widespread adoption of ADR in tax disputes.³²

This is because ADR is more flexible to tax payers and cost effective to tax administrators.³³

Principles of equality and legality in taxation are enshrined in ADR. When resolving tax disputes through ADR, care must be taken not to undermine rule of law, not to deal with issue that are not compatible to settlement or alter the responsibilities and powers of the administrative bodies.³⁴

Therefore, ADR in Tax disputes need to be designed to work swiftly in public interest and not become an excuse not to comply with the law.

Tax cases that involve fact finding where the truth can only be found by an impartial investigator are better dealt with through litigation.³⁵ In addition, matters where a tax law provision is open to different interpretation, litigation may be appropriate so as to solve the ambiguity.³⁶ However,

isolated cases may be more efficiently dealt with through ADR as long as the disputants are ready to arrive at amicable settlement. There are different types of ADR mechanisms adopted in tax disputes:

Negotiation, Mediation, Conciliation and Arbitration.

²⁹ Ibid.

³⁰ Ibid.

³¹ HM Revenue and Customs, *Resolving tax disputes: Commentary on the litigation and settlement strategy* (November 2013).

³² Frank Gilders, John Taylor, Michael Walpole, Mark Burton and Tony Ciro, *Understanding Taxation Law 2016* (LexisNexis Butterworths, 2015) 1091.

³³ Ibid

³⁴ Ibid

³⁵ Ibid

³⁶ Frank Gilders, John Taylor, Michael Walpole, Mark Burton and Tony Ciro, *Understanding Taxation Law 2016* (LexisNexis Butterworths, 2015) 1091.

1.2. Statement of Problem

A modern tax system involves five broad and integrated aspects namely tax dispute resolution, tax compliance, tax policy, tax law enactment and tax administration and enforcement.³⁷ An impartial and independent dispute resolution mechanism that is accessible to tax payers plays a critical role in operation of a tax system.³⁸ In Kenya, the procedures of resolving tax disputes have been articulated in the Tax Procedures Act of 2015 that became effective as at 19th January 2016.

The challenge with the current regulatory framework governing ADR in resolution of tax disputes in Kenya relates to effectiveness of the process, procedural justice and potential issues such as perception of fairness and costs. This indicates that there is a gap in knowledge of connection between tax dispute resolution and tax justice.³⁹ The gap in knowledge has informed the research which aim at examining the efficacy of tax dispute resolution mechanisms in KRA. The tax dispute resolution bodies have tried to address KRA and tax payers' grievances with professionalism.⁴⁰ This is because each body gives either of the party a chance to seek redress to the next appellate body thus offering fair hearing. The dispute resolution bodies have solved many tax disputes. However, the challenge is the excessive time the process takes to solve a dispute. The time a tax payer files an intention to appeal to assessment to ruling and conclusion of the hearing may take up to one year. It is crucial to note that the Tax Appeal rules provide only specific timelines within which an appeal should be lodged by a tax payer.⁴¹

These rules fail to provide timelines within which appellate bodies should conclude a hearing of a tax dispute. Thus, the appeal process ends up taking more time and expensive resulting to anxiety to tax payers. The unresolved tax disputes may threaten amount of revenue collected by KRA. The implementation of mediation in solving tax disputes is aimed at fast tracking resolution of disputes.

³⁷ Pope and Margaret McKerchar, "Understanding Tax Morale and Its Effect on Individual Taxpayer Compliance", (2011) 5 British Tax Review 587, 589.

³⁸ Ibid

³⁹ Suitably adapted from Kristina Murphy, 'The Relationship Between Procedural Justice, Legitimacy and Tax Non-compliance' (2005) 32(4) Journal of Law and Society 562, 566.

⁴⁰ Stanley Ngugi, Tax Dispute Resolution Mechanisms 2016.

⁴¹ Section 52 TPA.

In addition, The KRA ADR framework identifies facilitated mediation as the only form of ADR to be used in resolving tax disputes. KRA framework limits the tax payer from enjoy the variety of ADR mechanisms available especially in cases where mediation fails or is not preferred by the disputants. The research appreciates that not all ADR mechanisms are applicable in resolving tax disputes such as traditional dispute resolution.

The Constitution provide that no tax or license fee may be imposed or waived or varied except as provided by statute.⁴² The challenge is that the variation by the commissioner in ADR process would be contrary to the constitution. There is no provision in tax statutes granting the commissioner power to reach amicable settlement when collecting revenue.

Matters related to Value Added Tax (VAT), the full amount of taxes assessed by the tribunal should be paid before a disputant's appeal to the High Court. The tax appeal rules provide that for PAYE and withholding tax matters, the tax payer should pay all penalties assessed by the commissioner before filing an appeal before Income Tax Tribunal and Local Committee.⁴³ The current regulatory framework require that a tax payer pay the amount of tax in dispute before hearing of an appeal can be interpreted to mean that the tax payer has been condemned. This is against principles of justice that a person is considered innocent until proved guilty. This raises the need to develop a good relationship between tax payers and KRA. This will create an efficient tax administration system that resolves disputes.

The introduction of ADR by KRA in internal structures means that a third party can determine a dispute through mediation. KRA aim to reduce caseload of tax appeals by utilizing mediation.

1.3 Research Objectives

The study seeks to attain the following specific objectives:

- i) To evaluate the efficacy of regulatory framework governing ADR in resolution of tax disputes in Kenya.

⁴² Constitution Article 210.

⁴³ Ibid.

- ii) To determine what challenges tax payers and KRA face when resolving disputes through ADR mechanisms.
- iii) To examine to what extent the current ADR channels are adequate in resolving tax disputes.

1.4. Research Questions

The study will seek to answer the following questions:

- i) How effective is the regulatory framework governing ADR in resolution of tax disputes in Kenya?
- ii) What challenges do tax payers and KRA face when resolving disputes through ADR mechanisms?
- iii) To what extent are the current ADR channels adequate in resolving tax disputes?

1.5. Hypothesis

ADR has not been predominantly used thus occasioning minimal resolution of tax disputes and non-remittance of tax.

1.6. Methodology

The research will make use of both quantitative and qualitative data analysis. Qualitative will collect information from tax payers in Nairobi on the subject matter, getting opinion from tax analysts, lawyers and other stakeholders. Quantitative research will ask specific questions to the respondents. The interviews will be face to face interviews.

Qualitative method will make use of reading materials such as journals, online articles and books.

The library research will focus on both published and unpublished materials online.

The questionnaire will be simple and concise and distributed to tax payers through random sampling. The target population will be heterogeneous in order to represent different tax payers. The questionnaire will be open ended in order to allow respondent to provide additional information.

The questions may be asked several times in different wording to test reliability of information.

After data is collected, the information will be analyzed and summarized in terms of percentages and presented in charts, tables and graphs.

1.7. Limitation

The answers to the questionnaire may not reflect the true position because respondents may overstate matters when they realize they are important.

1.8. Theoretical framework

There are different schools of thought on ADR mechanisms. This research will mainly focus on social justice theory. Social Justice theory encompasses a multidimensional concept and mean different things to different people.⁴⁴ When defining social justice, there is a joint responsibility of fair redistribution of resources, a fair system of law and due process, equal access to opportunities and rights, and protection of the vulnerable.⁴⁵ The research is mainly interested in definition of social justice that delinks social justice to other attributes of a civil society such as human rights. Social justice means every person in a society has a right to enjoy equal access to government services regardless of his or her ability to contribute to generation of wealth.⁴⁶ The research is restricted to aspects of economic dimensions of social justice.

The issue of tax equity policy has been comprehensively covered in public finance. The research will only attempt to give an overview of the same. Tax policy is concerned with capacity of tax payers to pay expressed in vertical and horizontal equity.⁴⁷ However, it faces challenges of compliance due to variation in tax payer behaviour and opportunities to evade taxes.⁴⁸

The main objective of the research is to examine the efficacy of the current tax dispute resolution mechanisms in Kenya from a social justice perspective. Procedural justice in taxation comprises two main aspects: how tax payers are treated by tax administrator (tax equity policy), and access to external processes for resolving disputes (procedural justice).⁴⁹

The issue of tax policy equity is relevant to social justice system. However, it is the second aspect

⁴⁴ Charles O'Kelley, Rawls, Justice, and the Income Tax, 16 *GA. L. REV.* 1 (1981).

⁴⁵ *Ibid.*

⁴⁶ Kristina Murphy, "Regulating More Effectively: The Relationship between Procedural Justice, Legitimacy and Tax Non-compliance" (2005) 32 *Journal of Law and Society* 562.

⁴⁷ Jeff Pope and Margaret McKerchar, "Understanding Tax Morale and Its Effect on Individual Taxpayer Compliance" (2011) 5 *British Tax Review* 587, 592.

⁴⁸ *Ibid*

⁴⁹ BennoTorgler B, *Tax Compliance and Tax Morale* (Edward Elgar, 2007);

of tax justice that the research will mainly focus on. Tax justice involves tax procedural justice.⁵⁰ It encompasses issues related to ways in which tax disputes are resolved and a tax payer can disagree with a decision of a tax administrator and seek recourse to the legal system. This raises the issue whether a tax payer can have access to an independent dispute resolution procedure consistent with the definition of social justice.⁵¹

In the past, tax policy equity has dominated the debates in public policy consideration.⁵² However, tax procedural justice highlights the role of a legal system in designing policies that promote social justice.⁵³ The debate has mainly focused on efficiency, policy equity and tax reforms thus ignoring tax procedural justice. It is against this backdrop that the research explores tax procedural justice in KRA.

1.9. Literature Review

This study will endeavor to evaluate the efficacy of ADR (mediation) in resolution of tax disputes in Kenya. There is limited literature locally that focuses on alternative dispute resolution of tax dispute. The research will examine literature published from other jurisdictions. The study will be organized in various thematic areas as below.

Tax Compliance

James and Alley⁵⁴ in their article examine the importance of tax compliance with the development of electronic commerce and self-assessment. The authors define tax compliance. They argue that the existing definition of tax compliance is narrow to encompass the topic in full. The article describes the purpose of tax compliance and highlights factors that affect the willingness of taxpayers to comply with the tax system. The argument advanced is that caution should be shown when applying

⁵⁰ Binh Tran-Nam and Michael Walpole, "Independent Tax Dispute Resolution and Social Justice in Australia" (2012) 35 *UNSW Law Journal* 470.

⁵¹ *Ibid*

⁵² Frank Gilders, John Taylor, Michael Walpole, Mark Burton and Tony Ciro, *Understanding Taxation Law 2016* (LexisNexis Butterworths, 2015) 1091.

⁵³ Kristina Murphy, 'The Relationship Between Procedural Justice, Legitimacy and Tax Non-compliance' (2005) 32(4) *Journal of Law and Society* 562, 566.

⁵⁴ Simon James and Clinton Alley, "Tax Compliance, Self-Assessment and Tax Administration" (1999) 2(2).

penalties and focus should be on assisting taxpayers to meet their tax obligations. Devos⁵⁵ in his article examines empirical study carried out in Australian Taxation office. The author explores whether or not a relationship exists between the advices provided by tax professionals and the compliance behaviour of Australian taxpayers. The finding of the empirical study indicates that there is a significant relationship between the need for engaging tax professionals and compliance behaviour. The gap is that most tax compliance system fail to incorporate behavior and economic approaches. The articles are relevant to the research because the results will provide useful information for KRA tax dispute and have implications for tax development in Kenya.

Budak, James and Sawyer⁵⁶ in their article examine the experiences of tax simplification in eleven different countries. The argument advanced by the authors is that the call for simplification of taxation is heard but attempts to achieve actual simplification have rarely been met with lasting success. The article also explores other factors such as information on simplification in relation to tax system, taxpayer communication, tax law, and tax administration. The authors agree that a certain extent of degree of complexity is inevitable given aims of taxations and the social economic environment in which the tax system operates. They are of the view that it's important to distinguish complexity which is necessary for functioning of a successful tax system from that which is not. The article is relevant to the research because it focuses on the relevant factors and issues involved in classifying unnecessary and unavoidable complexity in respect to legislation, tax policy design and tax administrative systems.

The World Bank⁵⁷ note that the challenge of tax administration and tax dispute resolution is demanding. Investment climate survey conducted in sub-saharan Africa indicates that tax disputes and tax administration constitute a barrier to investment. Thus, a good tax system should pay attention to improving tax system to make it easy for investors to do business, lighten the bur den

⁵⁵Devos, Ken (2012) "The impact of tax professionals upon the compliance behavior of Australian individual taxpayers," Revenue Law Journal: Vol. 22 :Iss. 1 , Article 2. Available at: <http://epublications.bond.edu.au/rlij/vol22/iss1/2>

⁵⁶ Budak T, James S & Sawyer A 'International Experiences of Tax Simplification and Distinguishing Between Necessary and Unnecessary Complexity', eJournal of Tax Research 2017

⁵⁷ The World Bank, A Handbook for Tax Simplification, (2009) p. 4.

imposed on tax policy as well as tax dispute resolution. The World Bank recommends that governments should be cautious to cost imposed on taxpayers when complying with tax laws. This means that tax dispute resolution process should not be protracted or drains out time and resources of the tax authority and tax payers. The World Bank report is relevant to the research because it suggest ways of improving the efficacy of tax collection process and ensuring tax compliance. There is no doubt that taxpayers will always find and devise ways to avoid paying taxes. However, when there is trust between the tax administrator and taxpayer, there is conditional compliance. Ernst and Young⁵⁸ in their study report established that litigation is the worst case scenario for tax payers and tax administrators. This is because tax litigation is time consuming process and costly. They argue that developed and developing countries opt for ADR in resolving tax disputes because of efficiency, trust and voluntary compliance which is a crucial corner stone for an effective tax system. The report is important to the research because it informs why there is a wide spread adoption of ADR processes in resolving tax disputes.

Alternative dispute resolution in Tax Disputes

Tran-Nam and Walpole⁵⁹ argue that Tax dispute is an integral part of the operation of modern tax system. They argue that the availability of a fair, independent and impartial mechanism for tax disputes resolution between tax payers and revenue collection agency can be viewed as an indicator of advanced tax system of a country. They also argue that litigation cost for taxpayers engaging in tax disputes can be high especially if the services of professionals such as accountants and lawyers are engaged. The article is relevant to the research because it examines how high cost of litigation of tax dispute can act as a barrier to effective accessibility of external tax dispute resolution system and the neutrality of outcomes of disputes. This means that taxpayers with greater resources are better placed to obtain favourable outcomes than taxpayers with lesser resources.

⁵⁸ Ernst & Young, *Tax Dispute Resolution: A New Chapter Emerges*, (2010) P. 6

⁵⁹ Tran-Nam B & Walpole M, 2016, *'Tax disputes, litigation costs and access to tax justice'*, eJournal of Tax Research, vol. 14, pp. 319 - 336.

Tania⁶⁰ in her article argues that ADR processes are being used to deal with regulatory disputes involving government. The author examines use of ADR in disputes involving taxation and effectiveness of the process. The issue of procedural justice and perception of fairness is contrasted to the outcome of ADR tax disputes. The article is based on a study of selected cases involving Australian Tax payers that progressed to mediation and conciliation over a period of over twelve months. The article is relevant to the research because procedural justice factors can impact on the effectiveness of ADR process. Time taken and costs can affect perceptions of different participant of the dispute process.

Elliott and Moore⁶¹ in their article define alternative dispute resolution as a process that occurs when a third party is brought in with the agreement of both parties to a dispute to help parties reach amicable settlement. The authors take a look at the mediation process in United Kingdom and ways in which it can be used to help settled entrenched tax disputes. They are of the opinion that tax disputes can be resolved using ADR. They argue that facilitated mediation is the commonly used form of ADR. The article is relevant to the research because the article examine how disputes are resolved at the HMRC. The authors are of the view that mediation has been fruitful as a way of resolving tax disputes in small medium sized enterprises. They believe that there is a wide scope for application of mediation in large and complex tax disputes.

Lightman and Cullen⁶² in their article examine the scope of mediation in Tax disputes. They are of the opinion that there a number of special consideration to be taken in account when settling tax disputes. They attempt to differentiate application of mediation in private and public litigation. Private mediation can take a different stance with different defendants facing identical claims. However, this is not the position in public body. This is because public law requires fair and uniform application of the law with no preference for one tax payer over the other. In cases of revenue mediation, the tax tribunal should have regard of the principle of fairness and make it clear

⁶⁰ Sourdin, Tania, Dealing with Disputes About Taxation in a 'Fair' Way (2015).

⁶¹ Elliott K, and Moore S. Tax deadlock: The use of mediation to resolve disputes (2017)

⁶² Lightman G and Cullen F, "Mediation in Revenue Cases (2010) http://taxbar.com/wp-content/uploads/2016/01/Mediation_in_Revenue_Cases_FC.pdf.pdf accessed 28th February 2018.

what practice it follows with tax payers and justify any departure in application of principle of fairness. In private mediation, parties can enter into settlement which bears no relationship to the underlying merit of the dispute. There are mediators that believe that examination of the merits of a case has no part in mediation process. However, this cannot be the position of a public body in a public law dispute. This is because in such a dispute the underlying merit of a case must have same relevance as in a case of direct negotiations between the parties. Recourse to mediation should not change the rules or affect the outcome. This means a taxpayer should not be faced with a different outcome from another taxpayer because one and not the other had recourse to mediation. In private mediation, it is possible for the parties to keep the negotiations confidential. However, in public mediation the tribunal has to consider how far the public interest justifies disclosure of underlying dispute and terms of settlement. There is need to maintain public confidence in revenue system to avoid preferential treatment of favoured taxpayers. The article is relevant to the research because it highlight essential considerations to be taken into account when settling tax disputes. In revenue settlement, the merits of a dispute have a significant role to play. Thus the need for lawyers and mediators to understand the underlying principles and issues in tax disputes.

Parsly⁶³ in his article examines ADR approaches used by Internal Revenue Service (IRS) in United States. He discusses how the IRS has been able to meet demands for efficient tax administration by using mediation, arbitration and negotiation. The author examines the development of mediation as a flexible dispute resolution mechanism. The article is relevant to the research because it suggests recommendations geared towards enhancing efficacy, fairness and satisfaction in Tax disputes.

Muigua⁶⁴ in his article examines characteristics of ADR mechanisms. He argues that ADR is simple, flexible and accessible to parties when compared with formal dispute resolution mechanism. Though the article does not discuss use of ADR mechanisms in Tax disputes, it is still relevant because ADR is applicable to a wide range of disputes. ADR mechanisms emphasis on win-win

⁶³ David Parsly, [The Internal Revenue Service and Alternative Dispute Resolution: Moving from Infancy to Legitimacy](#) (2007). 677 *Cardozo Journal of conflict resolution*. <http://cardozojcr.com/vol8no2/677-716.pdf> Accessed 28 February 2018.

⁶⁴ Kariuki Muigua, *Settling disputes through ADR in Kenya*. Nairobi, (Glenwood Publishers Limited, 2012).

situation for all parties involved thus resulting to party satisfaction. In context of the research, ADR mechanisms open up different channels for tax payers to resolve their disputes with tax administrators without resulting to litigation.

Etia and Andrews⁶⁵ in their article examine Australian Tax Dispute resolution system. The taxpayer may seek review at Australian Tax office (ATO) or ADR. ADR was introduced as an extra forum because tax appeal procedure was slow, costly and adversarial. In 2007, Australia introduced ADR processes and procedures for managing tax disputes. The tax dispute resolution system recognizes mediation, neutral evaluation, case appraisal and conciliation.

In United Kingdom, mediation is introduced to resolve tax disputes as it is cost effective, consensual, and speedy. Mediation is preferred because it clarifies technical issues, narrows down the areas of disagreement and maintains good working relationships.⁶⁶ The tax dispute resolution in UK has separate procedural rules under the dispute settlement guidelines prepared by the tax authority HMRS. In South Africa, they have designed an efficient and effective tax dispute settlement scheme. Mediation is predominately used by taxpayers and tax administrators to resolve disputes outside the appeal procedure.⁶⁷

1.10. Chapter Break down

The study is broken down into the following chapters;

Chapter one focuses on the introduction and background of the study, the statement of problem, the research questions and objectives and the literature and theoretical framework.

Chapter two examines the regulatory framework governing tax disputes in Kenya. The main focus will be on Tax Procedure Act, 2015 and Tax Appeal Tribunal Act, 2013. The statutes were enacted to ensure uniform procedure in administration of tax disputes and enhance efficiency and consistency. The chapter will also discuss the gap in the regulatory framework.

Chapter three focuses on case studies and data analysis. The research will investigate an area of study

⁶⁵ Ron Jorgensen Etia & Harwood Andrews, "Objections and Written Tax Advocacy", *Taxation in Australia*, Vol. 45, (2011) pp. 362-370.

⁶⁶ HMRC, Annual Report and Accounts 2010-11, (2011).

⁶⁷ SARS, Guide on Tax Dispute Resolution, 2005 p. 14.

which the research intends to provide analysis of the topic being discussed. The research focuses on Nairobi as the area of study. The research analyses reactions of tax payers, tax consultants and lawyers. The case study carried out is based on information from tax payers and stakeholders who have reliable information. The information revealed help in revealing the situation on the ground with regards to research being conducted. Chapter four is a comparative study of United Kingdom. The chapter will also look at various mechanisms that are in place in HMRC and recommend what Kenya can learn. Chapter five sums up the discussions and makes recommendations based on case study and other information collected. The recommendations focus on KRA alternative dispute resolution mechanisms in hope that the information gathered can be used to improve resolution of tax disputes. The recommendations cover all aspect of the research conducted and the stand that the research takes based on the findings

CHAPTER TWO

2.0 Regulatory framework governing Tax Disputes

2.1 Introduction

The chapter examines the current regulatory framework governing tax dispute in Kenya. First part will highlighting the historical development of tax disputes from independence. The second part will examine the nature of tax disputes arising from tax cases in Kenya and recent legislative reforms in tax statutes.

2.2 Tax Disputes in Kenya

Since independence, resolution of tax disputes has been adversarial. The legal framework only provided two avenues for resolving disputes.⁶⁸ An aggrieved party could canvass the tax disputes before the Court of law or tribunal. In addition, disputes would be assessed through the objection procedures in tax statutes. The tax statutes in place provided an opportunity for taxpayers to agree on tax assessments with the revenue authority in order to reach amicable settlement.⁶⁹ The legal framework governing tax disputes has not been effective in resolving disputes between taxpayers and tax authority. This is why there have been major reforms in statutes governing tax matters. The Constitution stipulates that courts and tribunals should be guided by certain principles whenever they are exercising judicial authority. One of these principles is alternative forms of dispute resolution should be promoted.⁷⁰

2.2.1 Nature of tax disputes arising from tax matters

Tax disputes are unavoidable in taxation. Tax dispute between a taxpayer and a tax authority relates to tax assessment, tax declaration, audit and collection. Dispute inhibits tax authority and taxpayer from working together thus making the taxation and business ineffective. In cases where tax disputes are handled well, it helps identify problems that need resolution without threatening

⁶⁸ Waris, A. 'Taxation without Principles: A historical Analysis of the Kenyan Taxation System' (2007) Vol 1 Kenya Law Review <http://www.kenyalaw.org/Downloads_Other/waris_taxation.pdf> Accessed on 23rd April 2018

⁶⁹ Ibid.

⁷⁰ Constitution of Kenya Article 159.

stability of the relationship between tax authority and taxpayers.⁷¹ Therefore, efficient and effective tax disputes resolution mechanisms minimizes destructive elements in a dispute and promote good working environment.⁷² The nature of disputes arising from tax matters in Kenya includes the following.

Tax disputes involving assessment where the taxpayer and the Commissioner are disagreeing on the amount to be assessed as tax. Dispute can arise in relation to what is allowed or disallowed with regards to treatment of expenses. Collection proceedings in which the Commissioner can collect tax due through agency notices.⁷³ For example the Commissioner can resort to financial institutions holding monies belonging to a taxpayer and require them to pay such monies to the tax authority in settlement of a tax obligation.

There are also disputes relating to the Commissioner interpretation of statute. The tax authority has taken certain position in respect to different provisions of law. In most cases, taxpayers are required to conform to tax affairs in accordance to the Tax authority position. This has given the Commissioner an array of administrative power when it comes to applying tax law.⁷⁴ In most cases, the tax authority position is contentious and unacceptable to the taxpayer. This necessitates the need to seek remedy before a court of law in order for the court to interpret the law.

Disputes arising from failure of a person to execute their mandate either by omission or willfully. The tax regulatory framework provides provisions that place obligations on persons to collect and account for tax on behalf of tax authority.⁷⁵ A person making payment of fees for certain professional services are expected to deduct and remit to tax authority withholding tax. This must be done at the correct rate since different rates apply to different services. The person must account

⁷¹ Waris, A. 'Taxation without Principles: A historical Analysis of the Kenyan Taxation System' (2007) Vol 1 Kenya Law Review <http://www.kenyalaw.org/Downloads_Other/waris_taxation.pdf> Accessed on 23rd April 2018

⁷² Ibid.

⁷³ Ibid.

⁷⁴ Ibid.

⁷⁵ Waris, A. 'Taxation without Principles: A historical Analysis of the Kenyan Taxation System' (2007) Vol 1 Kenya Law Review <http://www.kenyalaw.org/Downloads_Other/waris_taxation.pdf> Accessed on 23rd April 2018.

to tax authority and file a number of returns in order to be tax compliant. For employers, they have an obligation to collect PAYE from salaries of their employees. The employer is expected to collect the correct amount and remit them before the due date. There is also an obligation to file returns in order to comply with the law. VAT also imposes an obligation on a person. VAT tax is charged on the person purchasing goods and services. The tax is collected on behalf of the tax authority by the person offering the services or selling the goods and the person is expected to account and file required returns. The kind of disputes that arise around the area of tax obligations include failure to charge or deduct tax on behalf of taxing authority, failure to comply with the correct rate, failure to remit amount collected and failure to file returns or filing them after the due dates.

Disputes relating to administrative action are also common. This relates to matters in which the taxpayer challenges the decision making process of the taxing authority. Commissioners are required to make numerous decisions on a day to day basis in order to actualize the mandate of KRA.⁷⁶ They determine how the enacted law should be applied in different business carried out by the taxpayer. In most cases, the law provides a framework and does not provide how all matters are to be dealt with. This means the commissioner is left with discretion to administer tax laws. Thus, the decisions of the commissioner are likely to aggrieve taxpayers who may not agree with their decisions. This mean there is need to fair administrative action when commissioners are applying their direction in decision making.

2.3 Tax disputes resolution under different statutes

In the past, the regulatory framework provided for dispute resolution through respective statutes. The research will mainly discuss tax dispute resolution mechanisms under the Income Tax, East Africa Community Customs Management Act, Customs and Exercise Act and Value Added Tax Act. In 2015, the TPA 2015 repealed the provisions relating to resolution of disputes in the above statutes and consolidated the dispute resolution mechanisms in TPA.

⁷⁶Ibid.

2.3.1 Income Tax Act, CAP 470

The dispute resolution under Income Tax Act revolved around charge of tax, refusal to grant allowances and deductions, imposition of penalties, challenge of administrative decisions and assessments.⁷⁷ Matters related to dispute resolutions were set out under Objections, Appeals and reliefs for mistakes.

Section 82 provided that the minister had power to appoint a local committee that that resolved a dispute.⁷⁸ A taxpayer dissatisfied with an assessment made an objection in writing by notice to the commissioner.⁷⁹ The notice was to be given within thirty days of service of an assessment. The time for filing an objection could be extended by the commissioner if the objector showed good cause. The taxpayer objecting was required to first pay the tax due before being heard by the local committee. The decision of the local committee on the tax dispute was final.

In respect to the objection notice, the commissioner had three options. The commissioner had an option of amending the assessment in accordance of the objection lodged. The second option was to amend the assessment in light of the objection lodged but in accordance with the commissioner discretion. Third option was to decline the objection in its entirety and the commissioner issued a confirmation notice.⁸⁰

The dispute resolution procedures envisaged appeal to the High court as well as the court of appeal. It is evident that the income tax act adopted an adversarial system in tax dispute resolution. This informed the repeal of section 83 of Income Tax Act and deleting of section 84 to 91A. The aim was to give room for incorporation of alternative dispute mechanisms in managing income tax disputes.

⁷⁷ Income Tax Act Cap 470.

⁷⁸ Ibid.

⁷⁹ Income Tax Act Cap 470 Section 83.

⁸⁰ Income Tax Act Cap 470 Section 84- 87.

2.3.2 Tax Appeals Tribunal Act (TATA) 2013

The act was enacted to make modifications to the existing tax statutes in relation to dispute resolution in order to expedite the process by setting timelines and procedures. The act consolidated all provisions in tax statutes that deal with tax appeals.

The act introduced a Tax Appeals Tribunal that replaced previous appeals systems. The role of the Tax Appeals Tribunal is to hear any appeal against any tax decision made by a commissioner under any tax statute.⁸¹

The tribunal is required to submit an annual report to the Cabinet secretary detailing the performance in a financial year. The requirement ensures that the tribunal is accountable for its performance and ensures reduction of backlog.

An appeal commence by filing notice of intention to appeal.⁸² The person appealing is required to pay a non-refundable fee of twenty thousand shillings. The appellant is required to file a memorandum of appeal and tax decision being appealed against within fourteen days after presenting notice of intention to appeal. The Commissioner responds to the appeal within thirty days after being served with the appeal. The commissioner file statements of facts, reasons for the tax decision and all relevant documents necessary for review of the decision by the tribunal.

In the tribunal, the burden of proof is on the appellant. The Act gives powers of the subordinate to the tribunals. The tribunal has powers to punish for contempt, issue summons, call witnesses, order stay of execution and award cost and direct them to be taxed in accordance with the law.⁸³

The tribunal is expected to render its decision within ninety days from the date the appeal was filed.

The tribunal can deliver its decision in three different ways which include ; affirm the decision under review, vary decision under review or set aside the decision under review by making a decision to substitute of the decision in order to set aside or refer the matter to the commissioner for

⁸¹ TATA 2013.

⁸² Ibid section 12.

Ibid 13.

⁸³ Ibid section 20.

reconsideration in accordance with the direction of the tribunal. A party dissatisfied with the decision of the tribunal may appeal to the High court.⁸⁴

The act is relevant to the research because it introduces ADR in tax disputes. Section 28 of Tax Appeals Tribunal Act provides for power of the tribunal to enter into settlement where parties have reached amicable settlement out of the tribunal.

2.3.3 Tax Procedure Act (TPA) 2015

TPA was enacted to harmonize and consolidate procedural rules for the administration of tax laws. The Act provides a uniform and consistent procedure for resolving disputes across different tax statutes. The research has highlighted that different tax statutes had a different dispute resolution platform. This meant that different tax statutes had different procedures on matters relating to tax dispute resolution. The act aimed to consolidate the procedures of resolving tax disputes in one statutes making dispute resolution effective and efficient.

Section 51 of the Act provides the procedure for lodging an objection against a tax decision of the commissioner.⁸⁵ The taxpayer is required to file an objection in writing within thirty days of being notified of the decision. The Notice must contain grounds of objections and in cases of assessment the taxpayer is required to pay the amount that is not in dispute. The taxpayer may apply for extension of time to lodge a notice of objection. After lodging the objection, the commissioner is expected to make an objection decision within sixty days, failure to make a decision the objection shall be allowed.⁸⁶

A party that is dissatisfied with the decision of the commissioner, they may appeal to the Tax Appeals Tribunal. In cases where a taxpayer is dissatisfied with the decision of the Tax appeal tribunal, they may appeal to the High Court within thirty days. If the taxpayer is dissatisfied by the decision of the High Court, they may appeal to the Court of Appeal only on the point of law. The

⁸⁴ Ibid Section 32.

⁸⁵ TPA 2015.

⁸⁶ Ibid Section 32.

act is relevant to the research because it introduces ADR in tax disputes. Section 55 of the Tax Procedures Act gives parties an avenue to resolve their disputes out of court or the tribunal.

2.4 KRA ADR Framework

In June 2015, KRA published ADR Framework to guide resolution of tax disputes through ADR. The framework finds legal backing in Article 159(2) of the Constitution which has been discussed in details in the previous chapter. The Courts and Tribunals are required to promote ADR mechanisms in dispute resolution. Section 55 of the Tax Procedures Act gives parties an avenue to resolve their disputes out of court or the tribunal. The framework also finds backing in section 28 of Tax Appeals Tribunal Act which provides for power of the tribunal to enter into settlement where parties have reached amicable settlement out of the tribunal.

The objective of the KRA ADR framework is to provide focused approach to tax disputes by giving parties an opportunity to seek early dispute resolution. As previously discussed in the chapter, it is clear most of the avenues available in different tax statutes have been adversarial and do not put the interests of the taxpayers at heart. KRA ADR framework provides internal structures and processes which support tax disputes resolution through oversight, monitoring and management of ADR processes.

ADR under KRA framework is voluntary and it may be initiated by the taxpayer or the commissioner. A party is at liberty to refer any tax dispute pending before the Tax Appeals Tribunal or Court to ADR mechanism. The party making the request is required to deliver a written request accompanied by a settlement proposal to the other party. The other party has an option of either to accept or decline the settlement proposal. Where parties have reached amicable settlement they are expected to inform the tribunal or court accordingly. The parties are also at liberty to apply for stay of hearing before the tribunal to allow the ADR process to proceed. In cases where a tax dispute has been referred for ADR, the parties have ninety days to reach an agreement and revert to the tribunal or the Court to record the agreement.

2.5 Specific challenges

There are specific problems associated with the regulatory framework governing tax disputes in Kenya that necessitate the study. The research examines the constitution and statutory provisions.

The constitution envisages broad application ADR. Article 159 provides for alternative form of dispute resolution mechanisms which include reconciliation, mediation, arbitration and traditional dispute resolution mechanism. The KRA ADR framework identifies facilitated mediation as the only form of ADR to be used in resolving tax disputes. The framework is restrictive as it does not contemplate adoption of the different forms of ADR mechanisms that can be used to resolve tax disputes. Therefore, the KRA framework limits the tax payer from enjoy the variety of ADR mechanisms available especially in cases where mediation fails or is not preferred by the disputants. Restriction on use of facilitated mediation limits access to justice to the disputants. The constitution guarantees access to justice to all.⁸⁷ It can be argued that providing facilitated mediation as the only form of ADR mechanisms in tax disputes restricts access to justice. This is because the framework fails to give disputations other forms of ADR when they are not keen on using facilitated mediation. Muigua argue that ADR is broad and applies to all disputes. This is an indication that ADR is accepted as mean of resolving variety of disputes.⁸⁸ The current framework lacks appreciation of applicability of ADR in different disputes. The research appreciate that not all ADR mechanisms are applicable in resolving tax disputes.

In addition, the KRA framework lacks legal basis in terms of substantive provision of the law. It is considered as a KRA policy and is non-binding. The KRA framework is confusing and devalues ADR. On the preamble, the policy advises parties to rely on substantive law.

The framework lacks structures that provide for equality and equity during the ADR process. Such structures prevent abuse of the process and preferential treatment of cases. The issue of good governance, integrity and accountability arise by virtue of the fact that KRA would in some cases

⁸⁷ Constitution Article 48.

⁸⁸ Kariuki, Muigua. "Alternative Dispute Resolution and Article 159 of the Constitution." In: Legal Resource Foundation Trust, Programme for Judges and Magistrates Training. Lake Baringo Soi Lodge; 2012..

forego taxes in a bid to reach amicable settlement. The fact that the taxes foregone are public funds, the officials need to be transparent and accountable when it comes to reaching amicable settlement. This would require accountability from another institution to ensure that settlement is justifiable. The framework fails to provide for accounting authority meaning that KRA is accountable to itself. The constitution provide that no tax or license fee may be imposed or waived or varied except as provided by statute.⁸⁹ This means that KRA must collect all taxes imposed or assessed and cannot vary any amount unless provided by law. The challenge is that during negotiation, parties must compromises in order to reach amicable settlement. Thus the commissioner may be required to vary different taxes in order to reach settlement and save time and costs. The challenge is that the variation by the commissioner in ADR process would be contrary to the constitution. There is no provision in tax statutes granting the commissioner power to reach amicable settlement when collecting revenue.

Under statutory law, reference will be made to Tax Appeals Tribunal Act and Tax Procedure Act.

Tax Appeals Tribunal Act section 28 provides that:

“Power of the Tribunal where the parties reach agreement (1) The parties may, at any stage during proceedings, apply to the Tribunal to be allowed to settle the matter out of the Tribunal, and the Tribunal shall grant the request under such conditions as it may impose. (2) The parties to the appeal shall report to the Tribunal the outcome of settlement of the matter outside the Tribunal.”⁹⁰

Tax Procedure Act section 55 provides that:

“Settlement of dispute out of Court or Tribunal (1) Where a Court or the Tribunal permits the parties to settle a dispute out of Court or the Tribunal, as the case may be, the settlement shall be made within ninety days from the date the Court or the Tribunal permits the settlement. (2) Where

⁸⁹ Constitution Article 210.

⁹⁰ Tax Appeals Tribunal Act section 28.

parties fail to settle the dispute within the period specified in subsection (1), the dispute shall be referred back to the Court or the Tribunal that permitted the settlement.”⁹¹

The above provisions are critical to the research because they are instrumental in establishing a framework for ADR. They make provision of initiating out of the tribunal settlement. However, the position taken in the research is that the provisions are not adequate in providing guidance on use of ADR. The regulatory framework fails to give prominence to ADR and instead provide for formal dispute resolution mechanisms. The provision of TPA empathizes on formal court system. There is no express mention of adoption of ADR mechanism. The position of the research is that the legal framework fails to make sufficient use of ADR opportunities in resolving tax disputes.

The provisions above are narrow and only provide for exploration of out of tribunal settlement. This means that parties have an opportunity to use entire spectrum of ADR mechanisms suitable to resolve the tax dispute. However, the KRA framework restricts the ADR mechanism to facilitated mediation. The position of the research is that the KRA framework restricts parties on the available ADR mechanisms.

2.6 Conclusion

The chapter examined the regulatory framework governing tax disputes in Kenya. In addition different types of disputes that arise in the course of tax collection in Kenya were discussed. The subsequent chapter will investigate the effectiveness of the ADR framework in resolution of tax disputes in Kenya.

⁹¹ Tax Procedure Act section 55.

CHAPTER THREE

3.0 Case Study and Data Analysis

3.1 Introduction

This chapter is divided into two. The first section will mainly focus on research methodology followed by data analysis and presentation. The case study is an area of investigation on which the research hopes to illuminate and provide analytical frame to the topic being discussed. The research seeks to find out the effectiveness of ADR in solving tax disputes.

3.2 Research methodology

Methodology is a body of knowledge that enables researchers to explain and analyses methods, indicating their limitations and resources, identifying their presuppositions and consequences, and relating their potentialities to research advances.⁹²

The research used survey questionnaire which involves asking a number of individuals the same type of questions. Hansel argue that survey research usually seek to provide empirical data collected from a population of respondents on a whole number of issues.⁹³ In the research, the questions posed to respondents were designed in such a way they would generate pragmatic responses. There were two set of research questions administered to tax payers and tax professionals.

Professor Mugenda argues that survey research involves the collection of quantifiable information.⁹⁴ The research employed survey research because it was suitable for answering evaluation questions and gathering data from information provided by the respondents themselves and also the sample was large and therefore survey was deemed the most appropriate technique to obtain data from such a sizable population.

⁹² Miller, D. (1983), Handbook of Research Design and Social Movement (4th edition), London: Longman.

⁹³ Hansel D, Mato G, Meunier C, Neltner L (1998) Numerical simulations of integrate-and-fire neural networks. *Neural Comp.* 10:467– 483.

⁹⁴ Mugenda, O.M. and Mugenda, A.G. (1999) *Research Methods: Quantitative and Qualitative Approaches*. Acts Press, Nairobi.

3.3 The Target Population

Wimmer and Dominick⁹⁵ define population in a research study as ‘a group or class of subjects, variables, concepts or phenomena’ from which a researcher seeks to study. A population therefore refers to an entire universe or subject to be studied. For instance this research sought to establish the efficacy of ADR in resolution of tax disputes in Kenya. In this case the population or universe under study is all tax payers having tax disputes with KRA. However, since it is not practical to sample all citizens having tax disputes with KRA in Kenya, the researcher narrowed down to a target group in Nairobi from whom a sample was chosen for the study.

Data was therefore obtained from a sample made up of 30 taxpayers residing in Nairobi, 10 members of staff from corporate tax resolution division of KRA and 10 advocates or tax consultants practicing in Nairobi. The reason why Nairobi was chosen is because many tax disputes are resolved at KRA headquarters.

Wimmer and Dominick⁹⁶ argue that ‘a sample is drawn from a homogeneous subset of the population that has similar characteristics.’ The choice to sample 30 taxpayers residing in Nairobi, 10 members of staff from corporate tax resolution division of KRA and 10 advocates or tax consultants practicing in Nairobi is informed by the fact that need sampling help ensure that an appropriate mix of respondents is surveyed so that the results are seen to reflect more accurately the population under study.⁹⁷

3.4 Data Collection

Data collection is the process of gathering information from the selected sample using the chosen data collection instrument.

The research aimed to generate quantitative data, and the most suitable tool for data collection was the use of survey questionnaire. The questionnaire as a method of data collection is easy to administer, can cover many respondents within a short period and is low cost. Hansel agree that the

⁹⁵ Wimmer, R. D. and Dominick, J. R (2011) *Research: An Introduction*. United Kingdom: Wadsworth.

⁹⁶ Ibid.

⁹⁷ Hansel D, Mato G, Meunier C, Neltner L (1998) Numerical simulations of integrate-and-fire neural networks. *Neural Comp.* 10:467– 483.

questionnaire is the most efficient tool for gathering survey research as ‘it standardizes and organizes the collection and processing of information.’⁹⁸

In this study 50 respondents were issued with the self-administered questionnaires that they filled on their own in the presence of the interviewer.

3.5 Data Analysis and Presentation

Since the data that was generated was quantitative and qualitative, it was analyzed quantitatively. The questionnaires were sorted and checked for completeness after which the completed questionnaires were coded and keyed of into a computer for data entry and analysis done on statistical package for social sciences. The programme was able to statistically organize and summarize the data by establishing the different associations and relationships of the key variables under the study and to graphically present these relationships through the use of descriptive statistics such as frequency distribution tables, graphs, pie-charts bar graphs and percentages.

3.6 Results and findings

The research reports on the findings of a survey conducted on ADR Practitioners at KRA pilot project and taxpayers.

3.6.1 Sample 1 Characteristics

The first question on the questionnaire asked practitioners whether they had taken in KRA pilot project and whether from their experience the ADR process allowed for personal interaction between the KRA and taxpayer. All the 20 practitioners had taken part in the KRA ADR pilot project. The practitioners are of the view that introduction of mediation in settling tax disputes will go a long way in ensuring tax compliance.

Table 1: Participation in the ADR process

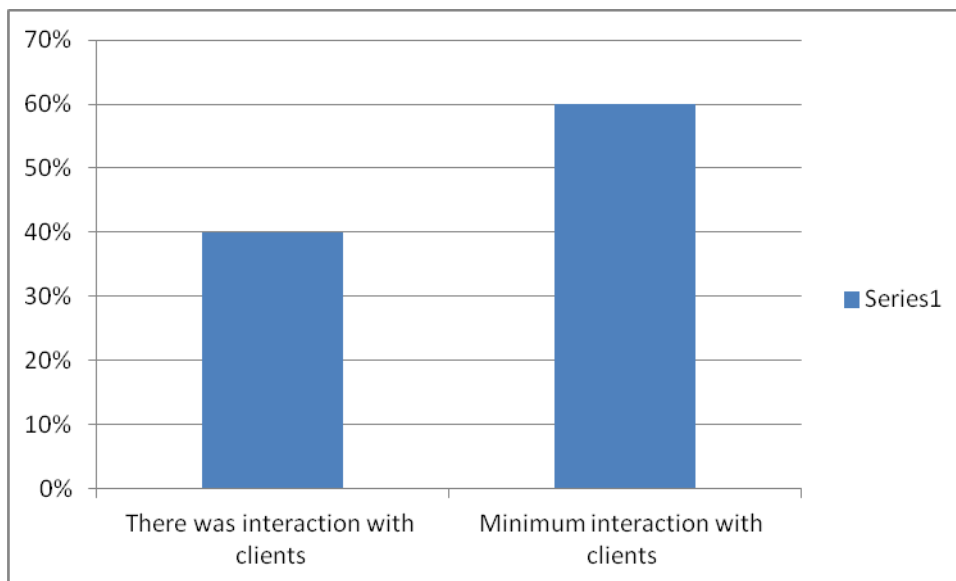
Practitioners in KRA ADR pilot project	How many have participated in the ADR
--	---------------------------------------

⁹⁸ Ibid.

	process in resolution of tax disputes.
10 Members of staff from corporate tax resolution division	10
10 Advocates or tax consultants	10

It is worth noting that 12 out of the 20 practitioners interviewed indicated that there were minimum interactions with KRA officials. This affected the outcome of negotiations because many clients believed their interest were not considered during negotiations. Clients preferred to go through the court process where they would win or lose than settle in KRA ADR process where the tax authority has no room for compromise. The clients are ready and willing to engage in the KRA mediation process if the outcome of negotiation is a win for each party.

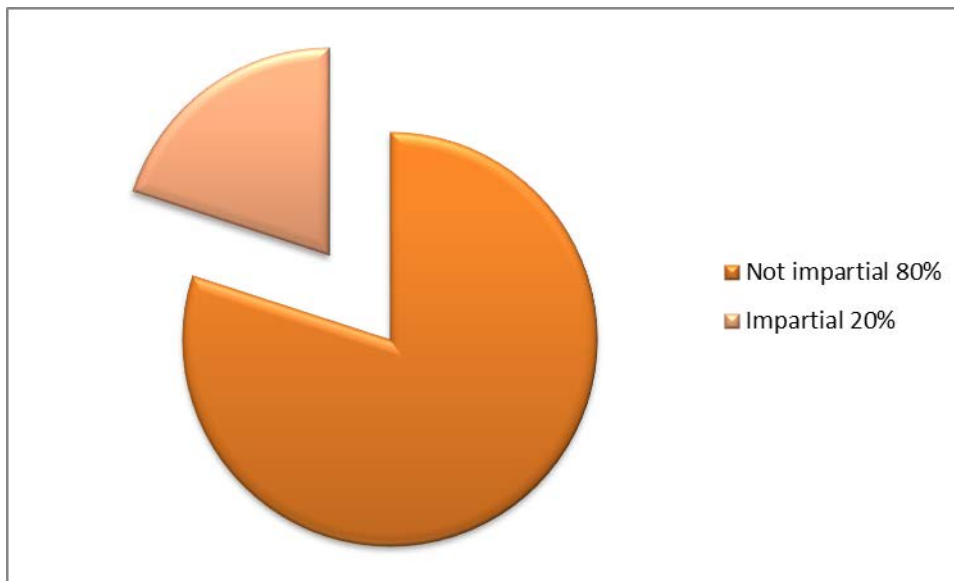
Table 2: Interaction with clients



Another observation is that all the 20 practitioners were of the view that the clients were well informed of the KRA ADR process. However, 16 out of the 20 practitioners were of the opinion that KRA officials negotiating on behalf of the tax authority were impartial and in some cases they had limited authority to settle cases. All 20 practitioners were of the view that it took an average of one year to settle a tax dispute through the KRA ADR process. The timelines for settling tax

disputes has reduced considering in the past the average elapsed time direct tax disputes are two years.

Table 3: Impartiality in the ADR process



As regards the outcome of cases where ADR was applied, 60 percent were successfully resolved, 30 percent unresolved and 10 percent partially resolved. The practitioners were of the view that the ADR project is experiencing challenges. The challenge of attitudinal change is alive to disputants taking part in the ADR process. From the initial stages, parties are reluctant to take part in ADR. There are parties that engage in ADR to try evaluate whether they can win and the other party cannot. The tax authority has power to secure payment from the tax payer whenever it deems it necessary which may amount to abuse of the ADR process. KRA is willing to take part in ADR process and at the same time force taxpayers to pay the assessed amount before parties engage in negotiations. In that sense, ADR as a mode of settling tax dispute become a failure. The public and private sector is not sufficiently infused with the spirit of resolving tax disputes through ADR. There is a need to redefine win-win philosophy of ADR from the perspective of the taxpayer and KRA. This is informed by the fact that the win-win philosophy should take into account all relevant circumstances of the parties. There is need to have benefits that will accrue to both the taxpayer and KRA when they forfeit some interests during settlement. Therefore, winning a tax dispute does not mean winning a case after long and expensive adversarial process. Thus, the need to understand the

broad advantages of ADR in tax disputes. Parties taking part in the ADR process need to observe the underlying philosophy of ADR. It is not enough to have KRA ADR framework and relevant tax laws enacted and amended, it is necessary to have our attitude readjusted.

The lack of trained ADR practitioners is another challenge in implementation of KRA ADR pilot project. Efforts to provide cheaper and better methods of resolving tax disputes require skilled ADR practitioners who play a critical role in guiding proceedings towards a fair solution. Kenya school of law train students for litigation system than for the art of reconciliation thus hindering growth of ADR profession. It is time for law school to incorporate ADR in their academic curriculum and take lead in training professionals in ADR in order to curtail shortage of ADR practitioners representing clients in tax disputes.

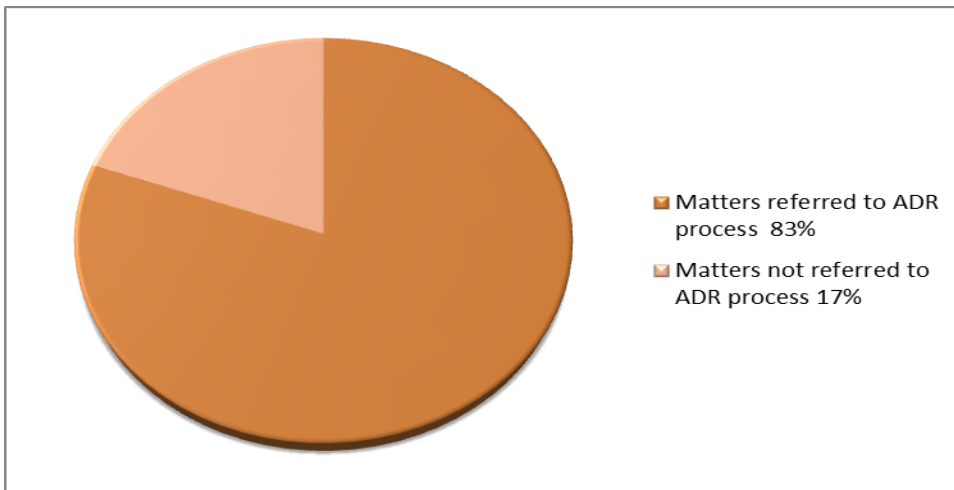
Corruption is present in both public and private forums of dispute resolutions. The privatization of tax disputes by KRA may further encourage corruption practices. Taxpayers and KRA officials may bargain against the interest of the public. This kind of corruption can reduce tax revenues that can affect fiscal sustainability. Therefore, introduction of ADR framework may pose a challenge to KRA which tend to be exposed to corruption. There is need to eliminate corruption in tax administration by designing corruption controlling mechanisms that are integrated with anti-corruption agency EACC.

The terms and condition of ADR should state clearly who will participate in the tax dispute on the behalf of KRA and who decide to accept or reject an outcome of ADR. The outcome of ADR should be subject to supervision and audit by separate independent body.

3.6.2 Sample 2 Characteristics

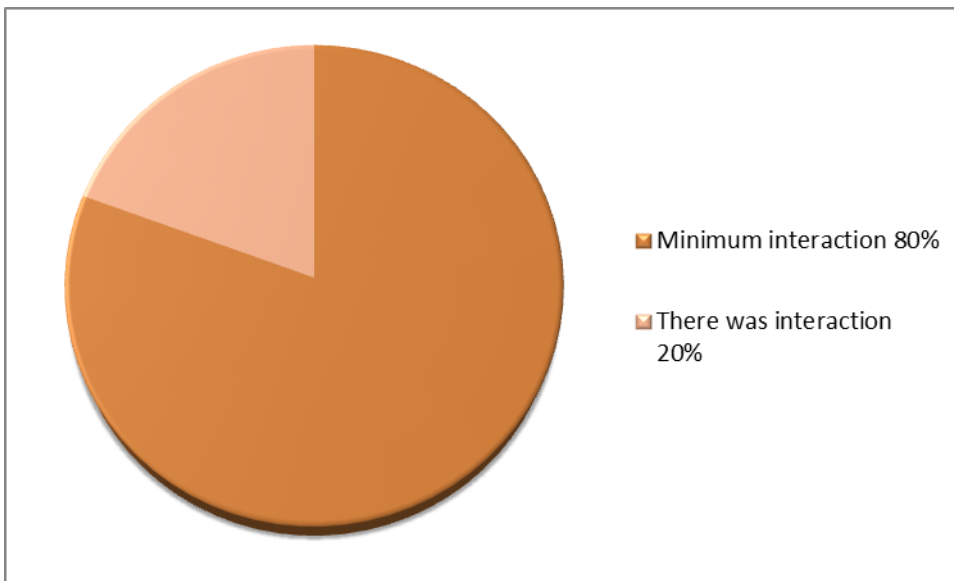
The research also interviewed 30 taxpayers residing in Nairobi. All the respondents were directors of companies operating in Nairobi. On the question of whether they have had disputes with KRA, the research revealed that 30 of the respondents had tax disputes with KRA. 83% of the respondents had their matters referred to ADR.

Table 4: Matters referred to ADR process.



On the question of whether they had personal interaction with KRA and well informed of the ADR process, 80% of the respondents indicated that there was minimum interaction with the officials and they were not well informed of the ADR process. As a result they had to hire expensive lawyers and tax consultants to represent them.

Table 5: Impartiality of the ADR process



When asked how long the ADR process took, 80% of the respondents indicated that the dispute took over 18 months to be resolved while 20% indicated that their matter took less than 1 year to be resolved. On the question of whether the tax dispute was resolved 80% of respondent indicated that their dispute were successfully resolved, 12% of the respondents indicated that their matter was partially resolved and 8% respondents indicated that their matters remain unresolved till to date.

On the question of impartiality, all the respondents agreed that the officials were impartial when handling tax disputes. 60% of the respondents were of the opinion that the ADR process may be open to manipulation due to lack of check and balances. 70% respondents agreed that the ADR process was effective and there is room for improvement.

3.7. Summary of Findings of the Study

The first objective of the study sought to evaluate the efficacy of regulatory framework governing ADR in resolution of tax disputes in Kenya. The findings of the study revealed that to some extent framework is not effective. This is informed by the fact that KRA officials negotiating on behalf of the tax authority were impartial and in some cases they had limited authority to settle cases.

The second objective of the study sought to find out challenges tax payers and KRA face when resolving disputes through ADR mechanisms. The findings of the research revealed that use of mediation in settling tax disputes reduced the timelines from two year to one year. In addition majority of tax disputes were resolved.

The third objective was to examine the extent to the current ADR channels are adequate in resolving tax disputes. The findings of the study revealed that mediation as alternative dispute resolution mechanisms is adequate in resolving tax dispute.

From the finding of this study, some conclusions can be drawn. First, many taxpayers and stakeholders have come to embrace mediation in solving tax disputes. Despite this, many people are not familiar with the mediation process. Secondly, there is minimal interaction with the disputants which affect voluntarily and compliance issues. Thirdly, the issue of impartiality and the process subject of manipulation due to lack of elaborate regulations. Fourthly, there ADR process has reduced the timelines of resolving tax disputes however its experiencing challenges that can be overcome.

CHAPTER FOUR

4.0 Comparative Study

4.1 Introduction

The research seeks to find out the effectiveness of ADR in solving tax disputes. The jurisdiction to consider is United Kingdom. This is because HMRC has tax laws which govern Assessments, Objections and Appeals and at the same time incorporate use of ADR in tax disputes. The research will then analyze KRA ADR framework and how it has been institutionalized and what we can learn from UK Alternative Dispute Resolution process in tax cases. In addition, the research will highlight briefly arguments advanced by academic scholars focusing on use of ADR in tax dispute resolution.

4.2 UK Alternative Dispute Resolution Process in Tax Disputes

Tax dispute resolution system in United Kingdom is similar to that in Kenya where appeals from a determination made by HMRC are first dealt with by an administrative tribunal, if parties are dissatisfied they can appeal to the Courts.⁹⁹ The HMRC determines the amount payable and the excess amount is returned. An enquiry is conducted as to the tax returns filed by the taxpayer from one year to another. Where there is a disputed amount that is payable, the taxpayer may file an appeal to the Tax Chamber of the first tier Tribunal. If a taxpayer is dissatisfied with the decision of the tribunal, they may file a further appeal to the Tax and chancery chamber of the Upper Tribunal, The court of Appeal or the Supreme Court deal only on points of law. In complex tax cases, an appeal maybe filed directly to the Upper Tribunal after the determination of HMRC. There is no doubt that the tax dispute resolution process in United Kingdom is complex and there are significant delays in resolution of disputes. In 2011, HMRC took pro-active efforts to resolve tax disputes through ADR mechanism such as facilitation, mediation and private settlement.¹⁰⁰

HMRC is focused in making the tax system simple and accessible to taxpayers. In furtherance of its mandate, HMRC has published the Taxpayers Charter that set out both rights and responsibilities of

⁹⁹ Section 11 of the Tribunal Courts and Enforcement Act, 2007.

¹⁰⁰ David Luban, "Settlements and the Erosion of the Public Realm", 83 Geo. L.J. 2619.

taxpayers. It is through the corroborative approach adopted by HMRC that led to adoption of ADR in the Tribunal Procedure (First tier tribunal) (Tax Chamber) Rules of 2009 which encouraged parties to consider ADR in solving tax disputes.¹⁰¹

In addition, HMRC has adopted a risk based approach in dealing with tax avoidance rather than focusing on a particular industry. This mean that HMRC is able to deal with complex tax risks efficiently, while at the same time improving its relationships with large businesses. The Litigation and Settlement Strategy provide guidance on resolution of disputes between taxpayers and HMRC. The HMRC is required to adopt a collaborative approach when resolving tax disputes. Therefore, where HMRC believe litigation may lead to a successful outcome, they will not settle the dispute out of court for less than the tax payable and in cases where the taxpayer is not willing to concede during the ADR process, it will attempt to attempt to resolve the dispute efficiently through litigation.¹⁰²

Low risk companies have been given light touch measures such as suspending all pending penalties against taxpayers, where there has been careless omission or errors on condition that they comply with conditions imposed by HMRC.¹⁰³ This encourages behavioral change and long term investment in improving compliance and accountability as opposed to focusing on revenue allocation. HMRC collaborates with taxpayers in order to achieve compliance. The confederation of British industry published principles providing for ideal tax conduct of companies which encourage transparency and cooperative compliance with HMRC.¹⁰⁴

In addition, the judicial system in United Kingdom encourages alternative dispute resolution. The Civil Procedure Rules contain specific rules that direct courts to encourage parties to use ADR

¹⁰¹ SI 2009/273 Tribunal Rules available at www.justice.gov.uk/downloads/tribunals/tax/consolidated_fttcrules2009-060710 accessed 4th June 2018.

¹⁰² Stipanowich, Thomas, The Multi-Door Contract and Other Possibilities (March 4, 2012). Ohio State Journal on Dispute Resolution, Vol. 13, No. 2, 1998. Available at SSRN: <https://ssrn.com/abstract=2015805>

¹⁰³ How Companies with unresolved issues with HMRC settle their disputes, see High Risk Management corporate Programmes available at www.gov.uk/largebusiness/proramme.com accessed 4th June2018.

¹⁰⁴ Ibid.

processes in order to achieve fair and expeditious settlement of disputes.¹⁰⁵ There are instances when courts have placed costs sanctions on applicants who refuse to consider ADR mechanism to settle their disputes.

The United Kingdom government departments and agencies are committed to settle legal disputes through arbitration or mediation whenever the other party is agreeable to negotiation. This means that litigation is resorted to as the last resort. The Solicitor Regulation Authority code, solicitors are expected to educate their clients the available option of ADR that can be used to settlement disputes.¹⁰⁶

There is an enabling environment that promotes ADR. HMRC approach of collaborative dispute resolution has been met by positive response from taxpayers. This is because litigation may be expensive and time consuming. Thus, settling tax dispute through ADR is favorable to the taxpayer. ADR is recommended at the earliest stage of dispute in order to avoid costs.¹⁰⁷

The LSS provides ADR mechanisms and mediation is preferred as a mode of dispute resolution mechanisms. In addition, LSS make of ADR mechanisms such as facilitative mediation, Evaluative mediation and non-binding neutral evaluation.¹⁰⁸

Facilitated mediation is preferred approach in pre-litigation settlement of tax disputes since evaluative and neutral evaluative mediation tend to duplicate the role of courts and tribunals. Since the year 2011, HMRC launched a pilot project for evaluating the benefits of implementing ADR in tax disputes. In this project, an HMRC official unrelated to the particular tax dispute would as an independent mediator try to settle the disputes. The finding of the pilot project indicates that it has been successful with respect to small business and individual taxpayers. The statistics indicate that an average age of direct tax disputes was around 23 months and average for elapsed time for all

¹⁰⁵ Paul Hopkins, 'ADR clients strategies in the UK: Leading lawyers on preparing clients, navigating the negotiation process and overcoming obstacles: the success of mediation in the UK', 2008 WL 5662128.

¹⁰⁶ Ibid.

¹⁰⁷ Ibid.

¹⁰⁸ Ibid.

closed ADR cases was 61 days. The outcome of cases where ADR was applied 58% was successful, 34% unresolved and 8% partially resolved. The findings from over 80 customers indicate there was an appreciation of personal interaction that that ADR process allowed and customers were well informed.¹⁰⁹

The findings indicate that the average time involved in a tax dispute has considerably reduced and the majority of cases have been successfully been resolved. In light of the above findings, it's proper to conclude that United Kingdom has successfully created a system where ADR mechanism can be effectively implemented in a tax scenario. This approach provides information that other nations can learn from when implementing ADR techniques to resolve tax disputes.

In Australia, Tax tribunal plays a critical role in promoting ADR in resolving tax dispute. The tribunal provides guidance to the parties where there is deadlock and requires disputants to indicate attempts made to resolve the dispute through ADR before resorting to litigation.¹¹⁰ In addition, the tribunal punishes parties by making them liable to pay cost where they have frustrated the ADR process.¹¹¹ It would appear that in Kenya, the tribunal is not involved in the ADR process. The responsibility is left to KRA, a party to the dispute to promote use of ADR process to resolve tax disputes thus raising concerns of Independence of the process.

4.3 Lessons Kenya can learn from United Kingdom

In Chapter two, the research highlighted the cumbersome tax dispute resolution procedure that taxpayers have to go through. In the traditional perspective Kenya and United Kingdom had a similar approach to tax dispute resolution owing to the fact that they are both common law countries. However, United Kingdom has evolved its mechanisms and have adapted to the modern world where court processes are incapable of resolving tax disputes expeditiously.

¹⁰⁹ Paul Hopkins, 'ADR clients strategies in the UK: Leading lawyers on preparing clients, navigating the negotiation process and overcoming obstacles: the success of mediation in the UK', 2008 WL 5662128.

¹¹⁰ Melinda Jone & Andrew Maples, 'Mediation As an Alternative Option in Australia's Tax Disputes Resolution Procedures' (2012) 27 Australia Tax Forum accessed at www.ciciljustice.infor/cgi/viewcontent.cgi?article=1003&context-med accessed on 4th June 2018.

¹¹¹ Ibid.

The modern approach adopted by HMRC appears to be perfect for solving tax disputes in Kenya. Kenya has a lot of lesson to learn from United Kingdom. One lesson relates to conduct of tax administration. There is a difference in organization and attitude of the Kenyan and United Kingdom tax administration bodies. The HMRC has evolved to appoint where it has taken measures to effectively adopt cooperative compliance as opposed to adversarial approach applied in Kenya where the revenue authorities look at applying coercive measures to ensure compliance. The cooperative approach engages taxpayers so as to understand shared interests. This averts tax risks and provides cost free resolution of tax disputes on both sides. The HMRC approach guarantees more certainty and create level-playing field between taxpayers and the tax authority.¹¹²

In addition, HMRC has developed compliance risk management plans that involve the study of a particular case and behavior analysis of taxpayers in order to determine the exact approach to be adopted. Thus, the conducive approached used by HMRC play a critical role in providing assurances to low risk taxpayers thus ensuring greater compliance.¹¹³

The outlook of HMRC is based on providing certainty to taxpayers and to ensure tax disputes are minimized in order to ensure collection of revenues.¹¹⁴ This is through constant participative approach adopted where top level firms, multi-nationals enterprises are actively consulted before crucial policy decisions are made. In addition, before HMRC make any policy decision, it has to first conduct a research or consultation that give a detailed rationale behind the proposed changes so as to invite input from stakeholders.¹¹⁵ This is a different from the approach adopted by Kenya Revenue authority where all possible avenues by which revenue can be raised are explored in order

¹¹² Paul Hopkins, 'ADR clients strategies in the UK: Leading lawyers on preparing clients, navigating the negotiation process and overcoming obstacles: the success of mediation in the UK', 2008 WL 5662128.

¹¹³ How Companies with unresolved issues with HMRC settle their disputes, see High Risk Management corporate Programmes available at www.gov.uk/largebusiness/proramme.com accessed 4th June2018.

¹¹⁴ HMRC, Resolving Tax Disputes Draft Practical Guidance for HMRC Staff on the Use of Alternative Dispute Resolution in Large or Complex Cases, 2011.

¹¹⁵ Paul Hopkins, 'ADR clients strategies in the UK: Leading lawyers on preparing clients, navigating the negotiation process and overcoming obstacles: the success of mediation in the UK', 2008 WL 5662128.

to ensure sufficient amount of tax is collected. There is no doubt that collection of revenue is important for developing the economy of a country. However, a confrontational approach turns taxpayers who maybe foreign investors hostile towards the investment and taxation regime of Kenya. The confrontational approach is counterproductive and damages the economy of a country. In light of the approaches adopted by HMRC, it is recommended that that Kenya need to implement a collaborative approach where KRA engages in discussions with taxpayers so as to ensure efficient tax administration. There is need to have a friendlier approach towards low risk taxpayers. This can be done by implementing a collaborative dispute resolution process such as mediation. The introduction of KRA ADR process is a first step towards reducing tax disputes.

Kenya needs to give serious consideration to the approach adopted by HMRC in cooperating compliance and encouraging the use of ADR to improve compliance and reduce cost.¹¹⁶ If KRA ADR process is implemented with safeguards, cooperative approaches and ADR mechanism as used by HMRC may immensely benefit the Kenyan system. HMRC has set a good example on how countries can implement ADR in tax cases, thus Kenya has several lessons to learn.

KRA has designed an ADR legal framework to help in resolving tax disputes. The next question that comes naturally is how is ADR going to be practiced. The research makes reference to UK experiences and evaluate whether KRA ADR legal framework is efficient in resolving tax disputes. United Kingdom, Australia and South Africa have laws that provide which cases are and are not amenable to ADR.¹¹⁷ ADR cannot be used every time by a tax payer or a tax authority unless it adds value to the tax dispute resolution process and the settlement is for the best interest of the state. Kenya should learn from other jurisdiction and provide tax cases where ADR is not appropriate. In United Kingdom, cases where the taxpayer has evaded tax cannot be dealt with through ADR. In addition, where the point of disagreement is purely legal and it's in public interest to have judicial

¹¹⁶ HMRC, Resolving Tax Disputes Draft Practical Guidance for HMRC Staff on the Use of Alternative Dispute Resolution in Large or Complex Cases, 2011.

¹¹⁷ Kevin P. Gallagher and Elen Shrestha, Investment Treaty Arbitration and Developing Countries: a Re-Appraisal, (2011)

clarification, ADR is not applicable.¹¹⁸ In Kenya, The ADR process is purely voluntary that demands the will of the tax authority in each and every tax dispute. It is important to consider who decides whether a tax authority can settle a tax dispute. In other jurisdictions such as Australia and United Kingdom, the decision is made in a collaborative manner with all departments of the tax authority. Thus, there is no single administrative unit who decide whether or not to settle a tax dispute through ADR.¹¹⁹ KRA department involved in tax collection, tax audit or assessment unit should participate in decision making process whether or not the tax dispute can be solved through ADR. The discussion from the different departments safeguards public interest by limiting individual judgments.

KRA can learn at what stage of tax dispute ADR should be used. The justification of using ADR in tax disputes is the shortcoming of the appeal procedures which is costly, adversarial and lengthy.¹²⁰ In addition, ADR is used in tax disputes to prevent parties from acting contrary to efficient and equitable tax collection. This informs the need for both parties to try ADR process at different stages of dispute. In USA, UK and Australia Mediation and other ADR mechanisms are considered early to a tax dispute in order to limit disputable issues. ADR does not only serve as a dispute resolution process but as a dispute prevention mechanism. In Kenya, parties use ADR after a dispute has occurred. Parties should be given an opportunity to settle the matter through ADR before the tax dispute is before the appeal tribunal.¹²¹

ADR is expedient at any stage of a dispute; we should consider what kind of ADR mechanisms can be adopted. Negotiation, mediation, conciliation and facilitative mediation are relatively familiar practices in Kenya. Mediation and conciliation is often preferred because of the involvement of a

¹¹⁸ HMRC, Resolving Tax Disputes Draft Practical Guidance for HMRC Staff on the Use of Alternative Dispute Resolution in Large or Complex Cases, 2011.

¹¹⁹ National Alternative Dispute Resolution Advisory Council, ADR Terminology: A Discussion Paper, (2002) pp.8-9

¹²⁰ Roger E. Hartley, Alternative Dispute Resolution in Civil Justice Systems, 2002, p.21.

¹²¹ Shannon Thomas, "Overview of ADR options at the IRS", Journal of Consumer & Commercial Law, Vol. 10, 2007, pp.126-129

third party that acts as a buffer and make practical suggestions. Mediators are not decision makers. They create trust between the disputants and helping in reaching amicable settlement. There are scholars who argue that Arbitration is not favored for tax dispute resolution.¹²² This is because it results in win and lose outcome which is binding to the parties. This means that arbitrator's final findings can infringe public interest as both the tax authority or taxpayer may be prevented from exercising their right to appeal. It is only the USA that accepts Arbitration as a tax dispute resolution process. South African and UK discourage arbitration in tax disputes because there is already a public tribunal in place and that it limits further right of appeal.¹²³ However, there is argument that arbitration in non-binding form can be used to resolve tax disputes.¹²⁴ However, non-binding arbitration incorporates mediation.

The issue of appointment of ADR practitioners who take part and determine tax disputes and cost associated with ADR process is important to KRA. The appointment of neutral, incorrupt and reasonable practitioner is crucial in building trust in KRA ADR process. Therefore, for ADR forum to be genuine, the practitioners must be appointed by the equal vote of the disputing parties. This is true in tax jurisdiction although in Kenya the panel is appointed by KRA. With regards to cost, a taxpayer is expected to pay twenty thousand shillings in order to take part in the ADR process. In Australia and UK, cost associated with the ADR is split equally between the tax authority and taxpayer.

The issue of representation in ADR process is crucial in the resolution of tax disputes. This is because the right of representation can affect the outcome of settlement. There should be check and balances or public audit on ADR settlement to prevent corruption. Thus, people who conduct ADR on behalf of the KRA should be authorized and make a report of outcome subject to auditing. This does not mean creation of bureaucratic structures where practitioners seek approval from others.

¹²² Roger E. Hartley, *Alternative Dispute Resolution in Civil Justice Systems*, 2002, p.21.

¹²³ Ibid.

¹²⁴ KARIUKI, DAVID MUIGUA. "Alternative Dispute Resolution and Article 159 of the Constitution.". In: Legal Resource Foundation Trust, Programme for Judges and Magistrates Training. Lake Baringo Soi Lodge; 2012..

KRA ADR framework need to address the issue of enforcement, appeal rights and confidentiality in simple terms. USA, UK and Australia legal framework provide that agreed issued are to be documented and signed by both parties so that the tax authority can give effect immediately to assure finality and certainty. In cases where parties are unable to reach amicable settlement during the ADR process, they retain the right of appeal through the normal appeal process so that the case will proceed at appropriate phase. Documents exchanges, discussions, proposals and other communication throughout the ADR process should be kept confidential and are inadmissible in any forum as evidence except with the willingness of the parties.¹²⁵ The purpose of this rule in ADR is to promote open and honest communication and encourage taxpayers to make full disclosures of their financial affairs hence maximizing tax compliance and settling the tax dispute.

4.4 Conclusion

The chapter focused on comparative study of United Kingdom. The chapter examines the ADR mechanisms used in HMRC in resolving tax disputes. The chapter also highlighted lesson Kenya can from the UK Alternative dispute resolution process in tax disputes.

¹²⁵ Roger E. Hartley, *Alternative Dispute Resolution in Civil Justice Systems*, 2002, p.21.

CHAPTER FIVE

5.0 Conclusion and Recommendations

The research had three objectives which included; evaluating the efficacy of regulatory framework governing ADR in resolution of tax disputes in Kenya, to determine what challenges tax payers and KRA face when resolving disputes through ADR mechanisms and to examine to what extent the current ADR channels are adequate in resolving tax disputes. The research has achieved the objectives set out in chapter one.

First, the research has been able to evaluate the efficacy of regulatory framework governing ADR in tax disputes in Kenya. The research examined what tax disputes entailed and highlighted different types of disputes that arise during the collection of tax. In addition, the research examined the ADR mechanisms available for resolution of tax disputes by considering the provisions of the Constitution, tax statutes and institutional policy. In chapter two, the research examined the legal and regulatory framework that governs ADR in tax disputes in Kenya and specific problems that necessitated the study were highlighted.

In chapter three, the research carried out a case study to assess whether the ADR mechanism applied by KRA are effective in resolving tax disputes. The research established that there is no barrier to application of ADR in resolving tax disputes. This is because the Constitution article 159 (2) has given prominence to use of ADR in resolving tax disputes. In addition section 28 of TATA provide for reference of matters to out of court or tribunal settlements. Section 55 of TPA also provides avenue for use of ADR in settlement of tax disputes. The applicable ADR mechanism in resolving tax disputes is mediation. The Constitution and tax statutes have given prominence to use of ADR within Kenyan legal system.

The use of mediation in resolving a tax dispute is cost effective, timely, confidential and voluntary. These ensure that there is increased tax compliance due to voluntarily of tax payers and access to justice due to cost effectiveness in resolution of disputes.

In chapter four, a comparative study to the UK was carried out. HMRC has tax laws that are similar to ones in Kenya governing assessments, objections and appeals and incorporates use of ADR in

resolution of tax disputes. The research has discussed some of the lessons Kenya can learn from other jurisdictions in using ADR in resolution of tax disputes. It appears that facilitated mediation is the most preferred ADR mechanisms in resolving disputes in Kenya. It appears other jurisdiction prefer mediation over negotiation, arbitration and conciliation. In UK and South Africa, mediation is the most preferred means of resolving tax disputes. In UK, HMRC has adopted post Appeal mediation which discourages parties to refer their matter for arbitration should mediation fail before appeal. The argument for exclusion of arbitration is that it's mandatory and there is no win –win outcome for the parties. The argument is that arbitration is accompanied by procedural complexities of discovery and producing evidence which complicate alternative means of resolving disputes.

The research has disapproved the hypothesis. The research has established that ADR is being used by KRA to resolve tax disputes. The research has also established mediation is the preferred mode of ADR used in tax disputes. This is because mediation it triumphs over the disadvantages of ADR mechanism. In addition, it has the ability to preserve the relationships. The KRA ADR framework has adopted facilitated mediation as a mode of resolving tax disputes.

Different countries have adopted different ways of resolving tax disputes. This is informed by relevant factors in each country. For UK, HMRC has adopted use of piloting system which works best for their economy. Countries should not borrow heavily from systems adopted in other jurisdiction rather they should examine common areas and strategies that can be adopted. States should make legal provisions and regulations to use ADR mechanism resolving tax disputes by exploring home grown solutions.

5.1 Recommendations

Short term recommendations

On the issue of cost, ADR process of resolving tax disputes should be free and fees applicable should be minimal. In other jurisdictions, the ADR process in tax disputes in facilitated by the tax authority. This is informed by the need to make the ADR process less costly. There may be need to enact regulations to govern the ADR process in Tax disputes aimed at making the process less

costly for tax payers. The institution to implement this recommendation should be Kenya Revenue Authority.

On the issue of awareness and sensitization, KRA have a role to play by encouraging use of ADR to settle tax disputes. The case study indicates that the public is not aware of the KRA ADR framework in place. In addition, the enactment of Tax Appeal Tribunal which gives different avenues of resolution of disputes has not been publicized to the public. The institution to implement this recommendation should be Kenya Revenue Authority.

Medium term recommendations

The current KRA ADR framework should provide guidelines and regulations to ensure confidentiality, transparency and effectiveness of the ADR process. The guidelines should ensure applicability of transparency and confidence in the ADR process. Transparency and confidence will ensure that parties take part in the process voluntarily. In addition, the system should be simple and avoid technicalities. Further; the ADR framework should be anchored on legislation in order to give it the force of law. The research recommends that the same can be achieved by amending the TATA. The amendment should require all disputes to go through the ADR process first before going to the Tribunal. The institution to implement this recommendation should be Kenya Revenue Authority.

There is need to train persons taking part in the ADR process. Facilitators and tax experts should be updated on current trends in mediation, effectiveness and transparency of the process. In other jurisdiction such as UK and Australia, they have formulated code of practice to govern settlements of tax disputes. The code of practice ensure independence, impartiality and transparency which is critical for the success of the ADR process as it boost confidence of the parties. The institution to implement this recommendation should be Kenya Revenue Authority.

Long term recommendations

There KRA ADR framework lacks oversight and reporting system. The KRA officials should report to parliament on how much tax they have foregone and how much they have saved in litigation cost. There is also need to curd corruption from creeping into the ADR process. On the issue of challenge presented by article 210 of the Constitution, there is need to have a legislation to give power to the commissioner to waive tax during ADR process otherwise the process will be inflexible. The ADR framework should apply integrated approach where all stakeholders are involved in the ADR process in order to boost confidence. At the moment, the ADR process is owned and driven by KRA. This means that the disputants are only left with the guidelines formulated by KRA. The institution to implement this recommendation should be parliament and Kenya Revenue Authority.

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APPENDICES

Appendix 1: Questionnaire

Questionnaire to Taxpayers

I am a postgraduate student of the University of Nairobi, and would be glad if you could answer the questions below for research purposes. The focus of the study is on effectiveness of regulatory framework governing ADR in disputes in Kenya; to what extent are the current ADR channels adequate in solving tax disputes and what are some challenges that taxpayers face. The Information you provide will be held in confidence and will not be used in any other forum. It is by free will that you are requested to answer the questionnaire.

1. Have you had a tax dispute with KRA?
2. If the answer above is positive, was the dispute refereed to ADR process?
3. Would you say that you had a personal interaction with KRA and well informed of the ADR process?
4. How long did the process take to resolve?
5. Was the dispute successful resolve, unresolved or partially resolved?
6. Were the ADR practitioners impartial?
7. If the answer above is Negative, Do you think KRA ADR mechanism may be open to abuse and manipulation or influence?
8. On a scale of 1 to 10, with 1 being “totally effective” and 10 being “extraordinarily effective” how would you rate the effectiveness of ADR framework in resolution of tax disputes in Kenya?

Thank you most sincerely for taking the time to fill the above questionnaire!

Appendix 2: Questionnaire

Questionnaire to ADR Practitioners at KRA pilot project

I am a postgraduate student of the University of Nairobi and would be glad if you could answer the questions below for research purposes. The focus of the study is on effectiveness of regulatory framework governing ADR in disputes in Kenya; to what extent are the current ADR channels adequate in solving tax disputes and what are some challenges that taxpayers face. The Information you provide will be held in confidence and will not be used in any other forum. It is by free will that you are requested to answer the questionnaire.

1. Have you taken part in KRA ADR pilot project?
2. Would you say that the ADR process allow for personal interaction between the tax authority and taxpayer?
3. Was the client or agent well informed of the ADR process?
4. Were ADR practitioners impartial when handling the tax disputes?
5. How long did the tax disputes take in the ADR pilot project?
6. What is the outcome of the case?
7. What are some of the challenges ADR framework is experiencing in resolving tax disputes?
8. What recommendations would you make to overcome those challenges?

Thank you most sincerely for taking the time to fill the above questionnaire!

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