

Effect of Alternative Dispute Resolution on VAT Compliance Among Tax Agents in Nairobi County, Kenya

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Abstract

Purpose: Tax is a vital source of government revenue in almost all countries in the world as it ensures that the government can offer goods and services to the general public. Therefore, tax compliance is critical in all economies, which recognize the role played by revenue collected from tax in national development. The key aim of the current study was to establish the effect of alternative dispute resolution on value added tax compliance among tax agents in Nairobi County, Kenya. The study was anchored on the theory of conflict of management.

Methodology: The study adopted an explanatory research design. The study targeted 321 agents in Nairobi County while the sample size was 178 respondents. In this study, 178 out of 134 distributed questionnaires were completed and returned correctly, achieving a 75% response rate. The study used primary data, which was collected through questionnaires. The data collected was analyzed using both descriptive and inferential statistics. A linear regression model was used to establish the strength of the relationship between independent and dependent study variables.

Results: Alternative Dispute Resolution also exhibits a positive and significant correlation with VAT Compliance, with a coefficient of $\beta = 0.093$ $p < 0.05$.

Conclusion: The study recommended that the KRA should enhance its alternative dispute resolution mechanisms by providing clear guidelines, increasing the availability of mediation and arbitration services, and ensuring that tax agents are well-informed about these options. Future research should examine the impact of the regulatory framework on VAT compliance.

Keywords: Tax Agents, Alternative Dispute Resolution Value Added Tax Compliance

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1.0 Introduction

Tax is a mandatory charge imposed by the government without any expectation of quid pro quo. In other words, tax is a compulsory payment by the people to the government for which there is no direct return to the taxpayers (Parameswaran 2019). The issue of tax compliance has gained more stress by researchers in the recent couple of decades because of increasing levels of tax noncompliance and its consequence on the capacity of the government to raise revenue. Taxpayer non-compliance is a continual and worldwide issue that is not readily addressed, especially in most developing countries, where the domestic tax bases are undermined by widespread tax avoidance and evasion (IMF 2021; Mc Kerchar & Evans 2019).

Value-added tax is a form of consumption tax. It is a tax collected on goods and services at every stage of its production, during which value is added to it, from its initial production to the point of sale. From the perspective of the buyer, it is a tax on the purchase price. The introduction of VAT over the past few decades has been the most visible tax reform undertaken in revenue performance (Tanzi & Zee, 2000). There is some evidence, particularly in third-world countries, that those countries that have adopted VAT raise more revenues (Keen & Lockwood, 2010). In Kenya, VAT is important in enhancing revenue collection to attain the set target of Ksh. 973.5 billion for the year 2013/2014 to fund the 1.6 trillion budget. However, revenue reports from KRA have shown that VAT revenue performance has been low over years, and KRA has not been able to achieve the set targets for VAT.

The tax dispute resolution process has evolved. The objective is the desire to ensure, faster, more objective, and more efficient resolution of tax disputes. A lot of reforms have taken place including the use of ADR and Independent Review of Objections (IRO). To harmonize, centralize, and ensure objectivity in tax dispute resolution processes, the Commissioner General has delegated powers and functions relating to post-assessment disputes to the commissioner responsible for Tax Dispute Resolution thereby separating tax processes up to the assessment issuance level and post-assessment dispute resolution processes. Dispute resolution process has undergone a further transformation in line with good practices in dispute resolution which include having a simple, transparent, and graduated dispute resolution mechanism (Simiyu, 2019).

A tax agent is a professional individual or organization authorized to represent and assist taxpayers in their dealings with tax authorities. Tax agents in Nairobi, like tax agents elsewhere, play a crucial role in assisting individuals, businesses, and other entities with their tax-related matters. The role of tax agents is to help their clients comply with the tax laws and regulations of Kenya. They ensure that tax returns are accurately prepared, filed on time, and in accordance with the requirements set forth by the Kenya Revenue Authority (KRA). To provide strategic tax planning advice to minimize tax liabilities while ensuring compliance with tax laws. They may advise on various tax-saving strategies, deductions, credits, and incentives available under Kenyan tax laws. Tax agents represent their clients in dealings with tax authorities such as the Kenya Revenue Authority. They can handle communications, inquiries, audits, and disputes on behalf of their clients, ensuring that their interests are protected and advocating for fair treatment under the law. Tax agents assist clients in maintaining accurate financial records and documentation necessary for tax compliance purposes. This includes organizing financial statements, receipts, invoices, and other relevant documents.

1.1 Problem Statement

Kenya Revenue Authority has been undertaking reforms to increase tax compliance it has of late failed to meet its revenue targets, particularly VAT tax targets. For instance, VAT tax is a major contributor to Kenya's Government revenue, for the last 2 financial years contributing an average of 12% to the exchequer. For instance, in the 2019/2020 financial year, the 2019/2020 revenue performance reports show that VAT reduced from Ksh. 464.2 billion in 2018/2019 to Ksh. 380.8 billion in 2019/2020 (KRA 2020). In 2020/2021 financial year, the VAT collected amounted to KShs. 478.2 billion against a target of KShs. 484.2 billion. These revenue shortfalls have been blamed on tax non-compliance.

Consequently, the government is not able to adequately provide the much-needed public services which include security, quality health care and education; water and better housing, and infrastructure developments. This has raised concern as the Government aims to achieve

its targets and hence the need for this study on the effect of alternative dispute resolution on value-added tax compliance among tax agents in Nairobi County, Kenya.

2.0 Literature Review

2.1 Theoretical Review

Theory of Conflict Management was propounded by Blake and Mouton in 1964. The theory explained styles for handling interpersonal conflicts into five types: forcing, withdrawing, smoothing, compromising, and problem-solving. In the 1970s and 1980s, researchers began using the intentions of the parties involved to classify the styles of conflict management that they would include in their models. The model is based on the concerns of the parties involved in the conflict. The combination of the parties concerned for their interests (that is, assertiveness) and their concern for the interests of those across the table (that is, cooperativeness) would yield a particular conflict management style. Pruitt (2013) called these styles yielding (low assertiveness/high cooperativeness), problem-solving (high assertiveness/high cooperativeness), inaction (low assertiveness/low cooperativeness), and contending (high assertiveness/low cooperativeness).

Pruitt (2013) adds that problem-solving is the preferred method when seeking mutually beneficial options. Lisa (2018), adds that the principles of conflict management are applicable where taxpayers and tax collectors (KRA), where there is a need to maintain a regular relationship between the two parties. The relevance of the theory to the study is that it stresses ways of handling tax disputes between taxpayers and tax administrators such as internal tax review, tax appeal tribunal, and alternative dispute resolution in an economy.

2.2 Empirical Review

Sarmiento (2013) argues that lack of understanding had a major adverse effect on the decision to approve ADR in the resolution of conflicts occurring in construction projects in the Philippines. He further argued that the lack of mediation experience, limited conciliation knowledge, and inadequate comprehension of arbitration had a detrimental effect on the use of these ADR approaches in the resolution of construction disputes. Khekale and Futane (2015) also found in their analysis that lack of knowledge had a major adverse impact on the use of ADR in conflict resolution in construction projects in India. They argue, in particular, that minimal knowledge of conciliation, mediation, and negotiation contributed significantly to the restricted use of these ADR approaches in the resolution of construction disputes.

Lord, (2010) argues that lack of understanding has significantly restricted the use of ADR in the resolution of conflicts in Kuwait's construction projects. They contend, in particular, that the presence of insufficient knowledge of the conduct of conciliation proceedings and a lack of awareness of arbitration, negotiation, and mediation had a negative effect on decisions to implement these ADR approaches in the determination of conflicts in construction projects. Onukwube (2011) found evidence showing a lack of understanding that greatly affected the adoption of alternative conflict resolution for dispute resolution in Nigeria's construction projects. In particular, he notes that minimal understanding of conciliation, inadequacy of negotiation knowledge, and inadequate understanding of arbitration contributed significantly to the restricted use of these ADR approaches in the resolution of disputes in construction projects.

2.3 Conceptual Framework

A conceptual framework is a structure or system of theories, concepts, presumptions, or feelings that inform the objectives of the research study (Maxwell, 2005) and it involves the

synthesis of the prevailing views in the literature with regard to a given state of affairs, both theoretical and empirical findings (Imenda, 2014). The conceptual framework of this study shows the connection between alternative dispute resolution (ADR) on VAT compliance levels. The conceptual model represented in Figure 1.

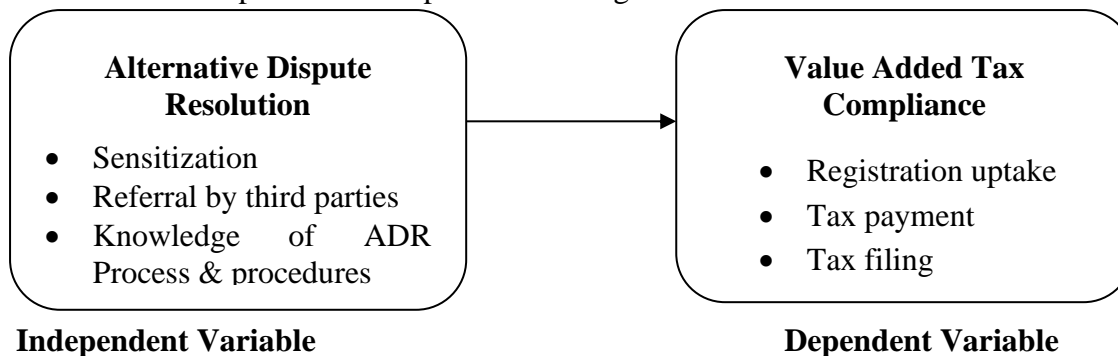


Figure 1 Conceptual Framework

3.0 Methodology

A research design is a blueprint for fulfilling the objectives of the study. The study will adopt an explanatory research design. This is because the design is well structured with clearly stated research questions. (Kothari, 2004). The study targeted 321 and a sample size of 178 agents in Nairobi County (KRA, 2023). The study used semi-structured questionnaires anchored on a five Likert scale was used to collect data from the tax agents within Nairobi County. In this study, 178 out of 134 distributed questionnaires were completed and returned correctly, achieving a 75% response rate.

Cooper and Schindler (2013) explained that Cronbach's Alpha, which ranges from 0 to 1, measures instrument reliability. Cronbach's alpha > 0.7 indicates high levels of reliability. Table 1 shows that the Alternative Dispute Resolution achieves excellent reliability with a Cronbach's α of 0.969 across 4 items, and VAT Compliance shows excellent reliability with a Cronbach's α of 0.982 for its 5 items. In summary, variables exhibit good to excellent reliability, ensuring the consistency and dependability of the questionnaire responses.

Table 1: Test of Reliability of Questionnaire

Factor	Number of Items	Cronbach Alpha score	Conclusion
VAT Compliance	5	0.982	Reliable
Alternative Dispute Resolution	4	0.969	Reliable

4.0 Results and Discussion

4.1 Descriptive statistics

4.1.1 Descriptive statistics on Alternative Dispute Resolution

The knowledge and awareness, we have of alternative dispute resolution has led to reduced dispute resolution costs had a mean of 3.96 and a standard deviation of 0.826). There is a faster resolution process as well as confidentiality due to our understanding of the alternative dispute resolution mechanisms received a mean score of 3.87 and standard deviation of 0.854), Lack of knowledge had a substantial effect on the use of alternative dispute resolution in solving a conflict was rated with a mean score of 4.12 and standard deviation of 0.832). The item Most taxpayers use alternative dispute resolution methods to solve conflicts in the tax field had a mean score of 4.23 and a standard deviation of 0.813).

Table 2: Alternative Dispute Resolution

Items	N	Mean	Std. Deviation	Skewness	Kurtosis
The knowledge and awareness we have of alternative dispute resolution has led to reduced dispute resolution costs	134	3.96	.826	-.092	-1.159
There is a faster resolution process as well as confidentiality due to our understanding of the alternative dispute resolution mechanisms.		3.87	.854	-.264	-1.075
Lack of knowledge had a substantial effect on the use of alternative dispute resolution in solving a conflict.		4.12	.832	-.028	-1.555
Most taxpayers use alternative dispute resolution methods to solve conflicts in tax field.		4.23	.813	.000	-1.488

4.1.2 Descriptive statistics of value-added tax compliance

Real-time updates of taxpayer ledger accounts have increased chances of accuracy and transparency with regards to VAT payment hence increasing revenue collections. This item had a mean score of 3.95 (SD = 0.798). Filing and payment of VAT has increased over time. The mean score for this item was 4.28 (SD = 0.841). Electronic tax systems have encouraged voluntary compliance among taxpayers hence increasing revenue collections. Respondents rated this item with a mean score of 3.99 (SD = 0.809). With the use of the i-Tax system, it is easy to detect under-declaration of VAT among taxpayers. This statement received a mean score of 4.20 (SD = 0.813). Electronic tax system has enabled KRA to detect unregistered taxpayers. The mean score of 4.02 (SD = 0.808).

Table 3: Value Added Tax Compliance

Items	N	Mean	Std. Deviation	Skewness	Kurtosis
Real-time updates of taxpayer ledger accounts has increased chances of accuracy and transparency with regards to VAT payment hence increasing revenue collections	134	3.95	.798	.094	-1.419
Filing and payment of VAT has increased over time.		4.28	.841	-.077	-1.400
Electronic tax system has encouraged voluntary compliance among taxpayers hence increasing revenue collections.		3.99	.809	.014	-1.469
With the use of i-Tax system, it is easy to detect under declaration of VAT among taxpayers.		4.20	.813	-.028	-1.487
Electronic tax system has enabled KRA to detect unregistered taxpayers.		4.02	.808	-.041	-1.467

4.2 Correlation Analysis

Table 4 shows that Alternative Dispute Resolution also exhibits a positive and significant correlation with VAT Compliance, with a coefficient of 0.478 $p < 0.05$.

Table 4: Correlation Analysis

	VAT Compliance	Tax Morale
VAT Compliance	1	0.478**
Tax Morale	0.478**	1

Correlation is significant at the 0.05 level (2-tailed).

4.3 Regression Analysis

The results in Table 5 indicated that Alternative Dispute Resolution had a positive correlation with VAT compliance up to 47.8% or ($R = 0.478$). The results reveal that Alternative Dispute Resolution caused a variation of 22.8% or ($R^2 = 0.228$ and adjusted $R^2 = 0.224$) on Value Added Tax compliance.

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.478 ^a	.228	.224	.32741

a. Predictors: (Constant), Alternative Dispute Resolution _mean

Table shows that the regression model was significant F-statistic =79.903, p-value <0.05.

Table 6: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	61.126	1	61.126	79.903	0.000
	Residual	101.091	132	0.765		
	Total	162.217	133			

a. Dependent Variable: VAT compliance

b. Predictors: (Constant), Alternative Dispute Resolution,

The coefficient regression analysis was conducted to determine the direct effects of the Alternative Dispute Resolution and VAT compliance.

The regression equation resulting from the model was;

$$Y = 0.368 + 0.093$$

Table 7: Regression Coefficients

Model		Standardized Coefficients		Unstandardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.368	0.159		2.314	0.022
	Alternative Dispute Resolution	0.093	0.037	0.099	2.514	0.008

a. Dependent Variable: VAT compliance

4.4 Discussion of the Findings

The study analyzed the effect of alternative dispute resolution on VAT compliance among tax agents in Nairobi County, Kenya. Alternative Dispute Resolution also exhibits a positive and significant correlation with VAT Compliance, with a coefficient of $\beta = 0.093$ $p < 0.05$. This implies that improving alternative dispute resolution improves VAT compliance. The study agreed with effect of the use of ADR in evaluating conflicts in Iran's construction projects. In addition, they say that awareness seminars and workshops have played a crucial role in disseminating and strengthening negotiation, mediation, and arbitration knowledge.

5.0 Conclusion

The study concludes that alternative dispute resolution methods positively affect VAT compliance. Improved dispute resolution processes lead to better compliance, suggesting that providing efficient and effective resolution mechanisms is essential for encouraging adherence to tax obligations.

6.0 Recommendations

The KRA should enhance its alternative dispute resolution mechanisms by providing clear guidelines, increasing the availability of mediation and arbitration services, and ensuring that tax agents are well-informed about these options. Future research should examine the impact of the regulatory framework on VAT compliance.

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