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# Kenya's tax dispute resolution system: a dispute system design evaluation

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Brian G. Kanyi  
*Strathmore Law School (SLS)*  
*Strathmore University*

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# Kenya's Tax Dispute Resolution System: A Dispute System Design Evaluation

Brian Gachii Kanyi



Master of Laws

2019

# Kenya's Tax Dispute Resolution System: A Dispute System Design Evaluation

Brian Gachii Kanyi

Submitted in partial fulfilment of the requirements for the Degree of Master of  
Laws at Strathmore University



Strathmore University

Nairobi, Kenya

June, 2019

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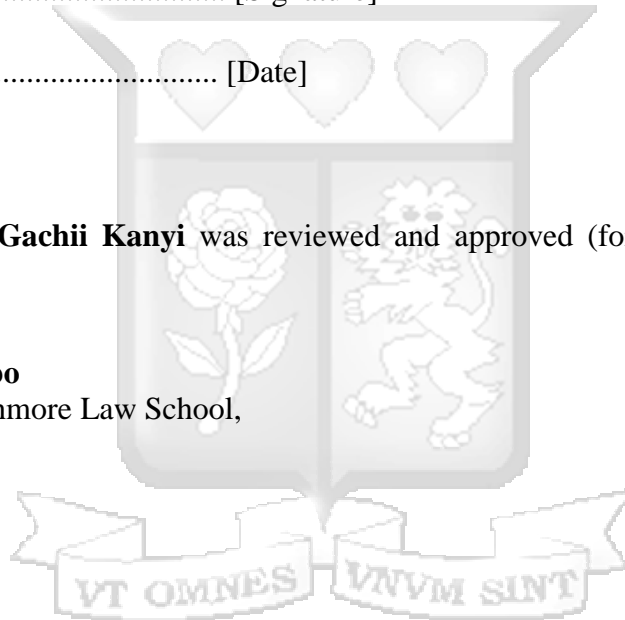
Approval

The thesis of **Brian Gachii Kanyi** was reviewed and approved (for examination) by the following:

**Dr Daisy L A Ogembo**  
Senior Lecturer, Strathmore Law School,  
Strathmore University

**Dr Luis G Franceschi**  
Dean, Strathmore Law School,  
Strathmore University

**Professor Ruth Kiraka,**  
Dean, School of Graduate Studies,  
Strathmore University



## Abstract

Tax dispute resolution is essential to any tax system. A tax dispute can be said to occur when the tax authority and the taxpayer have divergent views on the taxpayer's liability. The divergence in views often emerges from the perceptions that both parties have that the other party has not correctly applied the law. Resolution of tax disputes through adversarial means such as litigation is often considered the worst-case scenario for parties in a tax dispute. Litigation is often costly and time consuming for both the tax authority and the taxpayer. Furthermore, litigation of tax disputes can lead to delays in revenue collection, financial difficulties for businesses and less compliance. The adverse effects of resolving tax disputes through litigation have led tax authorities to turn towards Alternative Dispute Resolution procedures (ADR procedures) that are less adversarial such as negotiated settlement, mediation and facilitated discussion.

The use of ADR procedures in resolving tax disputes promises decreased costs, faster resolution, enhanced relationships between the tax authority and the taxpayer and enhanced voluntary compliance. Although there is a desire to use less adversarial means of dispute resolution to resolve a majority of tax disputes, use of out of court settlement procedure under the Tax Procedures Act, 2015 and the Tax Tribunal Act and the internal Alternative Dispute Resolution framework, the use of less adversarial means to resolve tax disputes remains low. Dispute Systems Design (DSD) as proposed by Ury, Brett and Goldberg seeks to design dispute resolution systems that are oriented towards a majority of disputes being resolved through less adversarial means which focus on the interest of the parties. DSD involves the intentional and systematic creation of procedures for handling disputes in a manner that promises lower costs, more satisfying outcomes and enhanced relationships. Ury, Brett and Goldberg propose six principles that can act as criteria for determining whether a dispute system is oriented towards resolving disputes by less adversarial means and the dispute system cuts the cost of disputing and achieves the gains promised by DSD.

This study evaluates Kenya's tax dispute system through the six DSD principles proposed by Ury, Brett and Goldberg to identify any shortcomings in the design of Kenya's tax dispute resolution system that may hinder the resolution of a majority of tax disputes through less adversarial means. The methodological approach adopted in this study was a review of the relevant literature on Kenya's tax dispute system, DSD and the six DSD principles proposed by Ury, Brett and Goldberg. The study finds that Kenya's tax dispute resolution system does

not meet four of the six principles proposed by Ury Brett and Goldberg and as such is not oriented towards a majority of tax disputes being resolved by less adversarial means such as negotiated settlement, mediation and facilitated discussions.



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## List of Abbreviations

ADR – Alternative Dispute Resolution

ADR framework - *Alternative Dispute Resolution Framework*, 2015

DSD – Dispute Systems Design

EACCMA - East African Community Customs Management Act, 2004

EACCU - East African Community Customs Union

ITA – Income Tax Act Cap. 470 of the Laws of Kenya

KRA – Kenya Revenue Authority

PEAL – Perceived Erroneous Application of Law

PIE – Perceived Injurious Experience

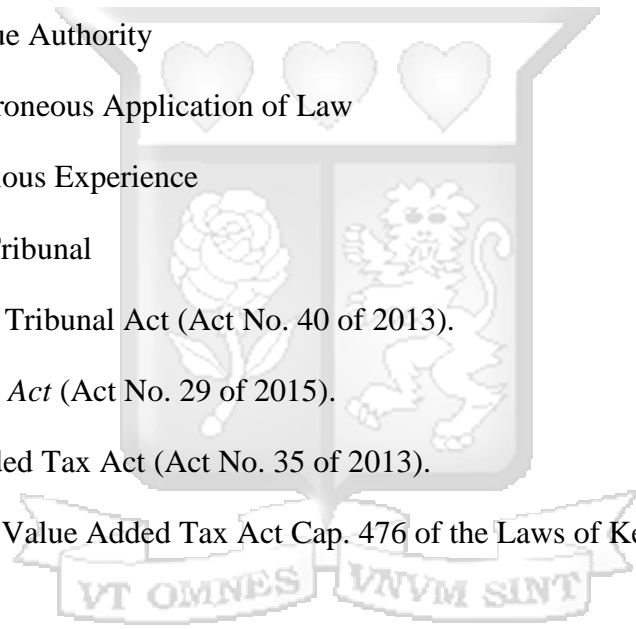
TAT – Tax Appeals Tribunal

TATA – Tax Appeals Tribunal Act (Act No. 40 of 2013).

TPA – *Tax Procedure Act* (Act No. 29 of 2015).

VAT Act - Value Added Tax Act (Act No. 35 of 2013).

VAT Act (repealed) - Value Added Tax Act Cap. 476 of the Laws of Kenya



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*Anne Wambui Njoroge v Kenya Revenue Authority & another* [2017] eKLR

*Ashby v White* (1703) 1 Bro Parl Cas 62

*Cimbria East Africa Limited v Commissioner of Investigation and Enforcement & another* [2016] eKLR,

*Diana Kethi Kilonzo & another v Independent Electoral & Boundaries Commission & 10 others* [2013] eKLR

*Jimbise Limited & 2 others v Kenya Revenue Authority* [2017] eKLR

*Kenya Revenue Authority v Jimmy Mutuku Kiamba* [2016] eKLR ruling No. 1.

*Kenya Revenue Authority v Jimmy Mutuku Kiamba* [2016] eKLR ruling No. 2.

*Kenya Revenue Authority, Commissioner of Customs Services and Julius Musyoki v Darasa Investments Limited* Civil Appeal No. 24 of 2018.

*Keroche Industries v Kenya Revenue Authority & 5 Others* [2007] eKLR.

*Oceanfreight (E.A) Limited v Commissioner of Domestic Taxes* [2018] eKLR.

*Okiya Omtatah Okoiti & another v Bidco Africa & 4 others* [2018] eKLR

*Pevans East Africa Limited & Another v Chairman, Betting Control & Licensing Board & 7 others* [2018] eKLR.

*R v IRC, ex parte National Federation of Self-Employed and Small Businesses Ltd* [1982] AC 617

*R v. Commissioner for Racial Equality ex P. Hillingdon LBC* [1982] AC779.

*Republic v Commissioner of Customs Services ex-parte Africa K-link International Limited* [2012] eKLR.

*Republic v Commissioner of Customs Services ex-parte Unilever Kenya Limited* [2012] eKLR

*Republic v Commissioner of Domestic Taxes Ex-Parte I & M Bank Limited* [2017] eKLR.

*Republic v Commissioner of Income Tax Ex Parte SDV Transami (Kenya) Limited* [2005] eKLR.

*Republic v Kenya Revenue Authority Ex Parte Abdalla Brek Said t/a Al Amry Distributors & 4 others* [2016] eKLR

*Republic v Kenya Revenue Authority Ex Parte M-Kopa Kenya Limited* [2018] eKLR

*Republic v Kenya Revenue Authority ex parte New Frarims Wholesalers Limited & 3 others* [2017] eKLR.

*Republic v Kenya Revenue Authority Ex-Parte Funan Construction Limited* [2016] eKLR.

*Republic v Kenya Revenue Authority Ex-parte KSC International Limited (In Receivership)* [2016] eKLR,

*Republic v Kenya Revenue Authority exparte Interactive Gaming & Lotteries Limited* [2016] eKLR

*Republic v Kenya Revenue Authority; v Kenya Revenue Authority; Kenol Kobil Ltd (Interested Party) Ex parte Rayan Logistics Ltd* [2019] eKLR

*Republic v Kenya, Revenue Authority Exparte Bata Shoe Company (Kenya) Limited* [2014] eKLR,

*Republic v National Environmental Management Authority* [2011] eKLR

*Republic vs. Kenya Revenue Authority Ex parte Yaya Towers Limited* [2008] eKLR

*SDV Transami Kenya limited v Commissioner of Customs Services* [2012] eKLR.

*Secretary, County Service Board & another v Hulbhai Gedi Abdille* [2017] eKLR,

*Silver Chain Limited v Commissioner Income Tax & 3 others* [2016] eKLR.

*Standard Resource Group Ltd v Attorney General & 2 others* [2016] eKLR

## **List of Statutes and Conventions**

*Alternative Dispute Resolution Framework, 2015*

*Constitution of Kenya, 2010*

*East African Community Customs Management Act, 2004*

*Excise Duty Act Cap. 469 of the Laws of Kenya*

*Income Tax Act Cap. 470 of the Laws of Kenya*

*Kenya Revenue Authority Act (Act No. 2 of 1995)*

*Protocol on the Establishment of the East African Customs Union, 2004.*

*Tax Appeals Tribunal (Appeals to the High Court) Rules, 2015.*

*Tax Appeals Tribunal (Procedure) Rules, 2015.*

*Tax Appeals Tribunal Act (Act No. 40 of 2013).*

*Tax Procedure Act (Act No. 29 of 2015).*

*The Revised Kyoto Convention, 3 February 2006.*

*Value Added Tax Act (Act No. 35 of 2013).*

*Value Added Tax Act Cap. 476 of the Laws of Kenya*



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# CHAPTER ONE

## INTRODUCTION

### 1.1. Background of the Problem

Taxation is the largest source of government revenue in Kenya.<sup>1</sup> Taxation inevitably requires individuals and corporations to involuntarily sacrifice portions of their property to the government in exchange for public goods and services.<sup>2</sup> The relationship between taxation and the right to enjoy possession of one's property is often considered antagonistic because taxation is prima facie interference with property rights.<sup>3</sup> Furthermore, the need for narrow outcomes in compliance and enforcement makes tax laws inherently complex.<sup>4</sup> The interference with property rights, coupled with the complexity of tax laws, tends to generate uncertainty and disagreements between the taxpayers and the tax authorities, especially concerning taxpayers' liability or their entitlements. It is therefore proper to conclude that disputes are a common feature of tax systems.<sup>5</sup> Institutions and procedures must, therefore, be put in place to deal with the uncertainty and disputes in a manner that is fair, efficient, convenient, and impartial, guaranteeing high-quality outcomes.<sup>6</sup>

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<sup>1</sup> Institute of Certified Public Accountants of Kenya, *Kenya Revenue Analysis 2010-2015: A Historical Perspective to Revenue Performance in Kenya*, 2016, 2.

<sup>2</sup> Xu Y, 'Tax dispute resolution, judiciary independence and property rights', University of Chicago Law School 2013 Summer Institute for Law and Economics, Chicago, 16 July 2013, 1.

<sup>3</sup> Baker P, 'Taxation and the European Convention on Human Rights' 4 *British Tax Review*, (2000), 211–377, 216. Interference with property rights is a major criticism advanced by academics in opposition to taxation going as far as equating it to forced labour and some crudely describing taxation as 'theft' or 'robbery' (See: Nozick R, *Anarchy, state and utopia*, Blackwell Publishers, Oxford, 1974, 169 and Chodorov F, 'Taxation is robbery' in Chodorov F, *Out of step: the autobiography of an individualist*, Devin-Adair, New York, 1962, 216-239).

<sup>4</sup> Cabrillo F and Fitzpatrick, *The economics of courts and litigation*, Edward Elgar, Cheltenham, 2008, 157. The ultimate advantage of such detail and the resulting complexity is the certainty. See: Stanley S S, 'Complexity and the internal revenue code: the problem of the management of tax detail', 34 *Law and Contemporary Problems*, 4 (1969), 673-710, 697.

<sup>5</sup> Tran-Nam B and Walpole M, 'Independent tax dispute resolution and social justice in Australia', 35 *University of South Wales Law Journal*, 2 (2012), 470-500, 477.

<sup>6</sup> Wright H L, Hoiutte J V, Kerlan P and Johnstone J A, *Comparative conflict resolution procedures in taxation: an analytic comparative study*, University of Michigan Law School, 1968, Ann Arbor, 4.

Overall, the main objective of a tax dispute resolution system ought to be to ensure that disputes and uncertainty are resolved in a timely, fair, and efficient manner. The tax dispute resolution system should also be convenient for the taxpayer and guarantee impartial determinations of high quality. Kenya's tax dispute system is largely adversarial in nature providing for tribunals and courts as the main way disputes may be resolved after an objection.<sup>7</sup> Furthermore, despite the existence of an integrated tax dispute resolution system based on internal review and a statutory tribunal in the first instance, Ado notes that, in practice, there are taxpayers that still prefer to file disputes directly to court in the form of judicial review proceedings.<sup>8</sup>

The increasing frequency and complexity of tax disputes is one of the main administrative and enforcement challenges facing many revenue bodies.<sup>9</sup> While a certain volume of tax disputes are to be expected in every tax system, Kenya was at one point plagued with significant tax litigation; 61 percent of tax disputes were being resolved through litigation, locking up billions of shillings in the judicial system for an average of four years.<sup>10</sup> In comparison, South Africa resolves only 34 percent of its tax disputes through litigation.<sup>11</sup> As at March 2015, the Kenya Revenue Authority (KRA) was pursuing Ksh 34.5 Billion in various court cases. Delays in collecting revenue subject to litigation in courts are worsened by the significant backlog of cases in the judiciary.<sup>12</sup> Both taxpayers and tax authorities often consider litigation of tax

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<sup>7</sup> Kashindi G A, 'Tax dispute resolution in Kenya: viability including alternative dispute resolution mechanisms', Unpublished LLM Thesis, University of Nairobi, 2017, 4. See also: Ado M, 'Transfer pricing disputes in Kenya: advance pricing agreements the way forward?', Unpublished LLM thesis, Lund University, 28 May 2015, 18.

<sup>8</sup> Ado M, 'Transfer pricing disputes in Kenya', 16. The Courts have been quick to emphasise that where a statute provides a remedy to parties (for example an appeal process such as the Tax Appeals Tribunal), the courts must restrain themselves from hearing the matter and first allow the relevant bodies or State organs to deal with the dispute. See: *Republic v National Environmental Management Authority* [2011] eKLR, *Diana Kethi Kilonzo & another v Independent Electoral & Boundaries Commission & 10 others* [2013] eKLR, *Secretary, County Service Board & another v Hulbhai Gedi Abdille* [2017] eKLR, *Kenya Revenue Authority, Commissioner of Customs Services and Julius Musyoki v Darasa Investments Limited* Civil Appeal No. 24 of 2018.

<sup>9</sup> Stilwell D K, 'Mediation of Canadian tax disputes', Unpublished LLM thesis, University of Toronto, 2014, 1.

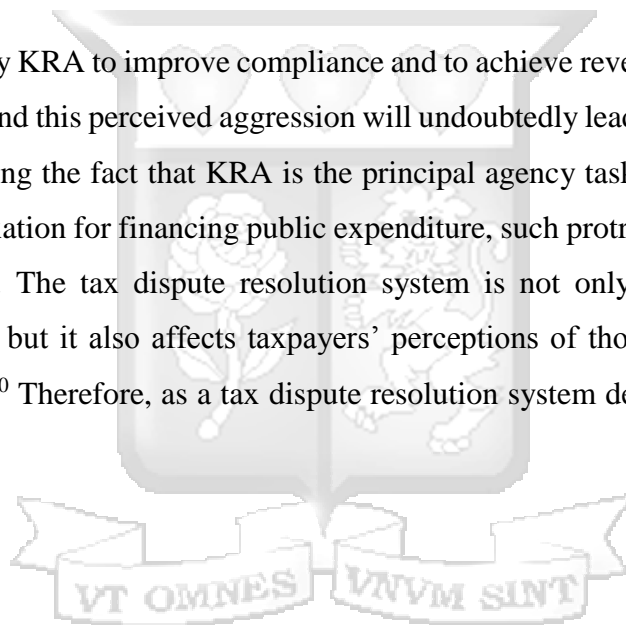
<sup>10</sup> Kenya Revenue Authority, *Sixth Corporate Plan*, 2015, 50. See also: Kenya Revenue Authority, *Seventh corporate plan 2018/19-2020/21: revenue mobilisation through transformation*, 2019, 37.

<sup>11</sup> Kenya Revenue Authority, *Sixth Corporate Plan*, 2015, 50.

<sup>12</sup> In the Financial Year 2016/2017 out of the 533,350 pending cases, 315,378 of them were considered backlog. See: The Judiciary of Kenya, *State of the Judiciary and the administration of justice annual report 2016-2017*, 6ed, 2017, viii.

disputes the worst-case scenario due to its protracted nature.<sup>13</sup> Litigation of tax disputes not only leads to delays in revenue collection, but it is also costly and time-consuming for both the tax authority and the taxpayer.<sup>14</sup> Litigation of tax disputes between the tax authority and the taxpayer can be an unfavourable interaction with the taxpayer which can lead to less future compliance.<sup>15</sup> Furthermore, litigation of tax disputes significantly contributes to uncertainty in the tax system and can lead to commercial difficulties for business which can deter investment from multinationals.<sup>16</sup> Tax authorities of both developing and developed nations are thus turning their attention towards the incorporation of ADR in the tax dispute system.<sup>17</sup> The use of less adversarial means of dispute resolution promises efficiency, enhanced trust, enhanced voluntary compliance and lower administration costs; hence, a global shift towards widespread adoption of ADR processes into tax dispute resolution system.<sup>18</sup>

Unfortunately, steps by KRA to improve compliance and to achieve revenue targets have come across as aggressive, and this perceived aggression will undoubtedly lead to more disputes with taxpayers.<sup>19</sup> Considering the fact that KRA is the principal agency tasked with the collection of revenue through taxation for financing public expenditure, such protracted tax litigation can harm public finances. The tax dispute resolution system is not only important because it determines outcomes, but it also affects taxpayers' perceptions of those outcomes and their compliance attitudes.<sup>20</sup> Therefore, as a tax dispute resolution system develops, it is critical to



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<sup>13</sup> Ernst & Young, *Tax dispute resolution: a new chapter emerges*, 2010, 4.

<sup>14</sup> Thuronyi V and Espejo I, *How can an excessive volume of tax disputes be dealt with?*, 4.

<sup>15</sup> Tran-Nam B and Walpole M, 'Tax disputes, litigation costs and access to tax justice', *eJournal of Tax Research*, 2 (2016), 319-336, 325.

<sup>16</sup> International Monetary Fund and Organization for Economic Co-operation and Development, *Tax Certainty*, 2017, 22.

<sup>17</sup> Thuronyi V and Espejo I, *How can an excessive volume of tax disputes be dealt with?*, 31.

<sup>18</sup> Ernst & Young, *Tax dispute resolution: a new chapter emerges*, 2010, 4.

<sup>19</sup> Mwititi L, 'Taxman, World Bank disagree over collection targets', Standard Digital, 22 December 2017, <https://www.standardmedia.co.ke/business/article/2001263845/kra-clashes-with-world-bank-over-revenue-targets> on 5 May 2018.

<sup>20</sup> Mirrlees J and Institute for Fiscal Studies, *Tax by design: the Mirrlees review*, Oxford University Press, Oxford, 2011, 33.

reconsider its efficacy continuously, and the efficiency of its design, to ensure that it meets its objectives and the stakeholders' needs.<sup>21</sup>

To minimise the cost of disputes, it is critical to focus on the interest of the parties through interest-based ADR processes such as negotiation, mediation and facilitated discussions when designing the system.<sup>22</sup> William Ury, Jeanne Brett and Stephen B Goldberg (Ury, Brett and Goldberg) highlight that focusing on the interest of the parties through interest based ADR processes leads to lower transaction costs, higher satisfaction with the outcomes, enhanced relationships amongst the disputants and lower recurrence of disputes of the same type than use of rights based processes such as adjudication and litigation.<sup>23</sup> Ury, Brett and Goldberg have set out six principles in Dispute Systems Design (DSD) through which transaction cost may be lowered, satisfaction with outcomes may be increased and relationships may be enhanced. The six principles are: 1) Creating ways for parties to reconcile their interests, 2) having loopbacks that encourage disputants to return to less adversarial procedures, 3) providing low-cost rights and 'power-backups', 4) preventing unnecessary conflict through notification, consultation and feedback, 5) arranging procedures set out for resolving disputes in a low to high cost sequence and 6) providing the necessary motivation, skills and resources to allow the system to work..<sup>24</sup> DSD, the process of developing and strategically organising dispute resolution procedures and processes in a manner that promises to lower costs, promotes higher quality resolution, improves dispute management and provides a lens through which efficacy and efficiency in the design of the system may be considered.<sup>25</sup>

Kenyan lawmakers and the Kenya Revenue Authority (KRA) have taken measures to modernise and improve tax dispute resolution in Kenya. Parliament enacted the Tax Appeals Tribunal Act (TATA) which creates the Tax Appeals Tribunal (TAT), an independent tribunal

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<sup>21</sup> Franck S D, 'Integrating investment treaty conflict and dispute systems design', 92 *Minnesota Law Review* (2007), 161-230, 163.

<sup>22</sup> McKenzie C, 'Designing a dispute system across an entire industry', 6 *ADR bulletin*, 1(2003), 16-20, 16.

<sup>23</sup> Smith S and Martinez J, 'An analytic framework for dispute systems design', 14 *Harvard Negotiation Law Review*, 1 (2009), 123-169, 128.

<sup>24</sup> See: Ury W, Brett J and Goldberg S B, *Getting disputes resolved: designing systems to cut through the cost of conflict*, Jossey Bass, San Francisco, 1988.

<sup>25</sup> Brett M J and Golberg S B, 'Dispute systems design', 1 *Perspectives on Work*, 1(1997), 53-55, 53.

to hear appeals filed against any tax decision made by the commissioner.<sup>26</sup> The TAT replaces Local Committees established under various tax statutes as the primary appeal mechanism.<sup>27</sup>

Parliament further enacted the Tax Procedures Act (TPA) which harmonizes the procedural rules that govern tax administration in Kenya.<sup>28</sup> The TPA consolidates procedural provisions from the Income Tax Act (ITA)<sup>29</sup>, the Value Added Tax Act (VAT Act)<sup>30</sup>, the Kenya Revenue Authority Act<sup>31</sup>, and the Excise Duty Act.<sup>32</sup> Besides consolidation and collation, the TPA seeks to simplify compliance and tax collection by the Kenya Revenue Authority and make the dispute resolution process more expedient.<sup>33</sup> The TPA simplifies compliance and enhances collection by eliminating duplication; the TPA does this by incorporating the general provisions in the various tax acts into one act, removing redundant administrative provisions and streamlining requirements that had previously existed in different pieces of legislation.<sup>34</sup> Furthermore, the TPA provides for both public and private rulings which are intended to give the taxpayer greater clarity in conducting their affairs, enhance tax compliance and potentially reduce the number of tax disputes.<sup>35</sup> The TPA also provides the option for parties to settle their disputes out of court once proceedings having been initiated in the tribunal or in court on appeal however this is subject to the approval of either the court or the tribunal.<sup>36</sup>

At the administrative end, KRA on its end launched an internal Alternative Dispute Resolution framework (ADR framework). The ADR framework is internal and is not expressly provided for in the tax acts. There is inferred legal backing for the framework under section 55 of the

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<sup>26</sup> Section 3, *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>27</sup> Section 41 and Section 42, *Tax Appeals Tribunal Act* (Act No. 40 of 2013) repeals Section 83 of the *Income Tax Act (Cap. 470)* which establishes an Appeal Tribunal.

<sup>28</sup> Preamble, *Tax Procedure Act* (Act No. 29 of 2015).

<sup>29</sup> Cap. 470 of the Laws of Kenya.

<sup>30</sup> Act No. 35 of 2013.

<sup>31</sup> Cap. 469 of the Laws of Kenya.

<sup>32</sup> Deloitte, *The Tax Procedures Bill 2015 analysis: diving deep*, 2015, 4.

<sup>33</sup> Deloitte, *The Tax Procedures Bill 2015 analysis: diving deep*, 2015, 4.

<sup>34</sup> South Africa Revenue Service, *Short Guide to the Tax Administration Act, 2011* (Act No. 28 of 2011), 2014, 4.

<sup>35</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 4.

<sup>36</sup> Section 28 (1), *Tax Procedure Act* (Act No. 29 of 2015)- "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." (Emphasis added).

TPA, section 28 of the TATA and Article 159 (2) of the constitution.<sup>37</sup> However, it has been argued that these provisions do not give a clear backing for the framework.<sup>38</sup> ‘Facilitated discussions’ is the primary dispute resolution mechanism under the framework.<sup>39</sup> Facilitated discussion (also known as facilitated negotiation) is a process where parties, having identified the issues in controversy, negotiate an outcome with the assistance of a neutral third party known as a facilitator.<sup>40</sup> The facilitator manages the process and assists the parties to reach an agreement in a fair, equitable, and expeditious manner.<sup>41</sup> The facilitator does not advise, adjudicate, or determine the dispute.<sup>42</sup> Through such a relationship-based mechanism, KRA intends to, increase transparency, establish the taxpayer’s trust, and therefore enhance compliance.<sup>43</sup> The adoption of mechanisms that enhance the relationship between KRA and the taxpayer are in line with KRA’s mission statement i.e. : *"Building Trust through Facilitation so as to foster Compliance with Tax and Customs Legislation"*.<sup>44</sup> The need to build trust between the tax authority and the taxpayer is emphasized because trust in the authority and fair interaction with the taxpayer has been recognized under theories such as the slippery slope framework as essential elements in fostering voluntary compliance.<sup>45</sup> The shift towards building high trust between the taxpayer and the tax authority is guided by empirical evidence that high trust is related to voluntary compliance with tax laws.<sup>46</sup> Furthermore, how a tax

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<sup>37</sup> It is inferred because section 55 of the TPA and section 55 of TATA both provide of out of Court and out of Tribunal settlement. However, the provisions above do not provide for any particular framework to guide the out of court or tribunal settlement.

<sup>38</sup> Kashindi G A, ‘Tax dispute resolution in Kenya’, 70.

<sup>39</sup> Preamble, *Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>40</sup> National Alternative Dispute Resolution Advisory Council, *Dispute resolution terms: the use of terms in (alternative) dispute resolution*, 2003, 4.

<sup>41</sup> Paragraph 12.0, *Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>42</sup> National Alternative Dispute Resolution Advisory Council, *Dispute resolution terms*, 7.

<sup>43</sup> Kenya Revenue Authority, *Transcript of the Commissioner General’s speech on launch of Alternative Dispute Resolution (ADR) framework*, 2015, 1.

<sup>44</sup> Kenya Revenue Authority, *Transcript of the Commissioner General’s speech on launch of Alternative Dispute Resolution (ADR) framework*, 1.

<sup>45</sup> Muehlbacher S and Kirchler E, ‘Tax compliance by trust and power of authorities’, 24 *International Economic Journal*, 4 (2010), 607-610, 609. For a discussion on the slippery slope framework of tax compliance and how trust in authorities interacts with tax compliance see: Kirchler E, Hoelzl E and Wahl I, ‘Enforced versus voluntary tax compliance: the “slippery slope” framework’, 29 *Journal of economic psychology*, (2008), 210-225.

<sup>46</sup> Kirchler E, Kogler C and Muehlbacher S, ‘Cooperative tax compliance: from deterrence to deference’, 23 *Current directions in psychological science*, 2 (2014), 87-92, 89. See; Muehlbacher S, Kirchler E and

authority treats a taxpayer during an encounter can shift their beliefs and attitudes either positively or negatively.<sup>47</sup> Positive and negative beliefs and attitudes ultimately determine the social distance that exists between the authority and the taxpayer and whether the taxpayer will be more compliant.<sup>48</sup>

## 1.2. Research Problem

Kenya aspires to significantly reduce the number of tax disputes that are settled through litigation.<sup>49</sup> To that effect, parliament has harmonised tax administration provisions and dispute resolution procedures; KRA has established an ADR framework and an independent tax tribunal has also been established. The tax dispute system established under the TPA, TATA, and KRA's ADR framework aims at ensuring that tax disputes are resolved in a timely and cost-effective manner which, in turn, will ensure efficient revenue collection, transparency, enhanced taxpayer satisfaction and improved taxpayer compliance. This paper is concerned with whether Kenya's tax dispute resolution system as set out in the TPA, TATA, East African Community Customs Management Act (EACCMA)<sup>50</sup> and in KRA's ADR framework are effectively designed to resolve tax disputes through less adversarial means. The thesis evaluates Kenya's tax dispute resolution system through the DSD principles proposed by Ury, Brett, and Goldberg to identify shortcomings in the design of the system that may hinder the resolution of tax disputes through less adversarial means.

## 1.3. Research Objectives

1. Critically evaluate the design of Kenya's tax dispute resolution system through the lens of the principles proposed by Ury, Brett and Goldberg.

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Schwarzenberger, 'Voluntary versus enforced compliance: empirical evidence for the "slippery slope" framework', 32 *European journal of law and economics*, 2010, 89–97.

<sup>47</sup> Braithwaite V, 'Dancing with tax authorities: motivational postures and non-compliant actions' in Braithwaite V (ed), *Taxing democracy*, Ashgate Publishing, Aldershot, 2002, 15-40, 35.

<sup>48</sup> Braithwaite V, 'Dancing with tax authorities: motivational postures and non-compliant actions', 35.

<sup>49</sup> Kenya Revenue Authority, *Sixth Corporate Plan*, 2015, 50

<sup>50</sup> The East African Community Customs Management Act also sets out dispute resolution procedures in relation to customs disputes.

2. Make recommendations that address any identified shortcomings and propose improvements to the design of the tax dispute system to ensure that a majority of tax disputes is resolved through less adversarial means.

#### **1.4. Hypothesis**

1. Kenya's tax dispute resolution system is not designed to resolve a majority of tax disputes through less adversarial dispute resolution procedures such as settlement, negotiation and facilitated discussions thus hindering the system's primary objective of providing fair, timely, and cost-effective dispute resolution.
2. Amending the TPA to provide for: compromise settlement of tax disputes, rules governing the use of ADR procedures, provision for a register of settlements and methods of reporting settlements reached between KRA and the taxpayer and mechanisms allowing the parties to loop back to ADR procedures at the appeal level all of which are based on the principles by Ury, Brett and Goldberg which would make the tax dispute system more oriented towards less adversarial dispute resolution.

#### **1.5. Research Questions**

The study seeks to investigate two main questions:

1. What is the current design of Kenya's tax dispute resolution system?
2. How does Kenya's tax dispute resolution system, as currently designed, measure up to the design principles proposed by Ury, Brett and Goldberg?
3. How can the design of Kenya's tax dispute resolution system be improved, based on the design principles proposed by Ury, Brett and Goldberg, to ensure that a majority of tax disputes are resolved through less adversarial means?

#### **1.6. Justification of the Study**

A fair, timely and cost-effective dispute resolution system is essential to a modern tax system that is primarily based on self-assessment.<sup>51</sup> The design of a dispute resolution system has

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<sup>51</sup> Okello A, *Managing income tax compliance through self-assessment*, International Monetary Fund Working Papers, 2014, 35.

implications on the cost of revenue collection by the tax authority, tax morale<sup>52</sup> and taxpayer compliance. Currently, only 39 percent of tax disputes are resolved under through ADR under KRA's ADR framework against an intended target of 66 percent.<sup>53</sup> The low rate of resolution of tax disputes under the ADR framework means some form litigation still resolves a vast majority of disputes either before the tax appeals tribunal or courts of law. It is against this background that KRA have sought to restructure and strengthen the ADR function.<sup>54</sup> A system that primarily uses some form of litigation either before courts or tribunals is what Ury, Brett and Goldberg refer to as a distressed system. In distressed systems, disputes are resolved through determining who is right or through power contests rather than reconciling the interests of the parties.<sup>55</sup> Rights-based approaches such as litigation are costlier in terms of time, money and resources expended than interest-based approaches such as negotiation, mediation and facilitated negotiation.<sup>56</sup> The ultimate goal of DSD is to improve a dispute resolution system by encouraging and supporting the primary use of interest-based dispute resolution mechanisms and low-cost rights methods where necessary.<sup>57</sup> Improvements to the dispute resolution system can be achieved by designing the dispute resolution system according to the six principles suggested by Ury, Brett and Goldberg.<sup>58</sup> It is therefore imperative, based on the principles of DSD proposed by Ury, Brett and Goldberg, to critically analyse the design of the system and root out any shortcomings that may hinder the tax dispute resolution system from resolving a majority of its disputes through interest-based approaches to dispute resolution.

While there have been numerous studies that have applied DSD principles in the analysis of tax dispute resolution systems, those studies have primarily focussed on dispute resolution

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<sup>52</sup> Luttmer and Singhal define tax morale as the "totality of non-pecuniary motivations and factors for tax compliance which fall outside the expected utility maximisation." See: Luttmer E F P and Singhal M, 'Tax morale', 28 *Journal of Economic Perspectives*, 4 (2014), 149-168, 153.

<sup>53</sup> Kenya Revenue Authority, *Seventh corporate plan 2018/19-2020/21: revenue mobilisation through transformation*, 2019, 37.

<sup>54</sup> Kenya Revenue Authority, *Seventh corporate plan 2018/19-2020/21: revenue mobilisation through transformation*, 2019, 37.

<sup>55</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18.

<sup>56</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 13.

<sup>57</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18.

<sup>58</sup> Smith S and Martinez J, 'An analytic framework for dispute systems design', 128.

systems in developed countries such as the United Kingdom<sup>59</sup>, Australia<sup>60</sup>, New Zealand<sup>61</sup>, and the United States of America<sup>62</sup>. The proposed project will contribute to existing knowledge on DSD and tax dispute resolution by evaluating the tax dispute resolution system in Kenya, a developing country in the African continent. The project will in some instances draw from the literature and experiences in developed jurisdictions.

## 1.7. Theoretical Framework

DSD, as conceptualised by Ury, Brett and Goldberg, is premised on three theoretical propositions.<sup>63</sup> The first proposition is that there are three approaches to resolving disputes based on the outcome function of each dispute resolution approach namely, interest-based procedures, rights-based procedures and power-based procedures.<sup>64</sup> The second proposition is that interest-based procedures are potentially more effective than rights-based procedures and that rights-based procedures are more effective than power based procedures.<sup>65</sup> The third proposition is that dispute resolution costs may be reduced by creating ‘interest-oriented’ systems.<sup>66</sup> Therefore, the overall goal is that most disputes are resolved through reconciling interest.<sup>67</sup>

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<sup>59</sup> Jone M, ‘What can the United Kingdom's tax dispute resolution system learn from Australia? An evaluation and recommendations from a dispute system design perspective’, 32 *Australian Tax Forum*, 1 (2017), 59-94.

<sup>60</sup> Bently D, ‘Problem resolution: does the ATO approach really work?’, 6 *Revenue Law Journal*, 1(1996), 17-42, Bently D, *Taxpayers rights: theory, origin and implementation*, Kluwer Law International, Alphen aan den Rijn, 2007, Mookhey S, ‘Tax dispute systems design’, 11 *eJournal of Tax Research*, 1(2013), 79-96, Jone M, ‘Evaluating Australia’s tax dispute resolution system: a dispute systems design perspective’, 13 *eJournal of Tax Research*, 1 (2015), 552-580.

<sup>61</sup> Jone M, ‘Evaluating New Zealand’s tax dispute resolution system: a dispute systems design perspective’ 22 *New Zealand Journal of Taxation Law and Policy*, 1 (2016), 228-258 and Jone M, ‘Tax dispute systems design: international comparisons and the development of guidance from a New Zealand Perspective’, Unpublished PhD thesis, University of Canterbury, 30 November 2016.

<sup>62</sup> Jone M, ‘Tax dispute systems design’, 139-176.

<sup>63</sup> Wolski B, ‘The model dispute resolution procedure for Australian workplace agreements: a dispute system design perspective’, 10 *Bond Law Review*, 1(1998), 7-42, 13.

<sup>64</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 6.

<sup>65</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 14.

<sup>66</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 16.

<sup>67</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18

From the three propositions, Ury, Brett and Goldberg formulate six fundamental principles to be applied in designing cost-efficient and interest-based dispute resolution procedures.<sup>68</sup> These fundamental principles, collectively known as the ‘Ury, Brett and Goldberg Model’<sup>69</sup>

The Ury, Brett and Goldberg model of DSD focuses on individual and matter-specific disputes.<sup>70</sup> This model places the focus on disputes and dispute resolution mechanisms as used to resolve disputes compared to other comparable models which focus on conflict management.<sup>71</sup> The model by Ury, Brett and Goldberg categorise the various means of resolving disputes and each of their consequences.<sup>72</sup> Dispute resolution systems based on Ury, Brett, and Goldberg’s propositions thus focus on the processes and approaches that people use, rather than the disputes themselves. The model also meets the two main requirements of a practical and useful conflict analysis model: first, simplicity in diagnosis and providing strategic guidance.<sup>73</sup> The model is simple in its diagnosis in that it proposes a single, detailed understanding of dispute resolution approaches and the costs and benefits associated with each approach. Second, the model also provides strategic guidance since the principles applied in DSD give directions that are practical and applicable to the practitioner.<sup>74</sup> The researcher will use the fundamental design principles to evaluate the design of the Kenyan tax dispute resolution system; thus the Ury, Brett, and Goldberg model form the conceptual springboard of this thesis. Each of these propositions is discussed in detail.

### **1.7.1. *There are three ways to resolve disputes***

#### **1.7.1.1. *Reconciling interests***

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<sup>68</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 6.

<sup>69</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 42-60.

<sup>70</sup> Costantino C A and Merchant C S, *Designing conflict management systems: a guide to creating productive and healthy organizations*, Jossey-Bass, San Francisco, 1996, 47.

<sup>71</sup> Furlong G T, *The conflict resolution toolbox: models & maps for analysing, diagnosing and resolving conflict*, John Wiley & Sons, Ontario, 2005, 20.

<sup>72</sup> Furlong G T, *The conflict resolution toolbox*, 20.

<sup>73</sup>: Furlong G T, *The conflict resolution toolbox*, 109.

<sup>74</sup> Furlong G T, *The conflict resolution toolbox*, 12.

The interests of the parties are the needs, desires and concerns of the parties.<sup>75</sup> The definition of ‘interests’ in this context is drawn from negotiation theory.<sup>76</sup> An interest-based approach focuses on the underlying interests of the parties to produce solutions which satisfy as many of those interests as possible.<sup>77</sup> Deep-seated concerns must be probed, creative solutions must be devised, and trade-offs must be made to satisfy as many interests as possible.<sup>78</sup> Interest-based procedures afford the parties more control in the nature, direction and outcome of the processes.<sup>79</sup> Interest-based methods indicate the underlying reason for the dispute and then using methods focused on this underlying principle to arrive at resolutions that are mutually acceptable and satisfactory.<sup>80</sup> Mainly, they take into account all the parties' interests.<sup>81</sup> There are two main interest-based dispute resolution methods; negotiation and mediation or facilitated discussions. These processes aim at producing a consensual settlement that accommodates the needs or interests of the parties. Often in tax disputes, the interests of the tax authority and the taxpayer subsumed and disregarded with more considerations being given to rights or exertions of power by the parties.<sup>82</sup>

#### 1.7.1.2. *Determining who is right*

Rights-based approaches involve a determination of who is ‘right’ according to some independent and objective standard which is perceived as legitimate and fair.<sup>83</sup> These objective and independent standards can be the terms of contract, custom, precedent or laws.<sup>84</sup> Often ‘rights’ are not always clear and so the parties have to turn to a neutral third party to apply agreed-upon principles or rules to the set of facts to determine who among the parties is right.<sup>85</sup> Arbitration and litigation, which are both forms of adjudication, fall in this approach of dispute

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<sup>75</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 5.

<sup>76</sup> Wolski B, ‘The model dispute resolution procedure for Australian workplace agreements’, 14.

<sup>77</sup> Fisher R and Ury W, *Getting to yes: negotiating an agreement without giving in*, Random House Business Books, 2 ed, 1991, 4.

<sup>78</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 6.

<sup>79</sup> Furlong G T, *The conflict resolution toolbox*, 112.

<sup>80</sup> Costantino C A and Merchant C S, *Designing conflict management systems*, 45.

<sup>81</sup> Costantino C A and Merchant C S, *Designing conflict management systems*, 45.

<sup>82</sup> Jones M, ‘Tax dispute systems design’, 65.

<sup>83</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 7.

<sup>84</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 7.

<sup>85</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 7.

resolution. Any form of adjudication that involves an independent tribunal making a binding and legally enforceable determination of matters in dispute is considered a ‘rights’-based procedure.

#### 1.7.1.3. *Determining who is more powerful*

Ury, Brett and Goldberg define power as ‘the ability to coerce someone to do something he would not otherwise do’.<sup>86</sup> The use of power characterises power-based approaches and these approaches often involve an exchange of threats, acts of aggression, and the withholding of benefits that derive from a relationship.<sup>87</sup> Ury, Brett and Goldberg note that the definition used is rather narrow.<sup>88</sup> This concept of power where A has ‘power’ over B to the extent A can get B to do something that B would not otherwise do is considered a ‘one-dimensional’ view of power.<sup>89</sup> It does make sense that this concept of power is used by Ury, Brett and Goldberg because this one-dimensional view of power is most observable when there is a social conflict and the parties test their capacities to affect outcomes, one such situation being disputes.<sup>90</sup>

Exercising power involves imposing a cost on the other side or threatening to do so.<sup>91</sup> The party with the most leverage determines the outcome of the dispute.<sup>92</sup> The obvious intent of these procedures is to coerce the other party to yield to terms that are more satisfactory to the party wielding power.<sup>93</sup> In a distressed dispute resolution system, many disputes are solved through power.<sup>94</sup>

#### 1.7.2. *Interest-based approaches are best*

Interests, rights, and power procedures generate different costs and benefits.<sup>95</sup> In comparing the approaches Ury, Brett and Goldberg focus on four criteria to determine which of the

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<sup>86</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 7.

<sup>87</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 8.

<sup>88</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 8.

<sup>89</sup> Lukes S, *Power: a radical view*, Palgrave Macmillian, London, 2ed, 2007, 16.

<sup>90</sup> Lukes S, *Power: a radical view*, 18.

<sup>91</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 8.

<sup>92</sup> Smith and Martinez, ‘An analytic framework for dispute systems design’, 128.

<sup>93</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*

<sup>94</sup> Costantino C A and Merchant C S, *Designing conflict management systems*, 45.

<sup>95</sup> Wolski B, ‘The model dispute resolution procedure for Australian workplace agreements’, 16.

approaches are better.<sup>96</sup> ‘Better’ or ‘best’ is measured by reference to transactions costs, satisfaction with procedures and outcomes, long-term effect on the parties’ relationship, and recurrence of disputes.<sup>97</sup> In this context, the transaction costs refer to time, money, resources consumed and destroyed, the emotional energy expended in disputing and the opportunities lost.<sup>98</sup> Satisfaction with procedures depends on the perceived fairness of the procedures.<sup>99</sup> The long-term effect on the parties’ relationship refers to the ability of the two parties to work together in the future.<sup>100</sup> Recurrence of the dispute focuses on whether the resolution will last or whether similar disputes will arise.<sup>101</sup> Ury, Brett and Goldberg propose that reconciling interests costs less and yields more satisfactory results than determining who is right, which in turn costs less and satisfies more than determining who is more powerful.<sup>102</sup> Based on this proposition, the costs associated with dispute resolution would be reduced, and the benefits of disputing would be increased if all disputes were resolved primarily through interest-based procedures such as negotiation and mediation.<sup>103</sup> However, it is neither possible nor desirable to resolve all disputes in this manner. Rights and power-based procedures may be necessary where the parties are unable or unwilling to use interest-based procedures.<sup>104</sup> There are also several situations, such as in cases concerning a significant question of public policy, where a rights-based procedure such as litigation is mandated.<sup>105</sup> Although reconciling interests is generally less costly than determining rights, rights-based procedures such as adjudication are the only procedures that can authoritatively resolve questions of public importance.<sup>106</sup>

### **1.7.3. The Goal: ‘Interests-oriented’ Dispute Resolution Systems**

Ury, Brett and Goldberg postulate that interest-based procedures have the potential to be the most cost-effective. They also recognise that rights and power-based procedures are necessary

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<sup>96</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 13.

<sup>97</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 11.

<sup>98</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 11.

<sup>99</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 12.

<sup>100</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 12.

<sup>101</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 12.

<sup>102</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 15.

<sup>103</sup> Wolski B, ‘The model dispute resolution procedure for Australian workplace agreements’, 16.

<sup>104</sup> Ury W, Brett J and Goldberg S B, *Getting Disputes Resolved*, 16.

<sup>105</sup> Ury W, Brett J and Goldberg S B, *Getting Disputes Resolved*, 17.

<sup>106</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18.

and desirable components of a dispute resolution system.<sup>107</sup> In order to reduce the costs of handling disputes, dispute systems designers endeavour to create systems that are ‘interests-oriented’, that is, systems that promote the resolution of disputes through use of interest-based procedures wherever possible but that also provide ‘low-cost ways to determine rights or power for those disputes that cannot or should not be resolved by focusing on interests alone’.<sup>108</sup> To sum up, the overall prescription for improved dispute resolution is to encourage interest-based methods and then use low-cost rights-based methods where necessary.<sup>109</sup> The goal of a designer is therefore to design a system where most disputes are resolved through reconciling interests.<sup>110</sup>

#### **1.7.4. Criticisms of the Model**

Although this model is considered revolutionary, it has been subjected to some criticism<sup>111</sup>. First, the model takes a linear approach to dispute resolution systems, focusing on the processes and approaches for resolving matter specific and single disputes.<sup>112</sup> While this first criticism is one of the aspects this model that was attractive for its use in this thesis, the model’s narrow approach to dispute systems does not address underlying systematic conflicts that traverse beyond the matter specific dispute between the parties.<sup>113</sup> Furthermore, the model does not address issues such as individual responses to disputes as a result of culture; rather, it places a focus on the ‘interests’ of the parties in the specific dispute.<sup>114</sup> The second criticism levelled against the model is that it does not place enough emphasis on the prevention of disputes as a necessary and essential aspect of the dispute resolution systems; the model revolves around the reconciliation of parties once a dispute has arisen.<sup>115</sup> Despite the criticisms levied, the model has been used to pursue the research objectives because of its focus on dispute resolution procedures as a core part of any dispute system.

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<sup>107</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18.

<sup>108</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18.

<sup>109</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18.

<sup>110</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18.

<sup>111</sup> Costantino C A and Merchant C S, *Designing conflict management systems*, 46

<sup>112</sup> Costantino C A and Merchant C S, *Designing conflict management systems*, 47.

<sup>113</sup> Costantino C A and Merchant C S, *Designing conflict management systems*, 47.

<sup>114</sup> Costantino C A and Merchant C S, *Designing conflict management systems*, 47.

<sup>115</sup> Costantino C A and Merchant C S, *Designing conflict management systems*, 47.

## 1.8. Research Methodology and Approaches

The author has adopted qualitative legal research methods for this thesis, i.e., the data underpinning the research is non numerical in contrast to quantitative research deals with numbers, statistics or hard data.<sup>116</sup> This thesis employs three qualitative approaches in addressing the research problem. The first approach is the doctrinal approach which involves the descriptive exposition of legal rules.<sup>117</sup> The purpose of this approach is to describe legal rules and offer commentary to give a complete statement on the law.<sup>118</sup> The doctrinal approach is mostly library based, focusing on primarily materials such as legislation and case law.<sup>119</sup>

The second approach utilized is the non-doctrinal approach. Non doctrinal legal research involves identifying a legal problem, analyzing the problem, and proposing changes to the law.<sup>120</sup> This thesis employs a non-doctrinal approach by evaluating the existing legal framework to outline an existing problem and then suggesting changes to the law.<sup>121</sup> The third approach used is a comparative approach which looks into “how different legal systems and legal cultures have addressed problems that our law faces but in a different way, and with what degree of perceived success or failure”.<sup>122</sup> This approach is particularly useful as it enables a researcher to consider the desirability of certain legal features that have been successfully introduced in other jurisdictions as a response to an analogous issue.<sup>123</sup> This thesis adopts a comparative approach by looking at some aspects of the tax dispute resolution procedures in other jurisdictions that have been more successful in utilizing non adversarial means of dispute resolution than Kenya.

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<sup>116</sup> Dobinson I and John N, ‘Qualitative legal research’ in McConville M and Chui W H (eds), *Research methods for law*, Edinburgh University Press, 2007, 16 - 45, 17.

<sup>117</sup> M Salter and Mason J, *Writing law dissertations: An introduction and guide to the conduct of legal research*, Pearson Education Limited, Essex, 2007, 49.

<sup>118</sup> Hutchinson T, ‘Doctrinal research’ in Watkins D and Burton M (eds), *Research methods in law*, Routledge, 2013, 7 – 33, 9.

<sup>119</sup> Chui W H, ‘Quantitative legal research’, in McConville M and Chui W H (eds), *Research methods for law*, Edinburgh University Press, 2007, 46 – 68, 47.

<sup>120</sup> Dobinson I and John N, ‘Qualitative legal research’,

<sup>121</sup> M Salter and Mason J, *Writing law dissertations*, 183.

<sup>122</sup> M Salter and Mason J, *Writing law dissertations*, 183.

<sup>123</sup> M Salter and Mason J, *Writing law dissertations*, 183.

The thesis commences with a review the literature on Kenya's tax dispute system, tax administration as well as Ury, Brett and Goldberg's DSD principles. Primary sources of data include the constitution of Kenya, the relevant acts of Parliament, secondary legislation and case law; these sources are essential as they delineate Kenya's economic system and tax dispute resolution system. Secondary sources of data, including books, online journal articles, theses, conference papers, and reports, will provide essential insight into tax administration and tax dispute resolution mechanisms and systems, as well as and Ury, Brett and Goldberg's dispute design principles.

## **1.9. Scope**

The thesis evaluates how Kenya's tax dispute system measures up against the Ury, Brett and Goldberg principles of dispute systems design. The focus is on the efficiency of the design of the dispute system. The thesis does not analyse whether the dispute system is effective in resolving tax disputes. This thesis does not seek to redesign the entire system of resolving tax disputes; instead, it considers how good design principles can ensure that more tax disputes are resolved by less adversarial to achieve lower dispute resolution costs, higher quality resolution, greater legitimacy, and an enhanced tax authority-taxpayer relationship. Furthermore, while it is acknowledged that local culture plays a significant role in tax dispute resolution, and may have a significant effect on the implementation of the proposed model in Kenya, an analysis of the cultural implications and the need for a culture change within KRA is beyond the scope of this thesis.

## **1.10. Literature Review**

The aim of undertaking a literature review is to account and evaluate the available literature on dispute systems design in tax dispute resolution to inform this study.

### ***1.10.1. Tax Dispute Resolution in Kenya***

Tran-Nam and Warpol note that a tax dispute occurs when a taxpayer takes a view contrary to that of the tax administrator with regards to their tax liabilities and entitlements and takes some course of action.<sup>124</sup> Although the authors identify a broad category of tax disputes, including complaints against the commissioner, this thesis will be restricted to the resolution of tax

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<sup>124</sup> Tran-Nam and Walpole, 'Independent tax dispute resolution and social justice in Australia', 477.

disputes arising from the assessment of tax liability and subsequent objection by the taxpayer.<sup>125</sup> In describing how tax disputes emerge and develop, Smith and Stanlas describe tax disputes as involving ‘Perceived Erroneous Applications of the Laws’ (PEALs) where both the tax authority and the taxpayer believe that the other party has not applied the law correctly, leading to contrary views on tax liability and entitlement.<sup>126</sup> Gordon states that tax administration law should provide for a fair, timely, and efficient manner of resolving tax disputes.<sup>127</sup> He goes on to state that it is preferable that a single method of resolving disputes from disagreement with an assessment up to the resolution of a final appeal.<sup>128</sup>

In Kenya, the first course of action available to the taxpayer is an objection to the commissioner's decision under the TPA.<sup>129</sup> Kashindi, while examining the viability of ADR as a mechanism in tax dispute resolution in Kenya, observes that historically, tax dispute resolution in Kenya has been mostly adversarial.<sup>130</sup> Kashindi further notes Kenya's legal framework only provides for adjudication before tribunals or the courts.<sup>131</sup> According to the KRA Sixth Corporate Plan 2015-2018, the majority of tax disputes in Kenya are resolved through some form of adversarial dispute resolution.<sup>132</sup> These processes are highly protracted, taking an average of 4 years to resolve disputes.<sup>133</sup> This situation is not limited to the Courts; the TAT has been at times lethargic despite the ninety-day limit provided for under the TATA.<sup>134</sup> A European Commission study observed that the main factors hindering effective resolution of tax disputes in Kenya include the adoption of an adversarial system of tax dispute resolution that focusses solely on winning, the backlog of cases in court, and the lack of

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<sup>125</sup> Tran-Nam and Walpole, ‘Independent tax dispute resolution and social justice in Australia’, 477.

<sup>126</sup> Smith W and Stalans L J, ‘Negotiating strategies for tax disputes: preferences of taxpayers and auditors’, 19 *Law & Social inquiry*, 2 (1994), 337-368, 345.

<sup>127</sup> Gordon R K, ‘Law of tax administration and procedure’, in Thuronyi V (ed), *Tax law design and drafting*, International Monetary Fund, Washington D.C, 1996, 106 – 142, 115.

<sup>128</sup> Gordon R K, ‘Law of tax administration and procedure’, 115.

<sup>129</sup> Section 51 (1), *Tax Procedures Act*, (Act No. 29 of 2015).

<sup>130</sup> Kashindi G A, ‘Tax dispute resolution in Kenya’, 36.

<sup>131</sup> Kashindi G A, ‘Tax dispute resolution in Kenya’, 36.

<sup>132</sup> Kenya Revenue Authority, *Sixth corporate plan*, 2015, 50.

<sup>133</sup> Kenya Revenue Authority, *Sixth corporate plan*, 2015, 50.

<sup>134</sup> *Okiya Omtatah Okiiti & another v Bidco Africa & 4 others* [2018] eKLR. In this case, the period granted to the Tribunal had been exceeded by two years. In view of its inordinate delay, the judge suggested that judicial review would have been appropriate for the issue of delay to be addressed.

specialist experience in tax committees and courts hindered the effective resolution of tax disputes in Kenya.<sup>135</sup> According to Ado, despite the existence of a statutory appeal mechanism against the decisions of the commissioner, taxpayers still prefer to file their disputes directly to courts.<sup>136</sup> The admission of such cases is then subsequently justified by the court's powers of judicial review.<sup>137</sup> For example, in *Republic v Commissioner of Income Tax Ex Parte SDV Transami (Kenya) Limited*,<sup>138</sup> a dispute over a decision by the commissioner of income tax to recover withholding tax payable, the court held that judicial review was an appropriate cause of action against the decision. Further in *Keroche Industries v Kenya Revenue Authority & 5 Others*<sup>139</sup> the Court held:

*“The respondents’ argument that the applicant came to court prematurely without exhausting the internal tax objection process as regards each category of tax, is a serious misdirection because as it has been stated elsewhere in this judgment the issues raised were greater than any of the internal tribunals could handle. The task before the court is not, and has not been that of counting the shillings, it has been one of adjudicating on illegality, the doctrine of ultra vires, irrationality, procedural impropriety, Wednesbury unreasonableness, oppression, malice, bias, discrimination and abuse of power.”*

A common objection raised by KRA, apparent from case law in such disputes, is that the taxpayer ought not to access the courts before exhausting the appeal mechanisms provided in statutes such as the TPA and the TATA.<sup>140</sup> However, Migai argues that tax litigation in the context of judicial review is not entirely unwarranted.<sup>141</sup> Taxpayers are prompted to pursue

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<sup>135</sup> European Commission, ‘Appendix D: country study Kenya’, *Transfer pricing and developing countries final report*, 2011, 16.

<sup>136</sup> Ado M, ‘Transfer pricing disputes in Kenya’, 16.

<sup>137</sup> Ado M, ‘Transfer pricing disputes in Kenya’, 16.

<sup>138</sup> [2005] eKLR.

<sup>139</sup> [2007] eKLR.

<sup>140</sup> See for example; *Republic v Kenya, Revenue Authority Exparte Bata Shoe Company (Kenya) Limited* [2014] eKLR, , *Republic v Kenya Revenue Authority Ex-parte KSC International Limited (In Receivership)* [2016] eKLR, *Republic v Kenya Revenue Authority exparte Interactive Gaming & Lotteries Limited* [2016] eKLR, *Cimbria East Africa Limited v Commissioner of Investigation and Enforcement & another* [2016] eKLR, , *Republic v Kenya Revenue Authority Ex Parte Abdalla Brek Said t/a Al Amry Distributors & 4 others* [2016] eKLR, *Republic v Kenya Revenue Authority ex parte New Frarims Wholesalers Limited & 3 others* [2017] eKLR.

<sup>141</sup> Aketch M, *Administrative law*, Strathmore University Press, Nairobi, 2016, 237.

judicial review to seek relief from the courts as a result of KRA's failure to issue tax assessment notices, give taxpayers proper hearings, and seek and enforce agency notices procedurally; the Authority also takes an inordinate amount of time to respond to objections and abuses its discretionary powers.<sup>142</sup> Unfortunately, needless aggression by KRA owing to higher tax targets will only result in more frivolous cases. While litigation of tax disputes through judicial review is instrumental in ensuring accountability in tax administration, taxpayers have utilised it as a dilatory tactic.<sup>143</sup> As has been noted though, the courts have been quick to emphasise that where statutory remedies have been provided, the courts must be reluctant in hearing the matters, and they must first give an opportunity to the relevant bodies or state organs to deal with the dispute.

Thuronyi and Espejo state that excessive litigation can lead to delays in the collection of taxes and is costly for the taxpayer and the tax authority.<sup>144</sup> Furthermore, in a study conducted by Worsham, he concluded that taxpayers who had indirectly had unfavourable experiences with the tax administrator were less likely to be compliant in future.<sup>145</sup> Tran-Nam and Walpole also observe that excessive litigation costs can negatively impact social justice and can compromise effective access to independent tax dispute resolution.<sup>146</sup> In a joint International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD) report on tax certainty, it was observed that issues associated with dispute resolution mechanisms, for example, lengthy dispute resolutions processes and unpredictability of the costs of litigation were likely to contribute to uncertainty.<sup>147</sup> Furthermore, lingering and unresolved tax disputes cause commercial difficulties which may, in turn, deter investment.<sup>148</sup> To this extent, Okello

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<sup>142</sup> Aketch M, *Administrative law*, 237.

<sup>143</sup> Aketch M, *Administrative law*, 236.

<sup>144</sup> Thuronyi V and Espejo I, *How can an excessive volume of tax disputes be dealt with?*, 4.

<sup>145</sup> Worsham R, 'The effect of tax authority behaviour on taxpayer compliance: a procedural justice approach', 18 *Journal of American Taxation Association*, 2 (1996), 19-39, 19.

<sup>146</sup> Tran-Nam B and Walpole M, 'Tax disputes, litigation costs and access to tax justice', 325.

<sup>147</sup> International Monetary Fund and Organisation for Economic Co-operation and Development, *Tax Certainty*, 2017, 22.

<sup>148</sup> International Monetary Fund and Organisation for Economic Co-operation and Development, *Tax Certainty*, 2017, 22.

concludes that fair and expeditious tax dispute resolution is essential to an effective self-assessment system.<sup>149</sup>

Thuronyi and Espejo make several recommendations to deal with excessive and protracted tax disputes: simplification of tax laws, organization of efficient appeals systems which incorporate ADR procedures, ensuring that tax administrations take a cooperative approach to taxpayers, specifying the law on administrative procedures, and taking administrative actions that lead to a greater culture of taxpayer compliance.<sup>150</sup> ADR procedures are of particular importance in alleviating the problem of protracted tax disputes. ADR has been described as ‘an umbrella term for processes, other than judicial determination, in which an impartial person assists those in dispute to resolve the issues between them’.<sup>151</sup> Broadly, ADR encompasses non-judicial processes such as arbitration, conciliation, mediation, negotiation, conferencing, facilitated discussions, adjudication, case appraisal, ombudsman and neutral evaluation.<sup>152</sup> ADR has been cited as being less expensive and more time efficient than litigation specifically, the use of facilitative dispute resolution procedures such as mediation, the efficiency of tax administration and voluntary compliance can be improved.<sup>153</sup>

The shift towards ADR in tax dispute resolution denotes KRA are oriented towards building trust, support and respect within the community which in turn encourages voluntary compliance. This is certainly evident in KRA’s mission statement<sup>154</sup> and seems to be the driving force behind the adoption of the ADR framework.<sup>155</sup> The OECD has suggested the use of cooperative compliance by tax administrators, especially when dealing with corporate tax disputes and vice versa.<sup>156</sup> Under cooperative compliance, tax administrators should demonstrate commercial awareness, impartiality, proportionality, transparency and

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<sup>149</sup> Okello A, *Managing income tax compliance through self-assessment*, 35.

<sup>150</sup> Thuronyi V and Espejo I, *How can an excessive volume of tax disputes be dealt with?*, 47.

<sup>151</sup> National Alternative Dispute Resolution Advisory Council, *Dispute resolution terms*, 4.

<sup>152</sup> National Alternative Dispute Resolution Advisory Council, *Dispute resolution terms*, 4-10.

<sup>153</sup> Meyercord L, ‘Avoiding state bankruptcy: mediation as an alternative to resolving state tax disputes’, 29 *Review of litigation*, 4 (2010), 925-950, 927.

<sup>154</sup> *"Building Trust through Facilitation so as to foster Compliance with Tax and Customs Legislation"*

<sup>155</sup> Kashindi G A, ‘Tax dispute resolution in Kenya: viability including alternative dispute resolution mechanisms’, 58.

<sup>156</sup> OECD, *Co-operative compliance: a framework from enhanced relationship to co-operative compliance: from enhanced relationship to co-operative compliance*, OECD Publishing, Paris, 2013, 15.

responsiveness.<sup>157</sup> The taxpayer, in turn, should exercise disclosure and demonstrate transparency.<sup>158</sup> The cooperative compliance approach aims at resolving disputes quickly, and thus ADR is the best basis of tax dispute resolution.<sup>159</sup> Kenya has taken measures to reform the tax dispute resolution system along these lines: TPA harmonised and simplified tax dispute resolution procedures, the TATA established a specialised independent tribunal, and the KRA has created an internal ADR framework and the CTDR. According to the Commissioner General of the Kenya Revenue Authority, the launch of the framework is informed by the need for transparency in dealing with taxpayers and enhancing compliance through building trust and fair treatment of the taxpayer.<sup>160</sup>

While KRA's ADR framework has been appreciated and applauded, the Institute of Certified Public Accountants of Kenya (ICPAK) makes two general observations of the framework.<sup>161</sup> First, that the framework is too limited in scope as it only provides for facilitated discussions as the sole dispute mechanism and second, that the framework does not present a balanced approach by KRA to the dispute resolution process.<sup>162</sup> The likely effect is that if the framework is implemented as is, it is likely to see limited uptake by taxpayers.<sup>163</sup> Furthermore, Kashindi notes that the disclaimer in the ADR framework absolving KRA of responsibility, liability or duty of care for consequences suffered on relying upon the information contained in the framework or any decision based on it does not inspire confidence in the taxpayer and displays unwillingness by KRA.<sup>164</sup>

Kashindi has also identified two critical shortcomings of the ADR framework. The first shortcoming is that the framework is inadequately supported within the law.<sup>165</sup> The second is that the ADR framework as is without any express statutory backing may be in conflict with

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<sup>157</sup> OECD, *Co-operative compliance*, 15.

<sup>158</sup> OECD, *Co-operative compliance*, 15.

<sup>159</sup> OECD, *Co-operative compliance*, 50-51.

<sup>160</sup> Kenya Revenue Authority, *Transcript of the Commissioner General's speech on launch of Alternative Dispute Resolution (ADR) framework*, 1.

<sup>161</sup> Institute of Certified Public Accountants of Kenya, *ICPAK comments on KRA alternative dispute resolution mechanism*, 2015, 1.

<sup>162</sup> Institute of Certified Public Accountants of Kenya, *ICPAK comments on KRA alternative dispute resolution mechanism*, 2015, 1.

<sup>163</sup> ICPAK, *ICPAK Comments on KRA Alternative Dispute Resolution Mechanism*, 1.

<sup>164</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 50.

<sup>165</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 50.

the Article 210 of the Constitution of Kenya.<sup>166</sup> Nevertheless, KRA has committed itself to use the Tax Appeals Tribunal and ADR.<sup>167</sup> The main objective being reducing litigation, freeing up revenue and timely resolution of tax disputes.<sup>168</sup> KRA also seek to reduce the cost of collection of revenue.<sup>169</sup> The courts based on Article 159 (2), as mandated have also encouraged the use of ADR in tax disputes.<sup>170</sup>

### 1.10.2. DSD

According to Ury, Brett and Goldberg, DSD principles assist in developing dispute resolution procedures that promise lower costs, promote higher quality resolution, and develop the motivation to use the procedures and the skills necessary to use the procedures effectively.<sup>171</sup> Frank remarks that DSD has its foundation in the ADR movement and more specifically in organisational dispute resolution.<sup>172</sup> Goldberg *et al.* provide a historical account of the ADR movement, and the goals and justifications of ADR championed by the ADR movement, amongst them are: reduced caseloads and expenses, speedy resolution, improve public satisfaction and increased public compliance.<sup>173</sup> The ADR movement also opposed the assumption and mentality that within an adversarial system of law that it is the lawyer's responsibility to 'win' for the client employing every means available and allowable - essentially that the object of dispute resolution is a victory.<sup>174</sup> The result of such an approach is that courts issue narrow win-lose outcomes rather than problem-solving solutions that take into account the context of the dispute and the broader relationships of the parties.<sup>175</sup> The search for win-lose outcomes was cited as one of the problems that hinder effective resolution of tax

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<sup>166</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 50.

<sup>167</sup> Kenya Revenue Authority, *Sixth corporate plan*, 49.

<sup>168</sup> Kenya Revenue Authority, *Sixth corporate plan*, 49.

<sup>169</sup> Kenya Revenue Authority, *Sixth corporate plan*, 20.

<sup>170</sup> *Standard Resource Group Ltd v Attorney General & 2 others* [2016] eKLR

<sup>171</sup> Brett and Goldberg, 'Dispute systems design', 53.

<sup>172</sup> Franck S D, 'Integrating investment treaty conflict and dispute systems design', 177.

<sup>173</sup> Goldberg S B, Sander E A, Rogers E A and Cole R S, *Dispute resolution: negotiation, mediation and other processes*, Aspen Publishers, New York, 4 ed, 2003, 8.

<sup>174</sup> Mackie K J, 'Dispute resolution: the new wave', in Mackie K J (ed), *A handbook of dispute resolution: ADR in action*, Routledge, New York, 1991, 5.

<sup>175</sup> Mackie K J, 'Dispute resolution', 6.

disputes in Kenya.<sup>176</sup> Under the current constitutional order which promotes the use of ADR<sup>177</sup> and mandates substantive justice over procedural technicalities<sup>178</sup>, this is no longer a tenable philosophy of dispute resolution philosophy.

Franck observes that DSD has been employed successfully to avoid expensive and destructive litigation. Furthermore, DSD has improved dispute systems by reducing the time and money involved in resolving conflicts.<sup>179</sup> Nabatchi and Bingham note that better dispute systems foster shared confidence and enhance prospects of cooperation.<sup>180</sup> Such dispute systems reinforce norms of reciprocity which are essential for continued relationships.<sup>181</sup> Norms of reciprocity are especially crucial in the context of tax dispute resolution with KRA since the latter seeks to enhance compliance through building trust and cooperation with the taxpayer.

Wolski summarises that the central goal is to reduce the costs associated with dispute resolution, where costs are measured by reference to four broad criteria: transaction costs (money, time and emotional energy expended in disputing), satisfaction with procedures and outcomes, long-term effect of the procedures on the parties' relationship and recurrence of disputes.<sup>182</sup> High transaction costs, lack of economic efficiency of dispute resolution, low economic competitiveness and high caseloads in civil justice systems have been cited as factors that motivate the use of DSD to institute dispute resolution reforms.<sup>183</sup> Another core concern

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<sup>176</sup> European Commission, 'Appendix D: country study Kenya', *Transfer pricing and developing countries final report*, 2011, 16.

<sup>177</sup> Article 159 (2) (c), *Constitution of Kenya* (2010), 'In exercising judicial authority, the courts and tribunals shall be guided by the following principles—... alternative forms of dispute resolution including reconciliation, mediation, arbitration and traditional dispute resolution mechanisms shall be promoted...'

<sup>178</sup> Article 159 (2) (c), *Constitution of Kenya* (2010), 'In exercising judicial authority, the courts and tribunals shall be guided by the following principles—... justice shall be administered without undue regard to procedural technicalities...'

<sup>179</sup> Franck S D, 'Integrating investment treaty conflict and dispute systems design', 178.

<sup>180</sup> Nabatchi T and Bingham L B, 'From postal to peaceful: dispute systems design in the USPS REDRESS program', 30 *Review of Public Personnel Administration*, 2 (2010), 211-234, 228.

<sup>181</sup> Nabatchi and Bingham, 'From postal to peaceful', 230.

<sup>182</sup> Wolski B, 'The model dispute resolution procedure for Australian workplace agreements', 13.

<sup>183</sup> Bingham B L, Lee W S and Chang KW, 'Participatory Governance in South Korea: Legal Infrastructure, Economic Development and Dispute Resolution', 19 *Symposium judicial independence and legal infrastructure: essential partners for economic development*, 2 (2007), 375-399, 397.

for DSD is justice and accountability.<sup>184</sup> According to Amsler and Sherrod, DSD, through design provides a forum through which justice can be accessed and when used as a tool for evaluation, it can be used to determine a system's commitment to and potential for justice.<sup>185</sup>

Constantino and Merchant state that the process of DSD consists of four stages; a) organisational diagnosis, b) system design, c) implementation and d) exit, evaluation, and diffusion.<sup>186</sup> Nabatchi and Bingham note that organisational diagnosis and systems design are the most critical.<sup>187</sup> System design as one of the four processes of DSD involves following the six general principles proposed by Ury, Brett and Goldberg.<sup>188</sup>

Nabatchi and Bingham claim that systems that follow these general design principles are more likely to produce more positive dispute outcomes.<sup>189</sup> Smith and Martinez state that the principles bear on whether the criteria and expected outcomes of a successful dispute system can be met.<sup>190</sup> This thesis will focus on the system design aspect of DSD.

### **1.10.3. DSD in Tax Dispute Resolution**

While DSD was initially developed in the context of ADR however, Bingham notes that its scope is wide enough to be used in "the creation of systems within administrative agencies for handling both their own internal conflict and for carrying out their public mission to create, implement, and enforce public policy."<sup>191</sup> To this end, in the field of tax dispute resolution, several studies have utilised DSD to evaluate the designs of tax dispute resolution systems.

Bentley utilises the six principles proposed by Ury, Brett and Goldberg to analyse the Australian Tax Office's (ATO) complaint-handling procedure.<sup>192</sup> In the analysis, Bentley concluded that the complaints handling procedure met all six of the principles and the

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<sup>184</sup> Amsler L B and Sherrod J, 'Accountability forums and dispute system design', 40 *Public performance & management review*, 3 (2017), 529-550, 531.

<sup>185</sup> Amsler L B and Sherrod J, 'Accountability forums and dispute system design', 546.

<sup>186</sup> Costantino C A and Merchant C S, *Designing conflict management systems*, 46.

<sup>187</sup> Nabatchi and Bingham, 'From postal to peaceful', 215.

<sup>188</sup> Nabatchi and Bingham, 'From postal to peaceful', 216.

<sup>189</sup> Nabatchi and Bingham, 'From postal to peaceful', 215.

<sup>190</sup> Smith S and Martinez J, 'An analytic framework for dispute systems design', 128.

<sup>191</sup> Bingham L B, 'Designing justice: legal institutions and other systems for managing conflict', 24 *Ohio State Journal on Dispute Resolution*, 1(2008), 1-52, 2.

<sup>192</sup> Bentley D, 'Problem resolution', 17-42.

Australian Tax Office was eager to resolve problems raised by the taxpayer, in line with their goal of increasing taxpayer compliance.<sup>193</sup> Bentley's study made several suggestions to make the procedure more effective based on the principles, including increasing flexibility on access to the procedure, increasing room for further interaction and allowing receipt of feedback from the taxpayer.<sup>194</sup> In an updated study, Bentley uses his previous study as a foundation to develop a model charter of taxpayers' rights to be used as best practice for tax administrators.<sup>195</sup> In the updated study he applies all six principles and suggests the inclusion of two more principles as follows: provide effective mechanisms for measuring qualitative success; and provide mechanisms for monitoring, reviewing and improvement.<sup>196</sup>

Mookhey also evaluates the Australian Tax Office's dispute resolution model against the Ury, Brett and Goldberg Model.<sup>197</sup> Mookhey finds that the Australian Tax Office's (ATO) dispute resolution model meets much of the best practice principles.<sup>198</sup> However, she identifies room for reform such as improving affordable access at the first levels of dispute resolution to ensure early stage negotiation with a positive outcome.<sup>199</sup> The study concludes that the fact that the ATO model meets much of the best practice principles reflects the assertions of the Australian Tax Office's eagerness to resolve disputes with taxpayers.<sup>200</sup>

Jone, evaluates the design of tax disputes systems in New Zealand, Australia, The United Kingdom and The United States.<sup>201</sup> In the study, Jones looks at how these systems achieve their objectives through DSD principles.<sup>202</sup> The study concludes that the United Kingdom and

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<sup>193</sup> Bentley D, 'Problem resolution', 41.

<sup>194</sup> Bentley D, 'Problem resolution', 42.

<sup>195</sup> Bentley D, *Taxpayers rights*, 198-205.

<sup>196</sup> Bentley D, *Taxpayers rights*, 207.

<sup>197</sup> Mookhey S, 'Tax dispute systems design', 79-96.

<sup>198</sup> Mookhey S, 'Tax dispute systems design', 94.

<sup>199</sup> Mookhey S, 'Tax dispute systems design', 94.

<sup>200</sup> Mookhey S, 'Tax dispute systems design', 94.

<sup>201</sup> Jone M, 'Tax dispute systems design', 69. Jones has also conducted separate studies evaluating the Australian tax dispute system, The United Kingdom tax dispute system and the New Zealand tax dispute system guided by fourteen DSD principles based on the principles proposed by Ury, Brett and Goldberg. See, Jone M, 'evaluating Australia's tax dispute resolution system: a dispute systems design perspective', 552-580, Jone M, 'Evaluating New Zealand's tax dispute resolution system', 228-258, Jone M, 'Evaluating New Zealand's tax dispute resolution system', 59-96.

<sup>202</sup> Jones M, 'Tax dispute systems design', 10.

the United States meet most of the DSD principles.<sup>203</sup> The two systems provide multiple points to access the system; however, their revenue authorities seem reluctant to promote or encourage ADR.<sup>204</sup> Of the four jurisdictions, New Zealand appears to be worst placed with no loopbacks to previous dispute resolution procedures.<sup>205</sup> Furthermore, the New Zealand system appeared to be lacking both in terms of the structure of the system and the support and championship of the system.<sup>206</sup> Jones notes that in all four jurisdictions, the taxpayers display negative perceptions of fairness which can be attributed to the fundamental adversity existing between the taxpayer and the tax authority and also due to the power imbalance that exists between them.<sup>207</sup> Bently provides the following justification for the application of DSD in tax dispute resolution, “For all tax systems, dispute system design within the tax administration is becoming critical to the successful engagement of taxpayers with the system.”<sup>208</sup> On Bentley and Mookhey’s studies, Jones notes that the focus on Australia provides “scope for a comparative DSD analysis to be conducted on the tax dispute resolution procedures in other jurisdictions in order to compare the effectiveness of the design of different jurisdictions’ tax dispute resolution procedures”.<sup>209</sup> This thesis aims to contribute to this body of literature by contributing a similar analysis of Kenya’s tax dispute resolution system.

### **1.11. Chapter Breakdown**

Chapter one contains the structure and contents of the research proposal. It states out the research problem, the research questions, the hypothesis, literature review, theoretical framework, the scope of the study and the methodology.

Chapter two gives a description of how general disputes emerge and how tax disputes in particular develop. This chapter will also give an overview of the interests of the parties in a tax dispute, which inevitably determines the positions they hold in a dispute and how the parties may approach tax disputes. Chapter three examines and discusses Kenya’s tax dispute resolution system and procedures.

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<sup>203</sup> Jones M, ‘Tax dispute systems design’, 182.

<sup>204</sup> Jones M, ‘Tax dispute systems design’, 182.

<sup>205</sup> Jones M, ‘Tax dispute systems design’, 182.

<sup>206</sup> Jones M, ‘Tax dispute systems design’, 183.

<sup>207</sup> Jones M, ‘Tax dispute systems design’, 183.

<sup>208</sup> Bently D, *Taxpayers rights*, 408.

<sup>209</sup> Jones M, ‘Tax dispute systems design’, 69.

Chapter four gives a critical background to DSD and explains the DSD principles utilised in this study. Chapter five critically evaluates Kenya's tax dispute resolution system and procedures through the DSD principles discussed in chapter four. Finally, chapter six summarises the research findings and makes recommendations and concludes the study.



## CHAPTER TWO

### EMERGENCE OF TAX DISPUTES

#### 2.1. Introduction

Disputes are inevitable in society.<sup>210</sup> They are not confined to any specific space, time or social traditions.<sup>211</sup> Disputes are to be expected in relationships where parties have different ‘interests’.<sup>212</sup> To this extent, human beings have been described as ingenious social animals in their responses to resolving disputes and interpersonal conflicts.<sup>213</sup> These responses to resolving disputes often involve merging positions based on divergent interests and turning them into a single outcome.<sup>214</sup> This chapter explores how tax disputes emerge by utilising general theories on how disputes, and highlight the interests that the tax authorities and the taxpayer often seek to protect in disputes between them.

For tax authorities, their interests can be conceptualised as task-interests, i.e., interests connected to the work that they perform.<sup>215</sup> These task-interests play a role in dispute resolution procedures and will be examined in this chapter. While the interests of the taxpayer may be varyingly complex, entangled and hard to identify, it is generally accepted in dispute resolution research has identified that taxpayer interests just like the parties in a civil dispute can fall within three broad categories: vindication and protection of their individual rights, self-interest maximization and fair treatment.<sup>216</sup> This chapter analyses the initial aspect of DSD namely what types of disputes exist.<sup>217</sup> By understanding the nature of the conflict and the interest of the parties, one is able to determine what channels would result in the most appropriate conflict resolution.<sup>218</sup>

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<sup>210</sup> Tran-Nam B and Walpole M, ‘Independent tax dispute resolution and social justice in Australia’, 477.

<sup>211</sup> Tran-Nam B and Walpole M, ‘Independent tax dispute resolution and social justice in Australia’, 477.

<sup>212</sup> Ury, Brett and Goldberg, *Getting disputes resolved*, xii.

<sup>213</sup> Felstiner W L F, ‘Influences of Social organization on Dispute Processing’ 9 *Law & Society Review*, 1 (1974), 63-94, 63.

<sup>214</sup> Ury, Brett and Goldberg, *Getting disputes resolved*, 18.

<sup>215</sup> Morgan G, *Images of Organization*, Berrett-Koehler Publishers, San Francisco, 2007, 157.

<sup>216</sup> Smith W and Stalans L J, ‘Negotiating strategies for tax disputes’, 345.

<sup>217</sup> Ury, Brett and Goldberg, *Getting disputes resolved*, 20.

<sup>218</sup> Ury, Brett and Goldberg, *Getting disputes resolved*, 20.

## 2.2. Emergence of Disputes

Disputes can be defined as a divergence of interest.<sup>219</sup> The ‘interests’ here can be broadly be conceptualized as the “predispositions embracing goals, values, desires, expectations, and other orientations and inclinations” that influence individual behaviour.<sup>220</sup> Disputes are said to emerge in three stages: naming, claiming and blaming.

In the first stage, an experience that was previously not perceived as injurious is perceived as an injurious experience.<sup>221</sup> Recognizing and labelling an experience as injurious is known as naming.<sup>222</sup> Naming arises when the potential disputant believes that another party has either made a mistake, denied them an entitlement or has acted in bad faith. The second stage involves attributing the injury to the fault of another individual which is known as blaming.<sup>223</sup> The third stage involves a request for some remedy for the perceived injury from the person who is believed to be at fault for causing the injury; this is known as claiming.<sup>224</sup> A claim is then transformed into a dispute if the person who is believed to be at fault rejects the claim in whole or in part.<sup>225</sup>

In summary, for a dispute to emerge, a grievance must be attributed to another party. The aggrieved party must then formulate goals or interests that the hold that directed at the other party, which they believe that the other party can address or satisfy.<sup>226</sup> The aggrieved party may seek a remedy in the form of more money, or other matters in the other party’s control such as a change in behaviour.<sup>227</sup> Considering disputes in this way helps us understand the

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<sup>219</sup> Ury, Brett and Goldberg, *Getting disputes resolved*, 18.

<sup>220</sup> Morgan G, *Images of Organization*, 157.

<sup>221</sup> Felstiner F W, Abel R L and Sarat A, ‘The emergence and transformation of disputes: naming, blaming and claiming’, 15 *Law & Society Review*, 4 (1980), 631-654, 633.

<sup>222</sup> Felstiner F W, Abel R L and Sarat A, ‘The emergence and transformation of disputes’, 635.

<sup>223</sup> Felstiner F W, Abel R L and Sarat A, ‘The emergence and transformation of disputes’, 635.

<sup>224</sup> Felstiner F W, Abel R L and Sarat A, ‘The emergence and transformation of disputes’, 636.

<sup>225</sup> Felstiner F W, Abel R L and Sarat A, ‘The emergence and transformation of disputes’, 636.

<sup>226</sup> Kriesberg L and Dayton Bruce W, *Constructive conflicts: from escalation to resolution*, Rowman & Littlefield Publishers Inc, Plymouth, 4 ed, 2012, 71.

<sup>227</sup> Kriesberg L and Dayton Bruce W, *Constructive conflicts*, 71.

underlying cause of the dispute, the interests of the disputing parties, and how effective a mechanism will be in resolving the dispute.<sup>228</sup>

### **2.2.1. *The Emergence of Tax Disputes***

Kenya employs a self-assessment system which was implemented in 1992.<sup>229</sup> Under the self-assessment system, individuals determine their tax liability directly, without any intervention from KRA and submit tax returns and payments.<sup>230</sup> The self-assessment model is based on voluntary compliance, and tax administrators generally accept the tax return and payment in the first instance without technical scrutiny.<sup>231</sup> This system acknowledges that the taxpayer is in the best position to determine their own tax liability as they have first-hand knowledge of their business affairs and financial transactions.<sup>232</sup>

As part of the revenue authority's role in ensuring compliance with tax laws, it is empowered to conduct tax audits.<sup>233</sup> Tax audits are essentially examinations into the taxpayer's return to determine whether the taxpayer has correctly assessed and reported their tax liability and fulfilled their legal obligations.<sup>234</sup> The primary purpose of a tax audit is to determine whether the information provided by the taxpayer in their tax return is accurate or not.<sup>235</sup> In determining the tax full tax liability of a taxpayer the commissioner may by written notice, require a taxpayer or registered person to produce for examination any documents.<sup>236</sup> A tax audit will involve auditors from KRA checking whether the taxpayer, based on the documents provided,

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<sup>228</sup> Felstiner F W, Abel R L and Sarat A, 'The emergence and transformation of disputes', 649.

<sup>229</sup> Okello A, *Managing income tax compliance through self-assessment*, 12.

<sup>230</sup> Eissa O N and Jack W, 'Tax reform in Kenya: policy and administrative issues', in Gordon H R (ed), *Taxation in developing countries: six case study and policy implications*, Colombia University Press, New York, 2010, 198-219, 211.

<sup>231</sup> Okello A, *Managing income tax compliance through self-assessment*, 11.

<sup>232</sup> Okello A, *Managing income tax compliance through self-assessment*, 11.

<sup>233</sup> Section 58, *Tax Procedure Act* (Act No. 29 of 2015).

<sup>234</sup> Organization for Economic Development, *Strengthening tax audit capabilities: general principles and approaches*, OECD Publishing, Paris, 2006, 9.

<sup>235</sup> Organization for Economic Development, *The changing tax compliance environment and the role of audit*, 2017, 58.

<sup>236</sup> Section 59 (1), *Tax Procedure Act* (Act No. 29 of 2015).

has correctly applied the law.<sup>237</sup> Under the TPA, the KRA is permitted to carry out audits for a period of 5 years from the year of assessment.<sup>238</sup>

A dispute begins to develop between KRA and the taxpayer where KRA identifies a possible misapplication of the law or inconsistency in the tax return. Within the framework of how disputes emerge, identification corresponds to naming.<sup>239</sup> In the case of an audit, the identified misapplication of the law is then brought to the attention of the taxpayer. The taxpayer under audit is then asked to respond or is requested to provide further information to the auditor that would explain the identified issues. The request for the taxpayer's response, coupled with a proposed adjustment of the tax return to reflect what the auditor considers to be the taxpayer's full tax liability corresponds to claiming.<sup>240</sup> Where the taxpayer agrees that there has been a misapplication of the law on their part and there exists some tax liability, the self-assessment initially submitted is amended and the commissioner issues the taxpayer with a written notice setting out the amendment and amount of tax due.<sup>241</sup> If the taxpayer and the tax authority do not agree on the auditor's findings, the commissioner will still amend the assessment and issue the taxpayer with a written notice setting out the amendment and amount of tax due. The issuing of an amended assessment does also correspond to the issuing of a claim. At this point, the taxpayer can reject the 'claim' of the commissioner in whole or in part by filing a notice of objection to the decision of the commissioner in writing within 30 days setting out the grounds of the objection.<sup>242</sup> Possible grounds of objection include the assertion that the commissioner has misinterpreted a specific provision of the law or that there is another relevant provision of the law pursuant to which an audit of the taxpayer's return would not result in the assessment decision.

Where the taxpayer has not submitted a tax return, the commissioner may issue what is known as a default assessment. In default assessment, the tax liability is assessed by the commissioner based on the information available to the commissioner and to the best of the commissioner's judgment.<sup>243</sup> Once a default assessment is issued the taxpayer can file a notice of objection

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<sup>237</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 342.

<sup>238</sup> Section 31, *Tax Procedure Act* (Act No. 29 of 2015).

<sup>239</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 342.

<sup>240</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 342.

<sup>241</sup> Section 31 (8), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>242</sup> Section 51 (1) and (2), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>243</sup> Section 29 (1), *Tax Procedure Act* (Act No. 29 of 2015).

against the default assessment within 30 days. The commissioner is expected to decide on the notice of objection from the taxpayer within 60 days either allowing the objection or confirming the assessment.<sup>244</sup>

### **2.2.2. Characteristics of Tax Disputes**

Unlike most civil disputes which involve a 'Perceived Injurious Experience' (PIE), tax disputes are usually about 'Perceived Erroneous Applications of the Law' (PEAL).<sup>245</sup> The claims raised by the tax authority are based on their interpretation of what the law provides, whether the law has been applied correctly by the taxpayer and whether the taxpayer has met their full obligations as set out in the law.<sup>246</sup> To persuade and convince the tax authority in a dispute involving a PEAL, the taxpayer would have to successfully advance legal arguments that showing that the in naming and claiming, the tax authority erroneously applied the law either through wrong interpretation or the facts correspond to another provision.<sup>247</sup> Disputes that begin with PEALs may at times become subsumed with disputes about a PIE.<sup>248</sup> A PEAL dispute may be subsumed where other interests other than tax liability become immediately more prominent to the taxpayer, for example, their rights as enshrined under the bill of rights or procedural justice. The need to protect property rights has been cited as one of the reasons behind tax disputes.<sup>249</sup>

## **2.3. Interests of the Parties in Tax Disputes**

### **2.3.1. KRA's Interests**

#### **2.3.1.1. Maximizing Revenue Collected and Enforcing the Law**

Taxation can be said to have three main goals: to raise revenue to fund public goods and services, to mitigate the harsh effects of unequal distribution of wealth and to regulate private economic activity.<sup>250</sup> In pursuit of these goals and to implement the laws that support these

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<sup>244</sup> Section 51 (11), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>245</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 342.

<sup>246</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 342.

<sup>247</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 342.

<sup>248</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 342.

<sup>249</sup> Xu Y, 'Tax dispute resolution, judiciary independence and property rights', 1.

<sup>250</sup> Avi-Yonah R S, 'The three goals of taxation', 60 *New York University Tax Law Review*, 2 (2006), 1-25, 1.

goals, legislatures transfer the power of administration to specific public agencies. Administration is how the state accomplishes its ends.<sup>251</sup> Therefore, it may be reasonably concluded that public administration serves political interests.<sup>252</sup> Virtually all job tasks undertaken by administrators relate to parliamentary goals.<sup>253</sup> Not only does public administration implement the legislation by parliament, but it also depends structurally on the executive branch of government.<sup>254</sup> In Kenya, Parliament is in charge of public finance functions such as appropriating funds and levying taxes.<sup>255</sup> Under Article 95 of the Constitution, the national assembly is tasked with appropriating funds for expenditure by the national government and other state organs. This Article effectively vests the power to levy taxes in the National Assembly.<sup>256</sup> The national government can impose income tax, value-added tax, customs duties and excise tax.<sup>257</sup> Tax administration, either through a collection agency embedded in the executive or a semi-autonomous authority, is essentially, a means in pursuit of these goals or ends. KRA was established in 1995 by the Kenya Revenue Authority Act<sup>258</sup>. KRA is a semi-autonomous revenue authority distinguished from other revenue collection agencies by a higher degree of administrative and financial independence from the national government.<sup>259</sup> According to the preamble and Section 5 (1) of its establishing Act, KRA's main purpose is to assess and to collect government revenue. In doing so, KRA administers and enforces 18 Acts of parliament<sup>260</sup>, advises the government on all matters relating to tax administration<sup>261</sup> and collection of revenue, and performs any other functions

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<sup>251</sup> Cassesse S, 'New paths for administrative law: a manifesto', 10 *International Journal of Constitutional Law*, 3 (2012), 603-613, 605.

<sup>252</sup> Napolitano G, 'Conflicts and strategies in administrative law', 12 *International Journal of Constitutional Law*, 2 (2014), 357-369, 359.

<sup>253</sup> Warren K F, *Administrative law in the political system*, Westview Press, 5 ed, 2011, 13.

<sup>254</sup> Napolitano G, 'Conflicts and strategies in administrative law', 359.

<sup>255</sup> Lumumba PLO and Francheschi F, *The Constitution of Kenya 2010: an introductory commentary*, Strathmore University Press, 2014, 395. It is described as the 'power of the purse'.

<sup>256</sup> *Pevans East Africa Limited & Another v Chairman, Betting Control & Licensing Board & 7 others* [2018] eKLR.

<sup>257</sup> Article 209 (1), *Constitution of Kenya* (2010).

<sup>258</sup> Act No. 2 of 1995.

<sup>259</sup> Manasan R G, 'Tax administration reform: (semi-) autonomous revenue authority anyone?', Philippine Institute for Development Studies (PIDS) Discussion Paper Series No. 2003-05, 2003, 3.

<sup>260</sup> 1<sup>st</sup> Schedule, *Kenya Revenue Authority Act* (Act No. 2 of 1995).

<sup>261</sup> Section 5 (b), *Kenya Revenue Authority Act* (Act No. 2 of 1995).

concerning revenue. Furthermore, under the TPA, it is one of the functions of the commissioner to control, collect and account for taxes.<sup>262</sup> KRA, therefore, operates based on delegated authority and power.<sup>263</sup> This delegated authority and power is exercised over taxpayers whose main obligation is the payment of tax, as well as the fulfilment of formal duties most of which require collaboration with KRA.<sup>264</sup> In the discharge of its core mandate, KRA collects and accounts for over 95 per cent of the government's ordinary revenue.<sup>265</sup>

### 2.3.1.2. Voluntary Compliance

Free-riders pose a significant problem in the provision of public goods.<sup>266</sup> The free-rider problem occurs when individuals do not contribute to goods, especially public goods from which they derive benefits.<sup>267</sup> Paying taxes presents an example of the free-rider problem—citizens who evade taxes will nonetheless utilize the public goods that are financed by the taxes paid by other law-abiding citizens.<sup>268</sup> Tax authorities are armed with legal measures to persuade free-riders to meet their legal obligations and contribute to the benefit of the community.<sup>269</sup>

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<sup>262</sup> Section 4 (1) (a) and (b), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>263</sup> *Okiya Omtatah Okioti v Cabinet Secretary, National Treasury & 3 others* [2018] eKLR.

<sup>264</sup> Soler R T M, 'Tax administration versus taxpayer: a new deal?', 4 *World Tax Journal*, 3 (2012), 282-296, 282.

<sup>265</sup> Kenya Revenue Authority, *Sixth corporate plan*, 12.

<sup>266</sup> Leach J, *A course in public economics*, Cambridge University Press, New York, 2004, 155-156. Public goods are goods which are non-rivalrous or partially non-rivalrous in their consumption. Such public goods are more easily provided by the government which can fund them through its general tax revenue. Examples include police protection, roads, bridges and national defence. Leach J gives the following example of how a freerider reasons: "If everyone else makes a large contribution, I will enjoy a relatively high level of public goods provisions even if I don't make a large contribution". See; Leach J, *A course in public economics*, 167.

<sup>267</sup> Rockart S, 'The free-rider problem' in Augier M and Teece D J (ed), *The Palgrave encyclopedia of strategic management*, Palgrave Macmillan, London, 2018.

<sup>268</sup> Hofmann E, Hartl B, Gangl K, Hartner-Teifenthaler M and Kirchler E, 'Authorities' coercive and legitimate power: the impact on cognitions underlying cooperation', 8 *Frontiers in psychology*, 5 (2017), 1-15, 1. For the different variations of tax "free riders" see; Bogoviz V A, Rycova I N, Kletskova E V, Rudakova I T and Karp V Marina, 'Tax awareness and "free rider" problem in Taxes' in Gachenko I V, Zima Yulia and Armenak D (ed), *Optimization of the taxation system: precondition, tendencies and perspectives*, Springer International Publishing, Basel, 2019, 117-123, 119.

<sup>269</sup> Hofmann E, Hartl B, Gangl K, Hartner-Teifenthaler M and Kirchler E, 'Authorities' coercive and legitimate power', 2.

These authorities are placed in social positions that allow them to foster and maintain environments that influence the behaviour of individuals.<sup>270</sup>

Tax compliance involves the taxpayer filing all required returns on time, and the tax return accurately reports the taxpayer's tax liability in accordance with the tax law applicable at the time of filing.<sup>271</sup> Voluntary compliance refers to instances where the tax authority relies or depends on the taxpayer to assess the correct amount of tax on their return, file those returns, and pay the tax due in a timely fashion without the tax authority's intervention.<sup>272</sup> Voluntary compliance is one of the principal goals of any tax authority because it lowers the overall operational costs<sup>273</sup> and reflects that, overall, taxpayers have accepted that paying taxes is an obligation as well as a necessity if the state is meant to provide public goods.<sup>274</sup>

Tax disputes can have a significant impact on the overall experience that taxpayers have in interacting with a tax authority.<sup>275</sup> The approach employed by the tax authority in a tax dispute shapes the experience of the taxpayer either positively or negatively, which can, in turn, impact voluntary compliance by taxpayers.<sup>276</sup> When disputing with a taxpayer, a tax authority is not just concerned with enforcing the law and raising revenue; it is also concerned with eliciting the cooperation of taxpayers and encouraging voluntary compliance in the future.<sup>277</sup> In a tax dispute, tax authorities would want to elicit the cooperation of the taxpayer and encourage better voluntary compliance so that disputes based on the same facts do not keep arising between the taxpayer and the tax authority. In their interactions with taxpayers, especially at the point of enforcement, the tax authority must be careful not to create an antagonistic climate

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<sup>270</sup> Hofmann E, Hartl B, Gangl K, Hartner-Teifenthaler M and Kirchler E, 'Authorities' coercive and legitimate power', 2.

<sup>271</sup> Devos K, *Factors influencing individual taxpayer compliance behaviour*, Science + Business Media Dordrecht, 2014, 4.

<sup>272</sup> Manhire J, 'What does voluntary tax compliance mean? a government perspective', 164 *University of Pennsylvania Law Review Online*, (2015), 11-17, 17.

<sup>273</sup> Tran-Nam B and Walpole M, 'Access to tax justice: how costs influence dispute resolution choices' 22 *Journal of judicial administration*, 1 (2012), 1-18, 9.

<sup>274</sup> Gangl K, Hofmann E and Kirchler E, 'Tax authorities' interaction with taxpayers: a conception of compliance in social dilemmas by power and trust', 37 *New ideas in psychology*, (2015), 13-23, 19.

<sup>275</sup> Jone M, 'What can the United Kingdom's tax dispute resolution system learn from Australia?', 66.

<sup>276</sup> Jone M, 'What can the United Kingdom's tax dispute resolution system learn from Australia?', 66.

<sup>277</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 345.

where the use of coercive power prevails.<sup>278</sup> Taxpayers already have an inherent fear of tax authorities using their power to exploit them, and thus they use judgements of how the authority treats them to guide their decisions within continued legal interaction.<sup>279</sup> If the tax authority's goal is cooperative compliance from the taxpayer, the tax authority would do well to foster a 'service climate' which emphasizes facilitation, fairness, and building trust.<sup>280</sup> Taxpayers who interact with the tax authority within a 'service climate' are more likely to reciprocate this attitude of cooperation by contributing their share and voluntarily complying with their tax obligations.<sup>281</sup>

### **2.3.2. Taxpayer Interests**

#### *2.3.2.1. Pragmatic Self-Interest Maximization*

Self-interest is a powerful motivator.<sup>282</sup> In classical economics, self-interest is concerned with maximizing profits and minimizing losses.<sup>283</sup> Other things equal, the greater the possibility of either making material gains or losses, the stronger the motivational pressure.<sup>284</sup> In dispute resolution, self-interest is also one of the goals of the parties to the dispute.<sup>285</sup> In the context of tax disputes, a pragmatic taxpayer would seek to avoid paying more taxes than they have already paid, thus maximizing the resources available to them. As explained in Section 2.2.1 above, agreeing with the commissioner's assessment would ultimately result in the transfer of resources that would otherwise be available to the taxpayer as profits. Tax disputes usually revolve around PEALs. For the taxpayer, the surest way of ensuring that their profits are maximized and losses minimized is to demonstrate that their interpretation and application of

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<sup>278</sup> Kirchler E, Hoelzl E and Wahl I, 'Enforced versus voluntary tax compliance', 219.

<sup>279</sup> Tyler T R and Lind E A, 'Procedural justice', in Sanders J and Hamilton V L (ed), *Handbook of justice research in law*, Kluwer Academic Publishers, New York, 2001, 65-92, 77.

<sup>280</sup> Gangl K, Hofmann E and Kirchler E, 'Tax authorities' interaction with taxpayers', 19.

<sup>281</sup> Gangl K, Hofmann E and Kirchler E, 'Tax authorities' interaction with taxpayers', 19.

<sup>282</sup> Cropanzano R, Goldman B and Folger R, 'Self-interest: defining and understanding a human motive', 26 *Journal of organizational behaviour*, 8 (2005), 985-991, 986. See also; David C B, Atkinson-Schnell J L and DiBacco E A, 'Explaining society: an expanded toolbox for social scientists', 4 *Journal of family theory & review*, 1(2012), 48-66, 52.

<sup>283</sup> Cropanzano R, Goldman B and Folger R, 'Self-interest: defining and understanding a human motive', 36.

<sup>284</sup> Cropanzano R, Goldman B and Folger R, 'Self-interest: defining and understanding a human motive', 36.

<sup>285</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 345.

the law is correct and that no further tax liability arises.<sup>286</sup> If the taxpayer's notice of objection does not persuade the tax authority, the taxpayer will need to resort to a third-party intervention process by way of an appeal to determine whose legal interpretation or application is correct.

#### 2.3.2.2. *Vindication of Rights*

Most tax disputes begin with PEALs, with the tax authority and the taxpayer at odds on the application of the law. A PEAL may be subsumed into a PIE with the taxpayer doing the naming, blaming, and claiming.<sup>287</sup> A good illustration of this is a situation where the taxpayer perceives an assessment or a tax authority's decision, which is a PEAL, as violating the Bill of Rights; in this case, the taxpayer would be seeking vindication of their rights. Rights can be described as prescriptive legal norms that serve specific normative goals; for example, rights protect intrinsic interests such as human dignity, fair administrative action, access to justice or property.<sup>288</sup> Consider the following example: a taxpayer seeks advice from KRA as to whether a particular exemption under the VAT Act applies to them. KRA replies in the affirmative, assuring the taxpayer that the exemption applies and that they are not required to charge VAT. After a few years, KRA realises that the exemption does not apply and that the advice they had rendered was based on the wrong interpretation of the law; KRA then elects to raise an assessment and demand the VAT not charged from the taxpayer. While the dispute is initially a PEAL, the taxpayer may feel aggrieved, having relied on KRA's advice, and perceive the assessment as a breach of their freedom from arbitrary deprivation of property and their right to fair administrative action. In this case, the aggrieved taxpayer may file a constitutional petition to have their rights vindicated by the High Court. Vindication involves the affirmation or the reinforcement of the right and a recognition of the inherent value of the underlying interest.<sup>289</sup> For example, the right to property would protect the taxpayer from being arbitrarily deprived of profits by the tax authority. In resolving disputes that transform from a PEAL to

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<sup>286</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 345.

<sup>287</sup> Smith W Kent and Stalans L J, 'Negotiating strategies for tax disputes', 345.

<sup>288</sup> Varuhas J N E, 'The concept of 'vindication' in the law of torts: rights, interests and damages', 34 *Oxford journal of legal studies*, 2 (2014), 253- 293, 258.

<sup>289</sup> Varuhas J N E, 'The concept of 'vindication' in the law of torts', 259.

PIE, a third-party is required to recognize the right and defend against its encroachment or interference and provide some remedy.<sup>290</sup>

### 2.3.2.3. Fair Treatment

Beyond just maximizing their self-interest, particularly in their interaction with legal authorities, citizens are generally highly concerned with whether they are being treated fairly, and whether the legal authority has followed due procedure leading up to their interaction.<sup>291</sup> In democratic societies, there is an expectation by citizens that administrative powers are exercised fairly.<sup>292</sup> As Lord Diplock put it:<sup>293</sup>

*“Where an Act of parliament confers upon an administrative body functions and powers which involve its making of decisions which affect to their detriment the rights of other persons or curtail their liberty to do as they please, there is a presumption that Parliament intended that the administrative body should act fairly towards those persons who will be affected by the decisions.”*

Concerns regarding unfair treatment and lack of a caring approach by the public service was one of the reasons that the right to fair administrative action was enshrined in the Bill of Rights of the Kenyan Constitution.<sup>294</sup> The concern with fairness ultimately stems from the inherent fear and apprehension that citizens have that legal authorities, including tax administrators, will use their immense power to deny them entitlements and exploit them.<sup>295</sup> People will use impressions of fairness, especially procedural fairness, as a way of determining whether they are being exploited by an authority and thus ultimately whether they will cooperate with the authority.<sup>296</sup> Fairness is highly valued because, if an authority is considered to be acting and

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<sup>290</sup> Caroll R and Witzleb N, ‘‘It’s not just about the money’- enhancing the vindicatory effect of private law remedies’, 37 *Monash law review*, 1 (2011), 216- 240, 219. See; Holt CJ in *Ashby v White (1703) 1 Bro Parl Cas 62: If the plaintiff has a right, he must of necessity have a means to vindicate and maintain it, and a remedy if he is injured in the exercise or enjoyment to it; and, indeed, it is a vain thing to imagine a right without a remedy; for want of right and want of remedy are reciprocal ...*

<sup>291</sup> Tyler T R and Lind E A, ‘Procedural justice’, 74.

<sup>292</sup> Wade W and Forsyth C, *Administrative Law*, 8ed, Oxford University Press, Oxford, 2000, 486.

<sup>293</sup> *R v. Commissioner for Racial Equality ex P. Hillingdon LBC [1982] AC779.*

<sup>294</sup> Lumumba PLO and Francheschi F, *The Constitution of Kenya 2010*, 215.

<sup>295</sup> Tyler T R and Lind E A, ‘Procedural justice’, 77.

<sup>296</sup> Tyler T R and Lind E A, ‘Procedural justice’, 77.

treating the citizen fairly, an assumption can be made by the citizen that cooperation is the better option without worrying too much about exploitation.<sup>297</sup> Thus, people who believe that they have been treated fairly in dispute resolution or decision-making procedures are more likely to comply with the outcomes of the dispute or the procedure.<sup>298</sup> In determining whether they are being treated fairly, and thus not being exploited by the authority, taxpayers will want to have: (i) the opportunity to present their case to the authority before final decisions are made, (ii) consistency in the way they are treated compared to other taxpayers, (iii) a decision based on consideration of all the facts and accurate information, (iv) a means of ventilating their perception of unfair treatment, and (v) evidence of concern for their rights by the authority.<sup>299</sup> If the taxpayer experiences what they consider to be unfair treatment by the authority, the taxpayer is alerted to the existence of conflicting interests with the tax authority.<sup>300</sup> The perceived unfair treatment energizes the taxpayer to combat the decision of the authority.<sup>301</sup> One possible remedy available for the taxpayer, and an avenue for ventilation of the claim of unfair treatment is judicial review, whereby courts exercise supervisory jurisdiction over the activities of the authority.<sup>302</sup>

## 2.4. Conclusion

This chapter has shown how disputes emerge within a three-stage framework of naming, claiming, and blaming. Tax disputes follow a similar framework in that the tax authority does the naming and claiming by raising an assessment, especially after an audit. The taxpayer rejects the claim through an objection which leads to a tax dispute. The basis of the naming, claiming, and subsequent rejection of the claim involves each party perceiving that the other party has erroneously applied the law. A dispute on a perceived erroneous application of the

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<sup>297</sup> Tyler T R and Lind E A, 'Procedural justice', 81.

<sup>298</sup> Tyler T R and Lind E A, 'Procedural justice', 74.

<sup>299</sup> Tyler T R, 'What is procedural justice?: criteria used by citizens to assess the fairness of legal procedures', 22 *Law & society review*, 1 (1988), 103-136, 111-113.

<sup>300</sup> Bently D, 'Problem resolution', 29.

<sup>301</sup> Bently D, 'Problem resolution', 29.

<sup>302</sup> *Republic vs. Kenya Revenue Authority Ex parte Yaya Towers Limited* [2008] eKLR, See also; Lewis C, *Judicial remedies in public law*, Sweet & Maxwell, London, 1992, 6.

law can at times be subsumed into a dispute involving a perceived injurious experience such as a breach of rights or unfair treatment.

This chapter has also considered the respective interests of the parties in tax disputes. KRA interests during a dispute are task-oriented, i.e., to maximize revenue collected, enforce the law, and encourage future voluntary compliance. The taxpayer's interests can fall into three broad categories: to maximize self-interest by avoiding the payment of additional taxes, the vindication of their rights, especially their right against arbitrary deprivation of property, and fair treatment by the authority.

From the discussion above, it is possible to begin to envision the dispute resolution procedures that would be most effective in resolving the disputes between the parties and satisfy as many interests as possible. For example, since it is the task of the tax administration to collect tax according to the law and not forgo revenue, the tax administration would probably seek to undertake this task with rigidity and employ coercive powers. Strictness and rigidity in enforcement, coupled with the pursuit of task-interests through litigation, may, however, result in an antagonistic climate between the taxpayer and the tax authority which may, in turn, result in reduced compliance. Furthermore, with less control over the process, the taxpayer may begin to perceive the authority's treatment as unfair. In this case, early engagement between the parties, through an interest-based procedure such as mediation, would allow the parties to ventilate and explore their underlying concerns whereby as many interests between the taxpayer and the tax authority are satisfied.

From this chapter it is also apparent that the interests of the parties in tax disputes are not too divergent; it is possible to secure significant trade-offs in resolving the disputes through interest-based approaches such as negotiation or mediation. For example, if the parties negotiate a settlement that results in KRA foregoing revenue, but the taxpayer was treated fairly, that taxpayer is likely to be voluntarily compliant in future and the same dispute is unlikely to arise again. Essentially, a win – win situation.

## **CHAPTER THREE**

### **LEGAL FRAMEWORK FOR TAX DISPUTE RESOLUTION**

#### **3.1. Introduction**

A tax dispute occurs when a taxpayer, having a contrary view to the tax authority on the application of the law takes a course of action rejecting the tax administrator's application of the law. Broadly, this chapter examines the legal framework and the procedures that enable the taxpayer to reject and ventilate their rejection of what the taxpayer perceives to be an erroneous application of the law. The framework set out in this chapter is used to resolve tax disputes which may be characterized as 'PEALs'. 'PEALs' are resolved by focusing on the merits of the commissioner's decision with the taxpayer having to prove that the decision was erroneous.<sup>303</sup> The procedures through which the taxpayer may prove that the tax administration erroneously applied the law include; objections, applications for review, facilitated discussions and appeals all of which are set out in the acts examined in this chapter.

#### **3.2. Tax Procedures Act**

The TPA came into force on 19<sup>th</sup> January 2016. The objective and purpose of the act is to provide for uniform procedures in tax law thus promoting consistency and efficiency in administration in administration and facilitating tax compliance.<sup>304</sup> Besides consolidation, the TPA also seeks to modernize tax administration in Kenya and align tax administration in Kenya to international best practices.<sup>305</sup> In line with its main objective and purpose, the TPA consolidates dispute resolution procedures in the ITA and the Value Added Tax Act (VAT Act (repealed)). Before, the TPA, both the ITA and the VAT Act each provided for their procedures for objecting to commissioners' decisions and appeals to their respective tribunals.<sup>306</sup> Procedures for dispute resolution were consolidated into part VIII of the TPA.

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<sup>303</sup> Section 56 (1), *Tax Procedure Act* (Act No. 29 of 2015). "In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect." (emphasis mine). Proceedings include objections and appeals to the tribunal, High Court and Court of Appeal. See; Section 50 (4), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>304</sup> Section 2, *Tax Procedure Act* (Act No. 29 of 2015).

<sup>305</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 4.

<sup>306</sup> Second schedule, *Tax Procedure Act* (Act No. 29 of 2015).

### 3.2.1. *Objections, Appeals and Settlement*

Taxpayers have a right to raise an objection against tax decisions made by the commissioner.<sup>307</sup> In section 2 of the TPA, a tax decision means; assessments, determination of tax payable by the taxpayer, decisions on application by a self-assessment taxpayer, a refund decision and a demand for a penalty. Under section 51 (1) of the TPA, an objection is the first recourse available to the taxpayer against any decision of the commissioner and must be filed before any proceedings under any written law. The courts have held that the purpose of section 51 (1) is to allow the commissioner to first entertain the objection and to determine the same.<sup>308</sup> The objection must be made within 30 days of being notified of the tax decision.<sup>309</sup> The period of 30 days can be extended if the objection is late due to absence from Kenya, sickness or other reasonable cause.<sup>310</sup>

An objection from the taxpayer should unconditionally set out the clear and unambiguous position of the taxpayer.<sup>311</sup> Grounds of an objection are precise if they unequivocally deal with all aspects of the assessment, provide clear answers for the assessment and specify the taxpayer's position on the figures provided by the commissioner in the assessment.<sup>312</sup> There is no particular form for the objection, but it should be sufficiently framed to differentiate it from correspondence from the taxpayer seeking further particulars or indulgence.<sup>313</sup> Provided the grounds of the objection are precise, and the taxpayer has paid the tax, not in dispute, the objection will be considered validly lodged.<sup>314</sup> If an objection is not validly lodged, the commissioner is supposed to notify the taxpayer.<sup>315</sup> Where a taxpayer has filed an objection which has been determined as invalid and filed out of time, some courts have entertained judicial review proceedings arguing that the judicial review proceedings are the only recourse for a taxpayer.<sup>316</sup> In *Anne Wambui Njoroge v Kenya Revenue Authority & another*, however,

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<sup>307</sup> McNeil R and Bechgaard K, *East African income tax*, Butterworth & Co. (Africa) Ltd, Durban, 1960, 297.

<sup>308</sup> *Anne Wambui Njoroge v Kenya Revenue Authority & another* [2017] eKLR

<sup>309</sup> Section 51 (2), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>310</sup> Section 51 (7), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>311</sup> *Republic v Kenya Revenue Authority Ex-Parte Funan Construction Limited* [2016] eKLR.

<sup>312</sup> *Republic v Kenya Revenue Authority Ex-Parte Funan Construction Limited* [2016] eKLR

<sup>313</sup> *Republic v Kenya Revenue Authority Ex Parte M-Kopa Kenya Limited* [2018] eKLR

<sup>314</sup> Section 51 (3), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>315</sup> Section 51 (4), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>316</sup> *Silver Chain Limited v Commissioner Income Tax & 3 others* [2016] eKLR.

the court held that the correct recourse for a taxpayer whose objection has been determined invalid is to seek an extension of time from the commissioner to file a fresh objection.<sup>317</sup>

The objection by the taxpayer is reviewed by an internal dispute resolution committee consisting of the audit manager, the compliance manager, the policy unit technical manager and the station head of the relevant station.<sup>318</sup> If the matter requires further consideration, it is escalated to the “Technical Forum” in the head office.<sup>319</sup> This internal review is vital to ensure the ‘correct or preferable decision is made’ and to minimize the number of applications for judicial review, especially on the ground that the decisions are unreasonable.<sup>320</sup> The commissioner may after considering the objection, allow it, allow it in part or disallow the objection.<sup>321</sup> The decision arising out of the objection is known as the objection decision.<sup>322</sup> The objection decision must be in writing, and it should include all necessary steps to give effect to the decisions.<sup>323</sup> If the commissioner does not decide within 60 days, the objection by the taxpayer is allowed.<sup>324</sup>

A taxpayer who is dissatisfied with an objection decision may appeal to the TAT by lodging a notice of intention to appeal in accordance with the provision of the TATA.<sup>325</sup> Sections 53 and 54 of the TPA provide for appeals to the High Court and subsequently to the Court of Appeal. For an appeal to the High Court, the appeal should be lodged within 30 days of the Tribunal's decision while an appeal to the Court of Appeal should be lodged within 30 days of the High Court's decision.<sup>326</sup> Appeals to the Court are on matters of law only.<sup>327</sup> Generally in appeals, either to the Court or to the Tribunal, the taxpayer ought to rely on the grounds of the objection unless the Court or the Tribunal allows the person to add new grounds.<sup>328</sup>

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<sup>317</sup> [2017] eKLR

<sup>318</sup> Aketch M, *Administrative law*, 228.

<sup>319</sup> Aketch M, *Administrative law*, 228.

<sup>320</sup> Minogue M, ‘Internal review of administrative decision’, AIAL Conference, Canberra, 5<sup>th</sup> July 2001, 56.

<sup>321</sup> Section 51 (8), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>322</sup> Section 51 (8), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>323</sup> Section 51 (9), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>324</sup> Section 51 (11), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>325</sup> Section 52 (1), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>326</sup> Section 53 and 54, *Tax Procedure Act* (Act No. 29 of 2015).

<sup>327</sup> Section 56 (1), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>328</sup> Section 56 (3), *Tax Procedure Act* (Act No. 29 of 2015).

Subject to the permission of the court or the TAT the parties to the dispute can be granted 90 days from the date of permission to settle the dispute out of court or out of the TAT.<sup>329</sup> If the parties fail to settle the dispute the matter is referred back the tribunal or court that had permitted the matter to be settled out of court.<sup>330</sup> This provision allowing for out of court settlement was a welcome addition to the TAT as it provided the parties with an opportunity to attempt to resolve the dispute out of court or out of the Tribunal.<sup>331</sup> Section 55 of the Tax Procedures Act has been criticised for not being adequate in guiding the parties on how to go about the settlement.<sup>332</sup> Beyond giving a timeline within which the settlement must take place, section 55 does not give any context to the settlement, neither does it provide for any framework or rules to guide the parties.<sup>333</sup> Despite the lack of a legislative framework to guide the parties, it has been argued that the wide framing of section 55 allows parties to theoretically explore a wide range of ADR options to settle the dispute.<sup>334</sup>

### **3.3. The East African Community Customs Management Act, 2004**

The East African Community Customs Union (EACCU) is established by Article 2 (1) of the Protocol on the Establishment of the East African Customs Union (The Protocol). The protocol is founded under Article 2, Article 5 and Article 75 of the Treaty for the Establishment of the East African Community.<sup>335</sup> The East African Community Customs Management Act, 2004 (EACCMA) provides for the management and administration of customs within the East African Community.<sup>336</sup> EACCMA provides for both the substantive and procedural law governing customs in the EACCU.<sup>337</sup> Furthermore, EACCMA is heavily based on the Revised

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<sup>329</sup> Section 55 (1), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>330</sup> Section 55, *Tax Procedure Act* (Act No. 29 of 2015).

<sup>331</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 50.

<sup>332</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 50.

<sup>333</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 50.

<sup>334</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 50.

<sup>335</sup> Preamble, *Protocol on the Establishment of the East African Customs Union*, 2004.

<sup>336</sup> Preamble, *East African Community Customs Management Act*, 2004.

<sup>337</sup> Kafeero E, 'Customs law in the East African Community in light of WTO law and the Revised Kyoto Convention', Unpublished Doctor of Laws Thesis, Wilhelminian University of Muenster, 7 April 2009, 109.

Kyoto Convention which simplifies customs procedures.<sup>338</sup> Part XX of EACCMA provides for appeals.

### **3.3.1. Applications for Review and Appeals**

Any person affected by a decision or omission of the customs commissioner has a right to appeal.<sup>339</sup> In section 229 (1) of EACCMA, a person directly affected by the decision or omission of the commissioner on matters relating to customs is required to apply for a review of that decision within 30 days. A person is 'directly affected' if the decision or omission of the commissioner is prejudicial to their interests or rights which includes both agents and principals.<sup>340</sup> The application for review must be lodged in writing setting out the grounds upon which the application for review is lodged.<sup>341</sup> Furthermore, for an application for review to be valid, it must be in terms that are unambiguous, clearly showing that the aggrieved person is requesting the commissioner to review their decision.<sup>342</sup> The commissioner is empowered in section 229 (3) to accept an application lodged out of time if there is a reasonable cause and there is no unreasonable delay. The commissioner must communicate their decision of the application for review under section 229 (1) within 30 days stating the reasons for the decision.<sup>343</sup> If the decision is not communicated within 30 days of lodging the application for review, the application will be deemed to have been allowed.<sup>344</sup> The courts have held that where an aggrieved party has filed an application for review, the commissioner must make their decision within 30 days otherwise it is deemed that the application is allowed this is even though the commissioner and the aggrieved party were engaging in correspondence beyond the 30 days given to the commissioner and the aggrieved party had seemingly consented to the delay in receiving the decision from the commissioner.<sup>345</sup> Within the 30 days that the commissioner has to make a decision, the commissioner may order that the goods be released

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<sup>338</sup> Kafeero E, 'Customs and trade facilitation in the East African Community (EAC)', 2 *World customs journal*, 1 (2008), 63-71, 65.

<sup>339</sup> Article 10.1, *The Revised Kyoto Convention*, 3 February 2006.

<sup>340</sup> *SDV Transami Kenya limited v Commissioner of Customs Services [2012] eKLR*.

<sup>341</sup> Section 229 (2), *East African Community Customs Management Act*, 2004.

<sup>342</sup> *Republic v Commissioner of Customs Services ex-parte Africa K-link International Limited [2012]eKLR*.

<sup>343</sup> Section 229 (4), *East African Community Customs Management Act*, 2004.

<sup>344</sup> Section 229 (5), *East African Community Customs Management Act*, 2004.

<sup>345</sup> *Republic v Commissioner of Customs Services ex-parte Unilever Kenya Limited [2012] eKLR*.

at the request of the applicant for review upon payment of duty or the provision of sufficient security for duty and penalties.<sup>346</sup>

Section 231 of EACCMA establishes a tax appeals tribunal. If a person is dissatisfied with the commissioner's decision on the application, they may appeal the decision to the tax appeals tribunal within 45 days of being served with the decision. EACCMA does not provide for out of court or tribunal settlement of disputes.

### **3.4. Tax Appeals Tribunal Act**

TATA came into force on 1<sup>st</sup> April 2015. The TATA establishes the Tax Appeals Tribunal (TAT) to hear appeals against any decision made by the taxpayer.<sup>347</sup> Furthermore, the TATA provides the procedure for appeals against tax decisions and consolidates the provisions of the ITA and the Customs and Excise Act Cap 472 (repealed) on appeals.<sup>348</sup>

#### **3.4.1. Tax Appeals Tribunal: Membership, Structure and Jurisdiction**

The TAT is established under section 3 of the TATA. The TAT consists of a chairperson and not less than 15 members but no more than 20 other members.<sup>349</sup> Not more than 5 members of the tribunal shall be advocates of the High Court of Kenya.<sup>350</sup> Both the Chairperson and the members are appointed by the cabinet secretary responsible for matters relating to finance.<sup>351</sup> The chairperson holds office for a term not exceeding 5 years and is not eligible for appointment.<sup>352</sup> Members of the tribunal hold offices for a term not exceeding 3 years, but unlike the Chairperson, the members can be reappointed for a further term of 3 years.<sup>353</sup> The Chairperson of the tribunal must be qualified to be appointed as a judge of the high court.<sup>354</sup> For members of the tribunal, the members must have a degree in law, business, finance, public finance, economics, insurance or related disciplines and must have at least 10 years' experience

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<sup>346</sup> Section 229 (6), *East African Community Customs Management Act*, 2004.

<sup>347</sup> Section 3, *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>348</sup> Section 41 and Section 42, *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>349</sup> Section 4 (1), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>350</sup> Section 4 (2), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>351</sup> Section 4 (1), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>352</sup> Section 5 (1) (a), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>353</sup> Section 5 (1) (b), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>354</sup> Section 4 (3) (a), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

in the disciplines mentioned above.<sup>355</sup> One of the shortcomings of local committees and tribunals established under the ITA or the VAT Act (repealed) for example was lack of requisite tax knowledge amongst the members of the local committees and the tribunal, hence the strict qualification requirements for membership to the tribunal under the TATA.<sup>356</sup>

The TAT replaces appellate bodies under the ITA, namely the local committees and the tribunal established under section 83 of the ITA.<sup>357</sup> The local committees and the tribunal under the ITA consisted of non-specialists who were independent of the KRA.<sup>358</sup> The tribunals under the ITA heard appeals on section 23 and section 24 of the ITA which are anti-avoidance provisions.<sup>359</sup> The local committees heard all other appeals.<sup>360</sup> The Customs and Excise Act Cap 472 also established its tribunal to hear appeals on disputes arising from the decisions of the Commissioner. The TAT has also replaced the tribunal that had been established under the Section 127E Customs and Excise Act Cap 472.<sup>361</sup>

The TAT is empowered to hear appeals filed against any tax decision made by the commissioner under any tax law provided the commissioner has been given notice.<sup>362</sup> The TAT can either: affirm the decision under review, vary the decision under review or set aside the decision under review and either substitute the decision with their own or remit the matter back to the commissioner.<sup>363</sup> The decision making powers that the TAT has under section 29 to ensure that any potential errors or defects, for example, an erroneous application of the law which may have led to a wrong may be set right.<sup>364</sup> Essentially, the primary purpose of the TAT is to review the merits of the decision of the commissioner to ensure that the 'correct and preferable' decision is made based on the correct law and the relevant facts.<sup>365</sup> In recognizing that the power of the TAT is not limited to the quantum of taxes payable or disputes of fact,

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<sup>355</sup> Section 4 (3) (b) (i) and (iii), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>356</sup> Ado M, 'Transfer pricing disputes in Kenya', 17.

<sup>357</sup> Section 41 and Section 42, *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>358</sup> Gray W J, *A guide to income tax in Kenya*, Longman Publishers, Nairobi, 1978, 118.

<sup>359</sup> Section 41 and Section 42, *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>360</sup> Gray W J, *A guide to income tax in Kenya*, Longman Publishers, Nairobi, 1978, 118.

<sup>361</sup> Section 41 and Section 42, *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>362</sup> Section 3, *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>363</sup> Section 29, *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>364</sup> Cane P, *Administrative tribunals and adjudication*, Hart Publishing, Oregon, 2009, 150.

<sup>365</sup> Cane P, *Administrative tribunals and adjudication*, 145. See also; *Republic v Kenya Revenue Authority Ex Parte M-Kopa Kenya Limited [2018] eKLR*.

the courts have held that the powers of the TAT are wide enough to determine the legality of the decision of a commissioner.<sup>366</sup> The reasoning behind the deference to the TAT especially where a party seeking judicial review remedies claims the decision by the commissioner is illegal is that judicial review by its nature is not supposed to go into the merits of a decision.<sup>367</sup> As such the most appropriate remedy for an aggrieved person is to appeal the decision to the TAT not to seek judicial review since it is most likely that a decision that is illegal is a decision that is not ‘correct or preferable’.<sup>368</sup> In summary, the TAT has very broad powers in relation to decisions of the commissioners under any tax law. Courts exercising judicial review authority, have held that where the taxpayer is aggrieved by the decision-making process rather than the merits, the TAT would not be the appropriate forum or remedy.<sup>369</sup> In ensuring that the jurisdiction of the TAT is respected, the courts have discouraged taxpayers from forum shopping where taxpayers file both appeals and institute proceedings for judicial review.<sup>370</sup>

### **3.4.2. Procedure for Appeal**

A person dissatisfied with the decision of the commissioner which is appealable may appeal to the TAT in accordance with the TATA.<sup>371</sup> The appeal is initiated by filing a written notice of appeal with the TAT within 30 days after receiving the decision of the commissioner.<sup>372</sup> The notice of appeal signifies the appellant's intention to appeal the commissioner's decision and sets in motion the exercise of the TAT mandate. The appellant must submit to the TAT a memorandum of appeal, the statement of facts and the tax decision within 14 days from the date of filing the notice of appeal. The appellant may seek an extension of time to file the notice of appeal and for submitting the appeal documents.<sup>373</sup> An application for extension of time may

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<sup>366</sup> *Kenya Revenue Authority, Commissioner of Customs Services and Julius Musyoki v Darasa Investments Limited. See also; Jimbise Limited 2 others v Kenya Revenue Authority [2017] eKLR*

<sup>367</sup> *Kenya Revenue Authority, Commissioner of Customs Services and Julius Musyoki v Darasa Investments Limited. See also; Republic v Kenya Revenue Authority; Kenol Kobil Ltd (Interested Party) Ex parte Rayan Logistics Ltd [2019] eKLR*

<sup>368</sup> Cane P, *Administrative tribunals and adjudication*, 162.

<sup>369</sup> *Republic v Kenya Revenue Authority Ex Parte M-Kopa Kenya Limited and Republic v Kenya Revenue Authority Ex-parte Neolife International Limited [2018] eKLR.*

<sup>370</sup> *Republic v Commissioner of Domestic Taxes Ex-Parte I & M Bank Limited [2017] eKLR.*

<sup>371</sup> Section 52 (1), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>372</sup> Section 13 (1), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>373</sup> Section 13 (2), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

be granted if the intended appellant was absent from Kenya, owing to sickness or any other reasonable cause that may have prevented the applicant from filing the notice of appeal or filing the appeal documents.<sup>374</sup> In determining an application for extension of time, the tribunal has been guided by the same principles that guide appellate courts in exercising their discretion to extend time, namely: whether the appeal is arguable, whether the delay was inordinate and whether extending time will be prejudicial to the respondent.<sup>375</sup>

Evidence before the tribunal can either be given orally or through affidavits, subject to the direction of the TAT.<sup>376</sup> The TAT is under an obligation to ensure that each party has an opportunity to make submissions on the evidence of the other party. The TAT is to determine the appeal within 90 days from the date the appeal is filed.<sup>377</sup> In *Okiya Omtatah Okoiti & another v Bidco Africa & 4 others*, the court stated that if there is inordinate delay by the TAT in determining an appeal, the appellant can initiate judicial review proceedings, this is because proceedings beyond the 90 days period of determining the appeal might be in excess of the tribunal's jurisdiction.<sup>378</sup> In determining the appeal, the TAT may affirm the decision under review, vary the decision under review or set aside the decision under the review and either substitute the decision with one of their own or remit the matter back to the commissioner.<sup>379</sup> The TAT can also award costs of the appeal.<sup>380</sup>

Under section 28 (1) of TATA, the parties may apply to the TAT to be allowed to settle the matter out of court. Section 28 further provides that the TAT shall allow the request subject to the conditions it may impose.<sup>381</sup> In a legislative sentence, the use of 'shall' creates a mandatory duty or obligation while the use of the word 'may' creates a discretionary power.<sup>382</sup> Section 28 (1) uses the words 'shall' and 'may' in the sentence when referring to the TAT effectively imposing two different obligations on the TAT. In essence, section 28 (1) places the TAT under an obligation to allow the parties to settle the matter out of court. On the other hand, how the

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<sup>374</sup> Section 13 (3), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>375</sup> *Keroche Breweries Limited vs Commissioner of Domestic Taxes Tax Tribunal Appeal No. 214 of 2015*

<sup>376</sup> Section 16 (2), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>377</sup> Section 13 (7), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>378</sup> [2018] eKLR.

<sup>379</sup> Section 29, *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>380</sup> Section 31, *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>381</sup> Section 28 (1), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>382</sup> *Crabbe V, Legislative drafting*, 1ed, Cavendish Publishing Limited, London, 1993, 76.

parties are to settle the matter out of court is subject to the discretion of the TAT. Compared to section 55 (1) of the TPA which also provides for out of court settlement, section 28 (1) is potentially restrictive. Section 55 (1) of the TPA is drafted in broad terms only providing that the parties have 90 days to settle the matter out of court or the tribunal, a plain reading of the provision does not reveal that the court or the tribunal may impose any restrictions or conditions on the out of court settlement. With regards to section 28 (1), it should be noted there are currently no rules or procedures under the TATA or the TPA providing procedures for out of court settlement or guiding the discretion of the TAT in imposing conditions for out of court settlement. The lack of rules or procedures however would not be a bar to their exercise of discretion under section 28 (1) of the TATA because rule 27 of the Tax Appeals Tribunal (Procedure) Rules, 2015 provides that where there is no applicable procedure, under the rules or under TATA, the TAT has the discretion to determine an appropriate procedure.

### **3.4.3. Appeals to Courts**

When the tribunal has made a decision, an aggrieved party has a right to appeal to the High Court and on the determination of the appeal by the High Court, to the Court of Appeal.<sup>383</sup> The aggrieved party has 30 days from the date of the decision of the TAT to give notice of the intention to appeal to the High Court.<sup>384</sup> For an appeal to the Court of Appeal, the Notice of Appeal must be filed within 30 days of the decision of the High Court.<sup>385</sup> Failure to give notice within the stipulated period would necessitate an application for the extension of time.<sup>386</sup> For an appeal to the High Court, the appellant must then file a memorandum of appeal within 30 days of filing the notice of appeal.<sup>387</sup> Section 56 (1) of the TPA provides that appeals to the High Court shall be matters of law only.<sup>388</sup> Thus an appeal in either the High Court and the Court of Appeal only involve judicial examination of the TAT's decisions and not re-litigation, where the parties can introduce new issues.<sup>389</sup> However, the fact that appeals are on matters of law only does not preclude the High Court from admitting additional evidence.<sup>390</sup> The High

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<sup>383</sup> Section 52 (1), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>384</sup> Section 32 (1), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>385</sup> Section 54, *Tax Procedure Act* (Act No. 29 of 2015).

<sup>386</sup> Rule 4, *Tax Appeals Tribunal (Appeals to the High Court) Rules*, 2015.

<sup>387</sup> Rule 3, *Tax Appeals Tribunal (Appeals to the High Court) Rules*

<sup>388</sup> Section 56 (2), *Tax Procedure Act* (Act No. 29 of 2015).

<sup>389</sup> *Oceanfreight (E.A) Limited v Commissioner of Domestic Taxes [2018] eKLR*.

<sup>390</sup> Rule 15, *Tax Appeals Tribunal (Appeals to the High Court) Rules*, 2015.

Court is allowed to admit additional evidence because issues of facts may give rise to questions of law.<sup>391</sup> Furthermore, additional evidence may be needed to determine the controversy considering the technical nature of tax appeals.<sup>392</sup>

Under section 55 (1) of the TPA, the courts may permit the parties to a tax dispute to settle out of court. Settlement out of court is to be made within 90 days from the date the court permits the settlement. The broad framing of the provision suggests that the parties are not restricted in the avenues they may employ to settle the dispute out of court.<sup>393</sup> If the dispute is not settled within 90 days, the dispute is referred back to the court. Unlike section 28 (1) of TATA, section 55 (1) of the TPA does not provide whether the court may impose conditions on the out of court settlement.

### **3.5. KRA's ADR Framework**

The ADR framework (framework) was introduced in June 2015 by KRA as a means to improve the internal dispute resolution process.<sup>394</sup> The framework provides for the use of ADR to supplement the judicial and quasi-judicial processes.<sup>395</sup> The framework recognizes that the tax dispute resolution process is mired with technical procedures, untimely decisions and high costs associated with litigation.<sup>396</sup> The framework thus seeks to provide for flexibility, time efficiency and lower costs.<sup>397</sup> The framework promises expedited dispute resolution, decreased costs, enhanced relationships and improved tax compliance.<sup>398</sup>

The objectives of the framework include; providing for a taxpayer approach to dispute resolution, providing internal structures that support tax dispute resolution and providing a complementary approach to dispute resolution beyond those provided for in the TPA.<sup>399</sup> KRA controls the framework and the ADR processes provided.<sup>400</sup> Furthermore, the framework state

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<sup>391</sup> *Oceanfreight (E.A) Limited v Commissioner of Domestic Taxes [2018] eKLR.*

<sup>392</sup> *Oceanfreight (E.A) Limited v Commissioner of Domestic Taxes [2018] eKLR.*

<sup>393</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 50.

<sup>394</sup> Paragraph 1.1, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>395</sup> Paragraph 1.2, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>396</sup> Paragraph 1.4, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>397</sup> Paragraph 1.4, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>398</sup> Paragraph 2.1 – 2.6, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>399</sup> Paragraph 3.1 – 3.6, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>400</sup> Paragraph 1.4, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

that it is legally underpinned by Article 159 (2) (c) of the Constitution 2010, Section 55 of the TPA and Section 28 of TATA.<sup>401</sup> Article 159 (2) (c) provides that the courts are to promote ADR mechanisms in the discharge of their judicial functions. Section 55 of the TPA and section 28 of TATA enable courts and the tribunal respectively to allow the parties to tax dispute, upon application, to settle the tax dispute out of court. A plain reading of section 55 and section 28 does not immediately reveal whether KRA can create, implement and control the framework or that the provisions mentioned above provide for any particular procedure to be followed in settling tax disputes out of court.

### **3.5.1. *Facilitated Discussion***

The ADR process provided for under the framework is facilitated discussions.<sup>402</sup> Facilitated discussions under the framework is a voluntary process in which a dispute resolution practitioner known as a facilitator assists the commissioner and the taxpayer in a dispute to identify issues causing controversy, develop options for resolution and to amicably resolve the issues in controversy.<sup>403</sup> The facilitator does not advise or determine the outcome of the process; instead they guide the parties.<sup>404</sup> The facilitator may, however, advise on the process of facilitation.<sup>405</sup> Under the framework, arbitration under the Arbitration Act, 1995 is expressly excluded.<sup>406</sup>

Under the framework, the facilitator or the facilitation panel may comprise of KRA officers not lower in rank than a manager or external members from the office of the Attorney General, the Director of Public prosecution or the commission of Administrative Justice (Ombudsman).<sup>407</sup> For effective facilitation, it is essential that the facilitators remain independent, as such facilitators are under a duty to disclose any conflict of interest and should not have been involved in the audit, investigation or the disputed decision.<sup>408</sup>

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<sup>401</sup> Paragraph 4.1.1 – 4.1.2, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>402</sup> Paragraph 1.3, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>403</sup> Paragraph 9.6, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>404</sup> Paragraph 1.4, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>405</sup> Paragraph 9.6 (b), *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>406</sup> Paragraph 1.3, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>407</sup> Paragraph 7.0, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>408</sup> Paragraph 11.0, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

The role of the facilitator with regard to the discussions between the commissioner and the taxpayer is to convene the ADR meetings, provide administrative guidance, attest to the signing of the ADR agreements and generally to assist the disputing parties to reach an agreement. In undertaking their mandate under the framework, the facilitator should endeavour to ensure fair, equitable, legal and expeditious resolution of the dispute between the parties.<sup>409</sup> The facilitator is not to be bound by unnecessary formality and should conduct discussions without undue procedural technicalities.<sup>410</sup> Furthermore, the facilitator should remain neutral at all times.<sup>411</sup>

Before engaging in ADR discussions, an ADR evaluation team must determine whether a dispute is suitable for ADR.<sup>412</sup> A dispute is appropriate for ADR if:<sup>413</sup>

- i. Settlement would be in the interest of good management of the tax system, overall fairness and the best use of recourses.
- ii. The cost of litigation would be high considering the prospect of success before a court or tribunal, the amounts due and the cost of collection.
- iii. There are complex facts and issues or evidential difficulties.
- iv. Settlement will promote compliance by the taxpayer

A dispute will be considered inappropriate for ADR if:<sup>414</sup>

- i. The dispute relates to tax evasion or fraud;
- ii. Settlement would be contrary to the constitution or revenue laws;
- iii. The pursuit of the matter through litigation would promote compliance;
- iv. It would be in the public interest to pursue the matter through the judicial system;
- v. The taxpayer has not complied with any tax act, and the non-compliance seems deliberate.

Where the parties reach an agreement under the framework, the agreement must be reduced into writing reflecting the issues resolved, the amount of tax recovered or not recovered, the issues resolved, withdrawal of the matter before the courts or the tribunal, undertakings given

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<sup>409</sup> Paragraph 12.0, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>410</sup> Paragraph 14.0 (a), *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>411</sup> Paragraph 14.0 (d), *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>412</sup> Paragraph 20.0, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>413</sup> Paragraph 20.1, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>414</sup> Paragraph 20.2, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

by each party and mode of payment.<sup>415</sup> The ADR negotiations and settlement must have a legal basis within the tax laws.<sup>416</sup> Where an assessment has been adjusted as a result of the agreement, the commissioner is mandated to amend the assessment to give effect to the agreement within 14 days of signing the agreement.<sup>417</sup> The taxpayer may seek a waiver of the penalties.<sup>418</sup> Where the dispute is not resolved, the commissioner must explain to the taxpayer their rights to further object or appeal since the framework is not prejudicial to either right.<sup>419</sup> Where the parties have failed to reach an agreement in ADR a second attempt is only allowed where there is fresh evidence or where there is reasonable cause as may be determined by the parties.<sup>420</sup>

### **3.5.2. When to Engage in ADR**

The commissioner and the taxpayer may engage in ADR in two instances under the framework: at the objection stage after the taxpayer files an objection; and at the appeal stage after the taxpayer institutes an appeal in the tribunal or either party appeals to the court.<sup>421</sup> At the objection stage, the framework provides that the parties may engage in ADR within the timelines that the commissioner has to make an objection decision.<sup>422</sup> The framework provides that the taxpayer has an opportunity to be heard before the commissioner confirms an assessment.<sup>423</sup> In the TPA the commissioner must decide within 60 days with regard to an objection, while under EACCMA, the commissioner must decide under within 30 days.<sup>424</sup> Engagement in ADR at this stage has no statutory basis as engagement in the TPA and TATA is linked to the appeal procedure. It is essential for the commissioner to decide under section 51 (8) of the TPA within 60 days if the intention is not to allow the objection. Even where the parties are engaged in discussion or correspondence, and it seems as though the taxpayer has

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<sup>415</sup> Paragraph 21.0, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>416</sup> Paragraph 4.1, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>417</sup> Paragraph 21.2, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>418</sup> Paragraph 21.2 (ii), *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>419</sup> Paragraph 21.4, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>420</sup> Paragraph 23.0, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>421</sup> Paragraph 6.1 and 16.1, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>422</sup> Paragraph 6.2, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>423</sup> Paragraph 6.1, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>424</sup> Section 51 (11), *Tax Procedure Act* (Act No. 29 of 2015) and Section 229 (5), *East African Community Customs Management Act*, 2004.

acquiesced to a delay in receiving the objection decision, the objection decision will be deemed allowed if the 60 days lapse.<sup>425</sup> Furthermore, it is questionable whether the parties will be able to engage in meaningful ADR within the 30-day period the commissioner has to decide on an application for review under EACCMA.

The second opportunity that the parties have to engage in ADR is during the appeal stage either at the TAT or the High Court or the Court of Appeal. The use of ADR in the appeal stage before the TAT has a statutory basis in section 55 (1) of the TPA and Section 28 (1) of the TATA. For the High Court and the Court of Appeal, the statutory basis is in section 55 (1) of the TPA. Section 28 (1) the TATA obliges the TAT to allow the parties an opportunity to settle out of the tribunal subject to the conditions it may impose. The question that may be raised is whether the framework can form the basis of the conditions the TAT may impose.

### **3.6. Conclusion**

This chapter has shown that the dispute resolution procedures in the legislative framework namely the TPA, TATA and EACCMA are adversarial in nature. The procedure available invites the taxpayer to prove that the decision by the tax administration was incorrect. The procedures include requesting the tax authority to reverse its own decision through objection or an application for review. If the tax administration does not determine that their decision was erroneous, the taxpayer has a right of appeal to the TAT where they ask for the tax administration's decision to be re-examined to determine whether the correct and preferable decision was made. Depending on the determination by the TAT, the aggrieved party being either the taxpayer or the tax authority may apply to the courts.

The provisions granting recourse against a "PEALs" are collectively in the Tax Procedures Act, the EACCMA and TATA. The TPA consolidated dispute resolution provisions from individual acts thus creating uniformity between the acts. TATA established a single tribunal with the power to review on merit the decisions of the commissioner. With the advent of TATA and the TPA, out of court and tribunal settlement was introduced. However, although the provisions are a welcome addition into the framework, the provisions hardly give any guidance or context as to how tax disputes are to be settled out of court. In 2015, KRA introduced a non-binding ADR framework to complement the statutory dispute resolution mechanism. Although not

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<sup>425</sup> *Republic v Commissioner of Customs Services ex-parte Unilever Kenya Limited* [2012] eKLR.

expressly provided for in the statutory framework, the framework provides rules of conduct, timelines and allows the taxpayer to be heard beyond the avenues provided for in statute.



## CHAPTER FOUR

### URY, BRETT AND GOLDBERG'S DSD PRINCIPLES

#### 4.1. Introduction

Disputes are inevitable.<sup>426</sup> They are part of all relationships between all individuals who interact frequently.<sup>427</sup> Fundamentally, they arise when parties express divergence because of perceived incompatibility of interests, needs and goals.<sup>428</sup> The cost of disputing is often high in terms of transaction costs incurred, time and emotional energy invested.<sup>429</sup> Furthermore, the outcomes of the dispute may be unsatisfactory meaning the parties do not get what they desire.<sup>430</sup> The pattern of high dispute cost and unsatisfactory outcomes results in reduced profitability and efficiency and strained relationships.<sup>431</sup> The inevitability of disputes means that not all dispute may be prevented.<sup>432</sup> The negative consequences of disputes can be minimized if the parties ventilate their divergent interests, make trade-offs and arrive at mutually beneficial settlements.<sup>433</sup> Thus disputes can be constructive consequences if the system the parties are using allows the parties to draw their deep-seated interests to the surface and channel them towards resolution.<sup>434</sup> DSD creates dispute resolution systems that harness the constructive elements of dispute resolution and minimizes the negative consequences.<sup>435</sup> Ury, Brett and Goldberg propose six principles to be followed when designing a dispute system that promises to cut costs and to achieve gains from satisfactory outcomes. This chapter first gives a brief background to give context to the DSD model by Ury, Brett and Goldberg. Thereafter, this chapter sets out and analyses the principles proposed by Ury, Brett and Goldberg, therefore, setting the stage for their use as a means of evaluating Kenya's tax dispute resolution system in the next chapter.

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<sup>426</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, xi.

<sup>427</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, xii.

<sup>428</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, xi.

<sup>429</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, xii.

<sup>430</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, xii.

<sup>431</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, xii.

<sup>432</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, xii.

<sup>433</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, xii.

<sup>434</sup> Franck S D, 'Integrating investment treaty conflict and dispute systems design', 177.

<sup>435</sup> Franck S D, 'Integrating investment treaty conflict and dispute systems design', 177.

## 4.2. Historical Background to the DSD Principles

DSD can trace its roots to the ADR movement in the United States during the 1970s and 1980s.<sup>436</sup> The ADR movement essentially sought to enhance access to dispute resolution to disadvantaged communities by providing alternatives to the public adjudication process.<sup>437</sup> The need for alternatives to the public dispute system was informed by three significant concerns; overloaded courts which caused delays and expenses, the need for a specialized forum to resolve commercial disputes and the need to ensure the actualization of the 'justice for all ideal'.<sup>438</sup> The ADR movement thus advocated for the allocation of adjudication from the judicial forum to other alternative methods such as negotiation, mediation and arbitration.<sup>439</sup>

The theories and practices underpinning DSD are drawn from conflict theory, organizational behaviour and ADR.<sup>440</sup> DSD emerged in the 1980s as practical methods of improving conflict resolution in organizations.<sup>441</sup> Initially, DSD was employed to systems that sought to manage fully developed disputes.<sup>442</sup> DSD, was popularized by Ury, Brett and Goldberg in their 1988 book, *Getting Disputes Resolved: Designing Systems to Cut the Costs of Conflict* where they set out a basic conceptual framework for dispute resolution and a practical approach to designing dispute systems.<sup>443</sup> In the book Ury, Brett and Goldberg make three theoretical propositions. First that there are three approaches to resolving disputes namely: reconciling the disputants' underlying interests (interest based approaches), determining who is right (rights-

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<sup>436</sup> Cohen A J, 'Dispute systems design, neoliberalism and the problem of scale', 14 *Harvard negotiation law review*, 1 (2009), 51 – 80, 54. It was considered a 'movement' because at the time many of the leading scholars and proponents of ADR believed they were in a social movement to shift the legal landscape with regards to dispute resolution. See; Meadow-Menkel C, 'Mothers and fathers of invention: the intellectual founders of ADR', 16 *Ohio state journal on dispute resolution*, 1 (2000), 1-37, 2.

<sup>437</sup> Meadow-Menkel C, 'Mothers and fathers of invention', 2.

<sup>438</sup> Meadow-Menkel C, 'Mothers and fathers of invention', 2.

<sup>439</sup> Kaufman I R, 'Reform for a system in crisis: alternative dispute resolution in the federal courts', 59 *Fordham law review*, 1 (1990), 1 – 38, 9.

<sup>440</sup> Schneider K A and Fleury N C, 'There's no place like home: applying dispute systems design theory to create a foreclosure mediation system', 11 *Nevada law journal*, 1 (2011), 368 – 396, 376.

<sup>441</sup> Amsler B L, Martinez J K and Smith S E, 'Christina Merchant and the state of dispute systems design', 33 *Conflict resolution quarterly*, 1 (2015), 7 – 26, 10.

<sup>442</sup> Amsler B L, Martinez J K and Smith S E, 'Christina Merchant and the state of dispute systems design', 10.

<sup>443</sup> Schneider K A and Fleury N C, 'There's no place like home', 376.

based approaches) and determining who more powerful (power-based approaches) is.<sup>444</sup> Second, Ury, Brett and Goldberg argued that interest-based approaches such as negotiation and mediation were less costly in terms of transaction costs and more rewarding in terms of outcomes.<sup>445</sup> Third, the goal of DSD is to design a system that is interest based and provides for low-cost rights-based procedures as back-ups.<sup>446</sup> In proving their propositions, Ury, Brett and Goldberg detail how the introduction of problem-solving negotiation into the dispute resolution system of a mine laden with wild cat strikes led to higher levels of satisfaction with outcomes and improved working relationships eventually leading to eleven months without a strike or mine closure.<sup>447</sup> Furthermore, the introduction of grievance mediation before grievance arbitration in coal industry union disputes led to higher satisfaction with outcomes and substantial time and cost savings.<sup>448</sup> Ury, Brett and Goldberg conclude by prescribing that parties should be encouraged to resolve their disputes by reconciling interests since it is less costly and more rewarding than rights and power based approaches.<sup>449</sup> Based on the findings mentioned above and the conclusion, it emerged that organizations could deliberately and strategically select dispute resolution approaches and process thus ensuring more effective dispute resolution.<sup>450</sup> Furthermore, instead of focusing on individual dispute resolution procedures in isolation, disputes would be more effectively managed through an integrated dispute resolution system comprising of negotiation, mediation and arbitration.<sup>451</sup>

From the background above, it is apparent that DSD was conceived to be employed in an organizational context.<sup>452</sup> DSD has grown beyond its organizational context and has employed to make proposals to address labour disputes, investment treaty disputes, consumer disputes,

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<sup>444</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 4 -5.

<sup>445</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 15.

<sup>446</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18.

<sup>447</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 132 -133.

<sup>448</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 157 -159.

<sup>449</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 169.

<sup>450</sup> Bingham L B and Nabatchi T, 'Dispute system design in organizations', in Pammer Jr J W and Killian J (eds), *Handbook of conflict management*, Marcel Dekker Inc, New York, 2003, 103 – 128, 107.

<sup>451</sup> Ury W, Brett J and Goldberg S B, 'dispute systems design: an introduction', 5 *Negotiation journal*, 4 (1989), 357 – 358, 357.

<sup>452</sup> Orna R and Katsh E, 'Technology and the future of dispute systems design', 17 *Harvard negotiation law review*, 2 (2012), 151 – 199, 159.

tax disputes and to manage political conflict.<sup>453</sup> The expanded scope of its application has led to DSD to be described as a new field of theory and practice to address dispute resolution.<sup>454</sup>

### 4.3. Ury, Brett and Goldberg's' DSD Principles

DSD as a process of creating an effective, efficient and fair dispute resolution process promises: lower transaction costs, less lost time, fewer missed commercial opportunities, fewer power struggles and higher party satisfaction.<sup>455</sup> DSD has also been said to enhance foster trust and enhance prospects of cooperation between parties within a continuous relationship.<sup>456</sup> As such the central goal of DSD can be said to be to reduce the costs associated with dispute resolution, where costs are measured by reference to four broad criteria: transaction costs (money, time and emotional energy expended in disputing), satisfaction with procedures and outcomes, long-term effect of the procedures on the parties' relationship and recurrence of disputes.<sup>457</sup> A dispute system that achieves cost savings, higher satisfaction, enhanced relationships and low recurrence of disputes would be considered an effective and efficient dispute resolution system. For Ury, Brett and Goldberg, a dispute resolution system is effective, efficient and fair if it is interest oriented meaning most disputes are resolved through reconciling interests, some through determining who is right and the least through who is more powerful.<sup>458</sup> Ury, Brett and Goldberg have developed six principles that are widely accepted for designing an effective and efficient dispute resolution system.<sup>459</sup> The six principles are:

- a) Create ways for reconciling the interests of those in dispute;
- b) Build in "loop-backs" that encourage disputants to return to negotiation;
- c) Provide low-cost rights and power "back-ups";
- d) Prevent unnecessary conflict through notification, consultation and feedback;
- e) Arrange procedures in a low to high-cost sequence; and
- f) Provide the necessary motivation, skills and resources to allow the system to work.

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<sup>453</sup> Cohen A J, 'Dispute systems design, neoliberalism and the problem of scale' 52.

<sup>454</sup> Cohen A J, 'Dispute systems design, neoliberalism and the problem of scale' 52.

<sup>455</sup> Franck S D, 'Integrating investment treaty conflict and dispute systems design', 177.

<sup>456</sup> Nabatchi and Bingham, 'From postal to peaceful', 230.

<sup>457</sup> Wolski B, 'The model dispute resolution procedure for Australian workplace agreements', 13.

<sup>458</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18.

<sup>459</sup> Orna R and Katsh E, 'Technology and the future of dispute systems design', 156.

Adherence to these principles bear on whether the dispute resolution system is efficient, effective, assures high satisfaction with the outcome and preserves the relationships between the parties.<sup>460</sup> Furthermore, dispute systems that follow these general principles are more likely to produce more positive dispute outcomes.<sup>461</sup> The quality of a system may thus be judged by how well it conforms with these principles.<sup>462</sup>

#### **4.3.1. Principle 1 - Create ways for reconciling the interests of those in dispute**

Interests are “needs, desires, concerns, fears” that a disputant has. Interests form the underlying positions that people take in a dispute.<sup>463</sup> Reconciling interests involves the disputing parties exploring their concerns, making trade-offs and compromises where the interests are divergent.<sup>464</sup> The most common procedure for reconciling interests is negotiation whereby the parties engage in discussions with a view of reaching an agreement that is mutually acceptable.<sup>465</sup> The dispute system must establish clear negotiation procedures that are easy to follow and bring about negotiation as early as possible.<sup>466</sup> The need for clarity in the procedure for the negotiation process cannot be overemphasized.<sup>467</sup> The lack of a procedural framework for negotiation can discourage parties from using the negotiation procedure.<sup>468</sup> Where there are procedural rules, it must be clear to the parties the applicable timelines to initiate and undertake the negotiations, the mechanisms for information exchange, the extent to which the parties are under a duty to maintain confidentiality and what happens if the negotiations are unsuccessful.<sup>469</sup> The availability of well set out procedures provides procedural certainty and a degree of uniformity in application.<sup>470</sup> Lack of clear procedures is a recipe for further disagreement between the parties.<sup>471</sup> To motivate the use of interest-based there should be

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<sup>460</sup> Smith S and Martinez J, ‘An analytic framework for dispute systems design’, 128.

<sup>461</sup> Nabatchi and Bingham, ‘From postal to peaceful’, 215.

<sup>462</sup> Smith S and Martinez J, ‘An analytic framework for dispute systems design’, 128.

<sup>463</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 6.

<sup>464</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 6.

<sup>465</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 6.

<sup>466</sup> Mookhey S, ‘Tax dispute systems design’, 94.

<sup>467</sup> Wolski B, ‘The model dispute resolution procedure for Australian workplace agreements’, 16.

<sup>468</sup> Wolski B, ‘The model dispute resolution procedure for Australian workplace agreements’, 19.

<sup>469</sup> Wolski B, ‘The model dispute resolution procedure for Australian workplace agreements’, 16.

<sup>470</sup> Wolski B, ‘The model dispute resolution procedure for Australian workplace agreements’, 16.

<sup>471</sup> Wolski B, ‘The model dispute resolution procedure for Australian workplace agreements’, 23.

multiple access points into the dispute system and procedures.<sup>472</sup> Furthermore, the system should provide a negotiator with authority to negotiate and settle disputes.<sup>473</sup> The dispute system should ensure that there are people available to assist and manage with respect to the negotiation procedures; this includes mediators who can help parties identify their interests and assist the parties to craft creative solutions.<sup>474</sup>

#### **4.3.2. Principle 2 - Build in "Loop-Backs" to Negotiation**

Interest-based procedures such as negotiation or mediation are not always successful. If the interest-based procedures are not successful, the parties may have to result to rights and power contests which are costlier<sup>475</sup>. The system should contain procedures or mechanisms that allow and encourage the parties to return to negotiation where the parties are engaged in a rights contest.<sup>476</sup> An example of a loopback procedure is advisory arbitration where the parties are provided with information about their rights and thus an independent standard that can help settle the case.

#### **4.3.3. Principle 3 - Provide Low-Cost Rights And Power "Backups"**

DSD as conceived by Ury, Brett and Goldberg adopts a broader perspective in developing dispute resolution procedures.<sup>477</sup> Instead of developing individual dispute resolution procedures, the Ury, Brett and Goldberg model seeks to form an integrated system.<sup>478</sup> This is because it is recognized that despite the numerous advantages of interest based procedures, it may not be possible or desirable to resolve all disputes through reconciling interests.<sup>479</sup> Interest-based procedures would not be advisable where adjudication is the only way to resolve a question between the parties authoritatively.<sup>480</sup> Primarily, the system should "consist of a series

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<sup>472</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 46.

<sup>473</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

<sup>474</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 48.

<sup>475</sup> Goh M G, *Dispute settlement international space law: a multi-door courthouse for outer space*, Martinus Nijhoff, Leiden, 2007, 325.

<sup>476</sup> Goh M G, *Dispute settlement international space law*, 325.

<sup>477</sup> Ury W, Brett J and Goldberg S B, 'dispute systems design', 357.

<sup>478</sup> Ury W, Brett J and Goldberg S B, 'dispute systems design', 357. See also: Bingham L B and Nabatchi T, 'Dispute system design in organizations', 108.

<sup>479</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 15.

<sup>480</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 15.

of safety nets".<sup>481</sup> Where one procedure fails another is available for use, this ensures that there are no procedural gaps in the system.<sup>482</sup> Furthermore, the back-ups provide a known endpoint to the system.<sup>483</sup> The rights and power procedures available should be flexible, simpler, quicker and relatively inexpensive.<sup>484</sup> Low cost rights procedures are often characterized by informality and flexibility in procedure.<sup>485</sup> An example of a low cost rights procedure is arbitration.

#### **4.3.4. Principle 4 - Prevent unnecessary conflict through notification, consultation and feedback**

To prevent unnecessary conflict, a party intending to undertake an action that is likely to affect the other party the party taking the action should notify and consult the other party.<sup>486</sup> Notification ensures that the other party feels included in the process.<sup>487</sup> Unilateral decisions are more likely to be perceived as unfair which could trigger aggression and reduce cooperation between the parties.<sup>488</sup> Furthermore, notification provided the parties with an opportunity to identify points of indifference early so that an interest-based procedure can be employed.<sup>489</sup> The system should also include some form of post-dispute analysis and feedback. This post-dispute analysis is essential to help the parties identify issues that may be symptomatic of a broader issue that needs to be dealt with.<sup>490</sup> It is advised that at the post-dispute stage, there should be procedures to record and analyse dispute data.<sup>491</sup> The post-dispute analysis is also important for purposes of ensuring accountability.

#### **4.3.5. Principle 5 – Arrange Procedures in a Low to High-Cost Sequence**

One of the main propositions underpinning DSD is that in general, reconciling interests is less costly (in terms of money, time and emotional energy expended in disputing) than determining

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<sup>481</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 172.

<sup>482</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 172.

<sup>483</sup> Wolski B, 'The model dispute resolution procedure for Australian workplace agreements', 19.

<sup>484</sup> Wolski B, 'The model dispute resolution procedure for Australian workplace agreements', 19.

<sup>485</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

<sup>486</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

<sup>487</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

<sup>488</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

<sup>489</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

<sup>490</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

<sup>491</sup> Wolski B, 'The model dispute resolution procedure for Australian workplace agreements', 13.

who is right which is in turn less costly than determining who is more powerful.<sup>492</sup> Considering this proposition, in order to save on costs of disputing, the procedures should be arranged gradually in steps from a low cost to a high-cost sequence.<sup>493</sup> The suggested sequence of procedures is a prevention procedure involving notification and consultation mechanisms, interest-based procedures, for example, negotiation followed by mediation if the parties are unable to resolve the disputes themselves, a low-cost right procedure such as arbitration and then power back-ups.<sup>494</sup>

#### **4.3.6. Principle 6 – Provide the necessary motivation, skills and recourses to use them**

To make sure the procedures work the parties must be motivated to use them; otherwise the procedures will fail.<sup>495</sup> The parties must be encouraged, assisted and taught how to use interest-based procedures which are the focal point of the system.<sup>496</sup> A pragmatic appeal should be made to the parties to forego power procedures in the first instance so that the parties may accrue reduced transaction costs increased party satisfaction with outcomes, improved relationships among the stakeholders and lowered recurrence of disputes, all of which are associated with interest-based procedures.<sup>497</sup> Where there is an imbalance in power dynamics, the procedures set out should ensure the parties have an opportunity for "voice" and control over the procedures.<sup>498</sup> The system should have the following resources to ensure that they work effectively: people, institutions, norms, precedents and laws.<sup>499</sup>

#### **4.4. Conclusion**

DSD involves intentional and systematic efforts to develop and arrange dispute resolution procedures in a way that promises lower costs and minimizes the negative aspects of dispute resolution. The central goal of DSD is to design interest-oriented dispute systems whereby most disputes are resolved through interest-based procedures such as negotiation and

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<sup>492</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 15.

<sup>493</sup> Wolski B, 'The model dispute resolution procedure for Australian workplace agreements', 21.

<sup>494</sup> Wolski B, 'The model dispute resolution procedure for Australian workplace agreements', 21.

<sup>495</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 64.

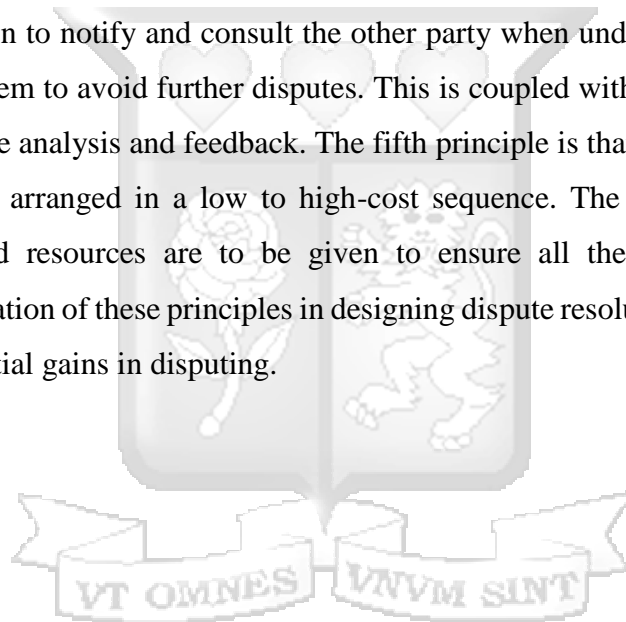
<sup>496</sup> Jones M, 'Tax dispute systems design', 39.

<sup>497</sup> Kinon, B A, 'Power before interest in dispute system design', 17 *Harvard law review*, 1 (2012), 273 -287, 279.

<sup>498</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 33.

<sup>499</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 37.

mediation, some disputes are resolved through determining who is right through arbitration and the courts and the fewest disputes should be resolved through power contests. Interest oriented dispute systems promise reduced time and money involved in resolving disputes while guaranteeing satisfactory outcomes. Ury, Brett and Goldberg developed six principles that provide a practical approach in designing effective and efficient dispute resolution system. Dispute resolution systems that adhere to these six principles are considered effective and efficient in resolving disputes, and as such, they are efficiently designed. The first principle is the most key as it emphasizes that the system should put a focus on interest by providing for ways in which the parties may reconcile their interests. The second principles that the system should provide rights and power procedures that loop back to negotiation. The third is that the system should provide for low-cost rights and power backup. The fourth principle is that there is built in an obligation to notify and consult the other party when undertaking any steps that are likely to affects them to avoid further disputes. This is coupled with the need to build into the system post despite analysis and feedback. The fifth principle is that the dispute resolution procedures should be arranged in a low to high-cost sequence. The sixth principle is that motivation, skills and resources are to be given to ensure all the procedures work. In conclusion, the application of these principles in designing dispute resolution systems promises lower costs and potential gains in disputing.



# CHAPTER FIVE

## DISPUTE SYSTEMS DESIGN EVALUATION OF KENYA'S TAX DISPUTE RESOLUTION SYSTEM

### 5.1. Introduction

The evaluation conducted in this chapter is motivated by KRA's concern about the large volume of tax disputes being litigated in Kenya, and the desire to have the majority of tax disputes settled through ADR outside the judicial and quasi-judicial dispute resolution processes. The resolution of tax disputes through litigation is often considered unfavourable due to the delays and high costs involved.<sup>500</sup> ADR in the context of tax dispute resolution promises: expedited dispute resolution, decreased cost of tax disputes, enhanced relationships between the taxpayer and KRA, and improved service delivery and voluntary compliance.<sup>501</sup> Spurred by the concern over large volumes of tax litigation, and the global trend towards ADR, KRA introduced the ADR Framework in 2015 hoping to improve the number of tax disputes settled by ADR, considering that in best practice up to 80 % of tax disputes are resolved by some form of ADR.<sup>502</sup> About four years after the introduction of the ADR Framework and statutory provisions providing for out of court settlement, a majority of disputes are still not resolved through ADR.<sup>503</sup> The objective of this chapter is to evaluate Kenya's tax dispute resolution system against the DSD principles proposed by Ury, Brett and Goldberg to determine whether Kenya's tax dispute resolution system is oriented towards the use of interest-based procedures and ADR to resolve a majority of tax disputes.

### 5.2. Evaluation against DSD Principles

#### 5.2.1. *The System Creates Ways for Reconciling The Interest Of Those In Dispute*

This DSD principle is the most important and crucial principle.<sup>504</sup> A tax dispute resolution system that prioritises this principle must focus primarily on interests. For a dispute resolution

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<sup>500</sup> Ernst & Young, *Tax dispute resolution: a new chapter emerges*, 2010, 4.

<sup>501</sup> Paragraph 2.0, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>502</sup> Kenya Revenue Authority, *Sixth corporate plan*, 2015, 50.

<sup>503</sup> Kenya Revenue Authority, *Seventh corporate plan 2018/19-2020/21: revenue mobilization through transformation*, 2019, 37.

<sup>504</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

system to be said to focus on rights, it must create ways for reconciling the interest of the parties. The system must establish a negotiation procedure, multiple access points to the interest-based approaches, strengthen motivation to use the interest-based approaches through transparent procedures and structures, and provide for the availability of a third-party to assist where the parties are unable to resolve the dispute themselves.

While Section 28 of TATA and Section 55 of the TPA enable parties to an appeal to settle the matter out of the tribunal and court respectively, these provisions give virtually no guidance, or context, on how the parties are to be engaged with a view of settling the matter out of court.<sup>505</sup> The dispute resolution system established under the TPA, TATA, and EACCMA does not create ways for reconciling the interests of the parties as contemplated by Ury, Brett, and Goldberg for four main reasons.

First, TPA, TATA, EACCMA do not establish clear negotiations procedures. This lacuna is especially true for EACCMA which does not provide for any form of ADR. Second, putting aside the lack of negotiation procedure, the engagement of ADR is not the first possible option under the TPA, TATA and EACCMA. Under the Acts, it seems to be part of the appeals procedure which are rights-based approaches to tax dispute resolution. Third, it is not enough to provide for out of court settlement; disputants need to be motivated to use the ADR procedure provided. A structured framework for interest-based approaches which emphasizes and encourages early use of interest-based approaches is the best way to motivate disputants to use it. TPA and EACCMA, the main procedural tax acts, lack such a framework. Fourth, the statutory framework lacks multiple entry points to the opportunity to use ADR. Under the TPA and TATA, the only express way by which the taxpayer and the tax authority may pursue ADR is when permitted to settle a matter out of court or out of the tribunal by the judicial body.

Ultimately, the lack of statutory accommodation for ways and procedures through which parties may reconcile their interests early on when the dispute arises has been interpreted as a statutory and policy reluctance to use ADR in tax.<sup>506</sup> Clearly, the statutory regime of tax dispute resolution does not focus on the interest of the parties. Furthermore, the lack of statutory procedure or guidance is a recipe for further disputes, rather than resolution. For example, in *Kenya Revenue Authority v Jimmy Mutuku Kiamba*<sup>507</sup> the taxpayer and the tax authority were

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<sup>505</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 70.

<sup>506</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 70.

<sup>507</sup> [2016] eKLR Ruling No. 2.

directed by the court to engage in ADR to determine the issues in controversy.<sup>508</sup> KRA was reluctant to engage the taxpayer as directed by the court and, as a result, the taxpayer filed review proceedings requesting the court to review its orders. KRA responded that their reluctance was premised on the view that ADR was not appropriate in this case since it involved tax evasion which was precluded from the ADR Framework. The court held that although a tax dispute could be referred to ADR during an appeal, referral to arbitration was inappropriate in the circumstances of the case. The court ultimately reversed its order directing ADR.

The ADR Framework does attempt to reconcile the interests of the parties through facilitated discussions. Although the Framework does not establish any negotiation procedure, it does provide clear procedures for facilitated discussions, setting out timelines, mechanisms for information exchange and what happens when facilitated discussions are unsuccessful. The main way in which the Framework fails in its attempt to reconcile the interests of the parties is that it does not enhance motivation for its use. The Framework lacks a clear and express statutory foundation which raises questions over procedural certainty and uniformity of application. Although it is apparently based on section 55 of the TPA and section 28 of TATA, this link is not clear to the provisions is not clear. The aforementioned provisions only provide for opportunities to engage in out of court settlement, it is not apparent how these provisions prescribe the use of the ADR Framework and furthermore, allow KRA to promulgate and apply the ADR Framework. Furthermore, there is a disclaimer in the Framework providing that KRA does not take responsibility for consequences suffered by anyone acting or refraining from acting in reliance on the information contained in the framework. This disclaimer hardly enhances or encourages taxpayers to use the framework.<sup>509</sup>

In general, despite the existence of the ADR framework and section 55 of the TPA and section 28 of the TATA which provide for out of court settlement, it is doubtful whether the tax dispute resolution system, as a whole, creates ways through which disputants can reconcile their interests. Admittedly, section 55 of the TPA and section 28 of TATA provide that the commissioner may settle disputes out of court upon appeal; however what is fundamentally lacking is the legal basis for such a settlement and this has implications for whether the parties' interests can actually be reconciled, even under the ADR framework.

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<sup>508</sup> *Kenya Revenue Authority v Jimmy Mutuku Kiamba* [2016] eKLR ruling No. 1.

<sup>509</sup> Kashindi G A, 'Tax dispute resolution in Kenya', 70.

In Chapter 2, it was pointed out that under the Constitution, Parliament impose taxes while KRA is mandated to collect the taxes. Further, Article 210 of the Constitution provides that no tax ought to be waived or varied except as provided by legislation. The Oxford Dictionary defines ‘waive’ as to ‘refrain from demanding compliance with a rule’.<sup>510</sup> Thus, any time KRA refrains from collecting or enforcing tax law, that action must be provided for under the law. As such, any negotiated settlement reached under the ADR Framework or pursuant Section 55 of the TPA and Section 28 of TATA, and which results in foregone taxes, must be strictly within the confines of the law. The type of settlement thus allowed under the current system is known as a principled settlement.<sup>511</sup>

In contrast, there exists another type of settlement known as compromise settlement which is reached based on a cost-benefit analysis taking into account the uncertainty of litigation and the cost involved.<sup>512</sup> Since there is no provision in the TPA allowing the commissioner to take into account factors such as the future voluntary compliance of the taxpayer in settling tax disputes, any settlements must be based on the same basis as the basis upon which assessments are made; this approach does not best advance or reconcile the interests of KRA and the taxpayer.<sup>513</sup> The only legal settlement would be on an all or nothing basis and would require one of the parties to concede that the other party’s interpretation of the law is correct.<sup>514</sup>

The use of principled settlements is reflected in the ADR Framework.<sup>515</sup> However, in setting out the criteria to be applied in determining whether a dispute is appropriate for ADR, the Framework advocates for a cost-benefit analysis and consideration of the litigation risk, factors which should not come into consideration and a principled settlement.<sup>516</sup> In other jurisdictions,

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<sup>510</sup> <https://en.oxforddictionaries.com/definition/waive> on 29 April 2019. Where words are not defined, the plain and simple meaning should be considered. See; *Boniface Oduor v Attorney General & another; Kenya Banker’s Association & 2 others (Interested Parties) [2019] eKLR*

<sup>511</sup> Campell C and Sandler D, ‘Catch -22: a principled basis for the settlement of tax appeals’, *57 Canadian tax journal*, 4 (2009), 762 – 786, 766.

<sup>512</sup> Campell C and Sandler D, ‘Catch -22’, 766.

<sup>513</sup> Keating M and Kristy M, ‘The settlement of tax disputes: the commissioner is able but not willing’, *15 New Zealand Journal of Taxation Law and Policy*, 4 (2009), 323 – 349, 324.

<sup>514</sup> Keating M and Kristy M, ‘The settlement of tax disputes’, 325.

<sup>515</sup> Paragraph 4.0, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015. “ADR negotiations and settlements must have legal basis within the Tax Laws.”

<sup>516</sup> Paragraph 20.1, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

the power to reach a settlement on compromise basis is either expressly provided in statute<sup>517</sup> or has been inferred by the court as part of the power to manage and control taxes.<sup>518</sup> Considering the import of Article 210 of the Constitution, the power to settle on compromise basis cannot be inferred; rather, it would have to be expressly conferred by statute.<sup>519</sup>

### **5.2.2. Principle 2 - Build In “Loop-Backs” To Negotiation**

The loop-back procedure contemplated by Ury, Brett and Goldberg is a procedure that allows the parties to revert to negotiation after they are engaged in a rights contest. These loopbacks are important as they form a source of information or standards to guide the second attempt at interest-based procedures.<sup>520</sup> The TPA and TATA contemplate that the first attempt to settle the matter is at the appeal stage and with the permission of either the court or the TAT.<sup>521</sup> There cannot be said to be a loopback under the statutory framework, because the statutory does not provide for any interest based procedure before an appeal has been filed in the TAT or the court.

Under the ADR Framework, once the first attempt at facilitated mediation is unsuccessful, a second attempt is limited to instances where there is reasonable cause for a second attempt or fresh evidence.<sup>522</sup> Thus, theoretically, it would be possible to engage in ADR at the objection stage, and if there is no agreement and the taxpayer appeals, the TAT allows the parties to settle the matter out of court. Although there is no loop-back procedure as contemplated by Ury, Brett and Goldberg, the Framework provides for a limited opportunity to loop -back to facilitated mediation even if the parties are engaged in a rights contest before a court or tribunal.

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<sup>517</sup> Section 143 (1), Tax Administration Act (Act No. 28 of 2011), (South Africa) :

“(1) A basic principle in tax law is that it is the duty of SARS to assess and collect tax according to the laws enacted by Parliament and not to forgo a tax which is properly chargeable and payable.

(2) Circumstances may require that the strictness and rigidity of this basic principle be tempered, if such flexibility is to the best advantage of the State.”

<sup>518</sup> *R v IRC, ex parte National Federation of Self-Employed and Small Businesses Ltd* in the United Kingdom and *Accent Management Limited v CIR*. 2007 NZCA 231 in New Zealand.

<sup>519</sup> Kashindi G A, ‘Tax dispute resolution in Kenya’, 67.

<sup>520</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

<sup>521</sup> Section 28 (1), *Tax Procedure Act* (Act No. 29 of 2015)- “ 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. ” (emphasis added).

<sup>522</sup> Paragraph 23.0, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

### 5.2.3. Principle 3 – Provides for Low-Cost Rights and Power “Back-Ups”

Interest-oriented dispute resolution systems resolve the majority of their tax disputes through interest-based procedures. However, it is recognized that not every dispute can be resolved through interest-based procedures that is why the model advocates for low-cost rights procedures and power back-ups. This principle is invariably tied to the first principle in that there should be ways in which the parties reconcile interest in the first instance, should these interest based procedures fail, low rights back-ups should be available. Kenya’s tax system is mainly adversarial; thus, rights procedures such as adjudication by a tribunal are provided for first, then alternatives to rights procedures are made available. Under Section 55 of the TPA and section 28 of the TATA, the settlement provided for requires the parties to have already been engaged in a rights contest in the form of an appeal either from the decision of the commissioner or from the TAT. Clearly, the use of interest-based procedures is a back-up for the rights procedure. The ADR Framework from KRA states that further complements the adversarial dispute resolution system. The approach of treating interest-based procedures as secondary to rights procedures such as litigation has been criticized since, under the new constitutional regime, ADR is elevated and applies to all disputes.<sup>523</sup>

Under the ADR framework it is recognized that not all tax disputes can be resolved through ADR, for example tax evasion, and these are in the exclusive domain of rights-based procedures.<sup>524</sup> As such there is a low cost “back-up” in the form of the TAT where the disputes that cannot be resolved in ADR cannot be resolved. Statutory tribunals are supposed to offer a lower cost experience for the user through lower filing fees, time expended and more flexible hearings.<sup>525</sup> The TAT does exhibit these characteristics. On the lower filing fees, the TATA provides for a fixed fee regardless of the matter the amount of taxes in dispute. Under section 12 of TATA, a person appealing has to pay a fixed fee of twenty thousand shillings. It should be noted that no portion of taxes is payable for a valid appeal to be lodged. In terms of time, the tribunal is mandated to decide within 90 days. Since the tribunal is only resolves a narrow

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<sup>523</sup> Kashindi G A, ‘Tax dispute resolution in Kenya’, 67.

<sup>524</sup> Paragraph 20.2, *Kenya Revenue Authority Alternative Dispute Resolution Framework in Tax*, 2015.

<sup>525</sup> McCabe B, ‘Perspectives on economy and efficiency in tribunal decision-making’, 85 *Australian institute of administrative law forum*, (2016), 40 -53, 40.

spectrum of legal i.e. tax disputes, it is expected that they are more efficient and such disputes would take reasonably less time in resolving than state courts.<sup>526</sup>

Informality in procedure has often been associated with efficiency and lower cost in dispute resolution.<sup>527</sup> Informality in procedure is what has led arbitration to be considered less costly than courts and the ultimate low cost procedure to determine right.<sup>528</sup> Similar to arbitration one of the reasons that administrative tribunals are preferred over conventional courts is procedural flexibility.<sup>529</sup> In terms of flexibility, the TAT is empowered to focus and limit the scope of hearings and they may even dispense with 'in person hearings'.<sup>530</sup> Also, although the proceedings are of a judicial nature, the taxpayer may appear in person or may be represented by their tax agent or an advocate.<sup>531</sup> Unlike courts the TAT does not prohibit non advocates from appearing before it. Furthermore, evidence may be presented in multiple ways.<sup>532</sup> Flexibility is also determined by the ability of the adjudicator to modify its procedures when it is considered appropriate.<sup>533</sup> Rule 27 of the of the Tax Appeals Tribunal (Procedure) Rules empowered the TAT to determine their own procedure where there is no applicable procedure.

#### **5.2.4. Principle 4 - Prevent Unnecessary Conflict Through Notification, Consultation, And Feedback**

It is necessary for a party undertaking an activity that is likely to affect the other party to notify and consult the other party in advance to prevent unnecessary conflict. Under Article 47, of the Constitution, every person has the right to administrative action that is expeditious, efficient, lawful, reasonable, and procedurally fair. Notification is a crucial component of procedural fairness, natural justice, and due process. When it comes to notices related to tax collection, the notice must state that it is a notice for tax collection, it must state the amount, the legal provisions supporting the notice, the sanctions, and inform the taxpayer of their opportunity to be heard.<sup>534</sup> Failure to adhere to this would put the notice at risk of being quashed by the

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<sup>526</sup> Cane P, *Administrative tribunals and adjudication*, 114.

<sup>527</sup> Cane P, *Administrative tribunals and adjudication*, 233.

<sup>528</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 56.

<sup>529</sup> Cane P, *Administrative tribunals and adjudication*, 233.

<sup>530</sup> Section 16 (2), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>531</sup> Section 25 (1), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>532</sup> Rule 25, *Tax Appeals Tribunal (Procedure) Rules*, 2015.

<sup>533</sup> Cane P, *Administrative tribunals and adjudication*, 233.

<sup>534</sup> *Geothermal Development Company Limited v Attorney General & 3 others [2013] eKLR*.

court.<sup>535</sup> Considering the right under Article 47 of the Constitution, KRA is always under an obligation to notify the taxpayer, in writing and with reasons, of their actions towards the taxpayer under the TPA. The notification under the TPA would allow the injured party to recognize indifference early so that they can act either through compliance or appeal.<sup>536</sup>

In terms of feedback, it is advised that the system must have some post-dispute analysis mechanism which should help the parties learn from the dispute. The TAT and the courts are under a duty to provide reasons for the decisions they make. Furthermore, the decisions are released to the public through the National Reporting Council.<sup>537</sup> This publication can help in identifying frequently occurring disputes that may be symptomatic of a broader systematic issue.<sup>538</sup>

In terms of settlement of tax disputes under the Framework, paragraph 26.0 which provides for records and maintenance of data in ADR settlements merits discussion. The addition of this paragraph, especially paragraph 26. 0 (iii) under which the commissioner shall notify the Auditor General of any revenue forgone and give a justification, forms a post-dispute analysis forum. This provision is welcome in light of the fact that foregone taxes affect the public purse, and it is desirable that the feedback under this provision is comprehensive in light of Article 10 (2) (c)<sup>539</sup> and Article 210 (2) of the Constitution.<sup>540</sup>

#### **5.2.5. Principle 5 – Arrange Procedures in A Low to High Cost Sequence**

After an assessment, once the taxpayer files their notice of objection, the ADR framework provides that the parties can engage ADR in the form of facilitated discussions. If the parties reach an agreement, the taxpayer either pays additional tax or the commissioner amends the assessment. If the parties fail to reach an agreement and the commissioner confirms the assessment, the taxpayer would have to appeal to the tax tribunal which is a rights contest. It

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<sup>535</sup> *Geothermal Development Company Limited v Attorney General & 3 others [2013] eKLR.*

<sup>536</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

<sup>537</sup> See; Legal Notice No. 29 of 2009.

<sup>538</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 61.

<sup>539</sup> (2) “The national values and principles of governance include— (c) ... good governance, integrity, transparency and accountability...”.

<sup>540</sup> “If legislation permits the waiver of any tax or licensing fee— (a) a public record of each waiver shall be maintained together with the reason for the waiver; and (b) each waiver, and the reason for it, shall be reported to the Auditor- General.”

is expected that as the dispute graduates from an objection to an appeal the costs become higher in terms of money and time for example while in the tribunal representation by an advocate is not mandatory<sup>541</sup>, in the appeals to the courts, advocates are mandatory. Furthermore, due to the inflexibility of procedure, more time and energy may be expended at the High Court and the Court of Appeal level. Tax dispute procedures in Kenya are gradually sequenced from a low to a high-cost sequence.

### ***5.2.6. Principle 6 – Provide the Necessary Motivation, Skills and Recourses To Use Them***

To make sure a system works, it must be provided with the necessary resources and the parties must be motivated to use it.<sup>542</sup> Unfortunately, despite the benefits that accrue from having interest-based procedures as the primary and first option to resolve disputes, the statutory tax dispute framework does not fully embrace interest-based approaches to tax dispute resolution and thus it does not provide adequate resources in the form of rules, procedures and norms to back the use of interest based procedures. While granting an opportunity to parties to settle tax disputes out of court, Section 55 of TPA and section 28 of the TATA do not provide any guidance or context for out of court settlement that could motivate the parties to settle the matter outside of the court or tribunal. Furthermore, EACCMA does not offer any opportunities for settlement. The framing of these provisions does not provide any legal assistance to parties seeking to engage in out of court settlement.<sup>543</sup> Furthermore, they are not framed in a manner that could adequately and legally sustain an interest-oriented dispute resolution system.<sup>544</sup>

### **5.3. Conclusion**

The evaluation conducted in this chapter indicates that Kenya's tax dispute resolution does not follow many of the DSD principles set out by Ury Brett and Goldberg. The tax dispute statutory framework enshrined in the TPA, EACCMA, and TATA does not: create ways for reconciling the interests of the parties in dispute, have built in loop back procedures, and provide low-cost rights and power back-ups. Furthermore, the TPA, EACCMA, and TATA do not provide the necessary motivation, skills and resources for the use of interest-based approaches of dispute

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<sup>541</sup> Section 25 (1), *Tax Appeals Tribunal Act* (Act No. 40 of 2013).

<sup>542</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 18.

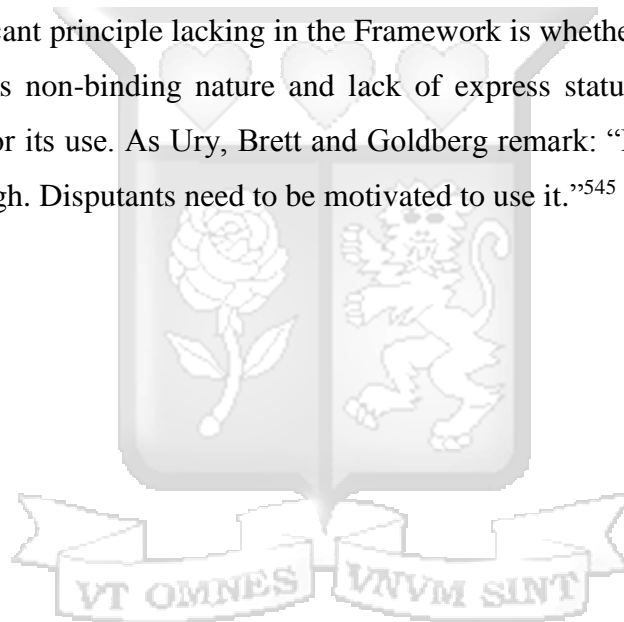
<sup>543</sup> Jones M, 'Tax dispute systems design', 40.

<sup>544</sup> Jones M, 'Tax dispute systems design', 40.

resolution. The statutory tax dispute resolution system does possess robust procedures for notification and feedback, especially at the appeals level where the decisions are reported to the public.

The ADR framework meets two DSD principles. The Framework creates ways for reconciling the interests of the parties in dispute despite the lack of early negotiation procedure. The ADR framework does have some form of loop-back to interest-based procedures; however, this is not a dispute resolution procedure in itself as contemplated by Ury, Brett and Goldberg. Furthermore, the Framework provide low cost rights procedure in the form of the TAT. The ADR framework benefits from the robust and mandatory notification procedures under the TPA. It was noted that the ADR Framework lacks a mechanism for post-dispute analysis.

Arguably, one significant principle lacking in the Framework is whether the Framework itself encourages its use. Its non-binding nature and lack of express statutory backing does not enhance motivation for its use. As Ury, Brett and Goldberg remark: “Establishing mediation procedure is not enough. Disputants need to be motivated to use it.”<sup>545</sup>



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<sup>545</sup> Ury W, Brett J and Goldberg S B, *Getting disputes resolved*, 50.

## **CHAPTER SIX**

### **CONCLUSION AND RECOMMENDATIONS**

#### **6.1. Introduction**

This chapter summarises the main research objectives, findings, and recommendations, of the study. The study sought to evaluate Kenya's tax dispute resolution system through the DSD principles proposed by Ury, Brett, and Goldberg to identifying shortcomings in the design of the system that may hinder the resolution of tax disputes through less adversarial means.

#### **6.2. Findings**

##### **6.2.1. *Emergence of Tax Disputes***

Tax disputes develop when KRA identifies a possible misapplication of the law by the taxpayer. The commissioner then makes a 'claim' against the taxpayer for redress. If the taxpayer rejects the commissioner's application of the law, a tax dispute arises. Tax disputes can thus be characterized as 'PEALs'. For a taxpayer to prevail against the tax authority, the taxpayer must prove that the tax administrator has erroneously applied the law. Disputes that may have begun as 'PEALs' may become subsumed into disputes about PIE resulting in a need for vindication of rights or judicial review.

In tax disputes, KRA has two main interests: to maximize revenue collection and enforce the law and to ensure voluntary compliance. These interests can be conceptualized as task-interests since they are related to KRA's statutory mandate. Although the taxpayer's interests may be entangled and hard to discern, their interests can be said to fall into three broad categories; pragmatic self-interest, vindication of rights, and fair treatment.

Chapter 2 concludes that taxpayer interests and KRA's interests are not completely incompatible. For example, the need to ensure voluntary compliance is compatible with the taxpayers need for fair treatment as they interact with the tax administration. This means that interest-based approaches such as mediation and negotiation can be used to resolve tax disputes more comprehensively, and trade-offs can be made if such considerations can be made during tax dispute resolution.

##### **6.2.2. *Kenya's Tax Dispute Resolution System***

Tax disputes, being PEALs, are resolved through objections, reviews, and appeals provided for in the TPA, TATA, and EACCMA all of which provide for some form adversarial dispute resolution. section 55 of the TPA provides for ‘settlement out of court’; however, beyond giving a timeline within which the dispute may be determined, section 55 of the TPA gives no context, guidance or rules on how the parties are to settle out of court. Section 28 of TATA creates a mandatory obligation on the TATA to allow the parties to settle out of court and then gives them a discretionary power to settle the dispute subject to conditions it may impose. section 55 of the TPA, the other provision providing for out of court settlement, is drafted in broader terms and does not seem to empower the court to impose conditions on the out of court settlement. There are doubts as to whether section 55 of the TPA and section 28 of TATA underpin KRA’s ADR framework, granting it legal status. Regardless, the framework does provide an avenue for interest-based dispute resolution.

### ***6.2.3. DSD Evaluation of Kenya’s Tax Dispute Resolution System***

Chapter 5 of this paper formed the crux of the study. Kenya’s tax dispute resolution system, as provided for in the TPA, TATA, EACCMA and KRA’s ADR framework, was evaluated against the DSD principles espoused in the Ury, Brett Goldberg Model which provide for the effective and efficient design of interest-oriented dispute resolution system. Overall, Kenya’s tax dispute resolution system does not meet four of the DSD principles including the most critical one that demands that ways of reconciling the parties’ interest are established. Kenya’s tax dispute resolution system, as a whole, substantially meets only two of the principles: it has built-in procedures for notification and consultation and dispute resolution procedures are arranged in a low to a high- cost sequence.

Since it has not met the DSD principles set out by Ury, Brett and Goldberg, one can reasonably argue that Kenya’s tax dispute system is not yet oriented towards resolving disputes through interest-based approaches which tend to result in lower transaction costs, greater satisfaction with outcomes, and less recurrence of disputes. In light of the above, the following recommendations can be made towards orienting the system towards resolving a majority of tax disputes through interest-based approaches such as negotiation, facilitated discussions, and mediation.

### **6.3. Recommendations**

The author recommends that the TPA, as the primary procedural tax law, should explicitly provide for ways for parties in a tax dispute to reconcile their interests. In addition to section 55 of the TPA which provides for out of court settlement, there is a need for the following provisions within the TPA which would embrace the six DSD principles of an effective dispute resolution system:

1. A specific section in the Act empowering KRA to settle a tax dispute on a compromise basis where it is in the best interest of the state. This provision should allow and grant KRA the flexibility to temper the principle that they cannot forgo taxes that are payable after conducting a cost-benefit analysis and considering the uncertainties of litigation. In deciding whether or not it is appropriate to settle in the best interest of the state, the following must be taken into account: whether the ‘settlement’ is in the best interest of good management of the tax system, the cost of litigation, complex factual issues that may make the resolution of disputes unsuitable for the courts and whether settlement is a cost effective way to promote compliance.
2. Rules governing the use of ADR procedures pursuant to which KRA and the person aggrieved by an assessment or ‘decision’ may resolve a dispute. More specifically, clear negotiation procedures first then facilitated discussions procedures if the negotiations prove unsuccessful. The appeal procedures currently in the TPA would remain as rights backups. It is important that these rules be made with consultation with the judiciary to ensure compatibility with the justice system. Furthermore, in the formulation of the rules, stakeholders such as taxpayers, tax advisers, and the Attorney General should also be consulted. The involvement of stakeholders is essential since it will enhance the legitimacy and credibility of the rules which will then motivate the use of the rules.
3. Further, on the rules for settlement, the procedure ought to set out: which officers have the authority to negotiate on behalf of the commissioner, the timelines within which ADR processes must be undertaken, who can assist the parties to reach settlement if negotiations between them seem to be failing, and how the Commissioner may alter or amend their decision on settlement. These procedures rules would ensure that there is certainty which creates legitimate expectations of fairness in the process which, in turn, motivates the use of interest-based approaches.
4. For proper post-dispute analysis, there should be a provision for a register of settlements and methods for reporting of settlements reached between KRA and the taxpayer. This reporting will create a statutory obligation for which KRA can be held accountable

unlike the current one contained in the non-binding internal ADR Framework. The proposed register would maintain a record of all disputes settled under ADR procedures and document the process by which each dispute was settled. Furthermore, the Commissioner should provide a summary of settlements to the Minister in charge of national finance and the Auditor General in format that does not reveal the taxpayer but contains details of the number of settlements, the class of taxpayers and the estimated gains and savings of engaging in ADR in terms of time and money not spent litigating disputes. The mandatory obligation under this provision based on article 210 (2) (a) (b) of the Constitution would ensure accountability which would enhance motivation for the use of ADR procedures to resolve tax disputes.

5. The provisions for out of court settlement as currently provided should be maintained; however, the following improvements should be made. If there were no ADR discussions before the appeal was filed, the parties should indicate, in their notice of intention to appeal, whether they would like to engage in ADR in the first instance before the tribunal hears the appeal. It should be clear that the out of court settlement process, either at the tribunal stage or at the judicial stage, will be subject to the rules created under the TPA. If the ADR proceedings are not successful, the matter would then be fixed for hearing; this would effectively make the hearing of the tribunal a “back-up”. A loop-back mechanism should also be put in place where the parties had engaged in ADR before the appeal at the objection stage, the court or tribunal may allow the parties to loop back to the ADR procedure subject to certain deliberation such as whether the loop back is reasonable or whether it will cause delay.
6. Two opportunities to engage in the ADR procedure. The first would be at the objection stage before the Commissioner confirms the assessment. The second one at the appeals stage. This would ensure that the ADR process has multiple entry points.

In terms of KRA’s ADR Framework, instead of anchoring it in the tax statute, it is recommended that the Framework be scrapped in favour of rules and procedures created in the TPA. Legislating the use of ADR in tax dispute resolution as recommended above would be the best way to show commitment towards having a majority of tax dispute being resolved by less adversarial means of dispute resolution.

#### **6.4. Conclusion**

In light of the objectives, statement of the problem, hypotheses, and theoretical framework, the study has achieved its intended objectives and addressed the statement of the problem. The objectives of the study were to:

1. To critically evaluate the design of Kenya's tax dispute resolution system through the lens of the principles proposed by Ury, Brett and Goldberg.
2. To make recommendations that address the identified shortcomings and improve the design of the tax dispute system to make it more interest-based.

### **Objective 1:**

The author has critically evaluated the design of Kenya's tax dispute resolution system through the lens of the principles proposed by Ury, Brett and Goldberg. The analysis in chapter 5 identified several short comings that preclude the dispute system from being interest-oriented. This objective has been met.

### **Objective 2:**

The author has made recommendations that address the identified shortcomings and would improve the design of the tax dispute system to make it more interest oriented. The study recommends the addition of several provisions in the TPA providing for: compromise settlement of tax disputes, rules governing the use of ADR procedures, provision for a register of settlements and methods of reporting of settlements reached between KRA and the taxpayer, and mechanisms allowing the parties to loop-back to ADR procedures at the appeal level.

This objective has been met.

The statement of the problem was that despite the provisions in the TPA and TATA providing for out of court settlement, KRA's ADR framework, and KRA's desire to employ ADR in tax dispute resolution, a majority of tax disputes are still resolved through litigation. Recommendations have been made, based on the principles by Ury, Brett and Goldberg, to make the system more oriented towards the interest of the parties. The study was premised on the hypothesis that:

1. Kenya's tax dispute resolution system is not designed to resolve a majority of tax disputes through less adversarial dispute resolution procedures such as settlement, negotiation and facilitated discussions thus hindering the system's main objectives of providing fair, timely, and cost-effective dispute resolution.

2. Amending the TPA to provide for: compromise settlement of tax disputes, rules governing the use of ADR procedures, provision for a register of settlements and methods of reporting of settlements reached between KRA and the taxpayer, and mechanisms allowing the parties to loop-back to ADR procedures at the appeal level, based on the principles by Ury, Brett and Goldberg, would make the tax dispute system more oriented towards less adversarial dispute resolution.

### **Hypothesis 1**

The study has tested this hypothesis by showing that the current system is not designed to resolve a majority of tax disputes through less adversarial dispute resolution procedures such as settlement, negotiation and facilitated discussions. This failure is because the TPA, EACCMA, and the TATA mostly provide for adversarial dispute resolution mechanisms. Even where the Act does provide an avenue for out of court or tribunal settlement, it does not create ways for parties to reconcile their interest, there are no procedures to loop-back to less adversarial means of dispute resolution, the system does not provide for ADR as the main form of dispute resolution, and the system does not provide resources in terms of rules and norms for disputes to be resolved through interest-based methods.

### **Hypothesis 2**

This hypothesis has been proven since the addition of compromise settlements of tax disputes, rules governing the use of ADR procedures, provisions for a register of settlements and methods of reporting of settlements reached between KRA and the taxpayer, and mechanisms allowing the parties to loop-back to ADR procedures at the appeal level would align Kenya's tax dispute system towards the Ury, Brett, and Goldberg model and would make Kenya's tax dispute system more interest-oriented.

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