# Effect of Dispute Resolution Mechanism Reforms on Rental Income Tax Compliance Among Property Owners in Ngong Town, Kenya

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## Abstract

**Purpose**: Despite these reforms tax compliance for the rental income tax has remained low since its introduction. This study aimed to determine the effect of dispute resolution mechanism reforms on rental income tax compliance among property owners in Ngong Town, Kenya. The study was guided by the following theories: Ability to pay Theory and Conflict Resolution Theory.

**Methods:** The study adopted an explanatory design and the target population was 2,468 rental income tax compliance among property owners in Ngong Town, Kenya and sample size of 344 respondents. Out of a total of 344 issued questionnaires, 251 individuals correctly filled their questionnaires and submitted them resulting in a response rate of 73%. Primary data collection was collected using structured questionnaires. The data was analyzed using descriptive, inferential statistics and multiple linear regression analysis.

**Results:** The study regression analysis found that dispute resolution mechanisms reforms had a positive and significant effect on rental income tax compliance $\beta = 0.568$, $p = 0.000$,

**Conclusion:** It is recommended that the government ought to prioritize enhancing dispute resolution mechanisms. The significant positive effect of these mechanisms on rental income tax compliance suggests that improving them can lead to better tax compliance rates. Future research could explore the effects of socioeconomic factors on rental income tax compliance.

**Keywords:** *Property Owner, Dispute Resolution Mechanism Reforms on Rental Income Tax Compliance*

## 1. Introduction

Taxes by property owners in the real estate sector are becoming common in most countries. There is a growing body of research into taxpayer compliance behavior that is helping to develop a better understanding of what motivates taxpayers to comply, or not, with requirements of the tax system (Gayer & Mourre, 2022). Penalties are conferred upon property owners who fail to comply with some of the tax laws, irrespective of the conferment of these penalties; property owners in the real estate continue to evade taxes.

Rental business has been mainly functioning as an informal sector of the economy, however, there is an instantaneous development in the real estate segment adding to the informal businesses, (Luttmer & Singhal, 2019). An informal economy encompasses economic activities not controlled by laws such as environmental, labor, or taxation however is subjected to the rules of the local authorities. Research studies approximate that the informal sector contributes for 35-50% of gross domestic product in many first-world economies. Likewise, in Kenya, the informal segment is quite huge accounting for over 25% of the state's gross domestic product (OECD, 2019).

Dispute resolution mechanisms for rental income taxation aim to resolve conflicts between taxpayers (landlords) and tax authorities, or occasionally tenants, efficiently and fairly. These reforms are crucial for fostering trust, reducing compliance resistance, and improving the overall effectiveness of the rental income tax system, Li et al. (2019), Service delivery reforms aim to improve the efficiency, accessibility, and reliability of services related to rental income taxation. These reforms help reduce compliance burdens for taxpayers, enhance trust in tax systems, and boost voluntary tax payments by making processes simpler and more user-friendly (Badara, 2019).

Ngong is a town near the Ngong Hills along the Great Rift Valley within Kajiado County, located in the southwest of Nairobi, in southern Kenya. The word "Ngong" is a Maasai word derived from the word "enkong'u" meaning both "the 'eye'" and "eye of water" or thus spring of water. The original place name is, literally the eye of the rhinoceros but functionally Rhinoceros Spring; an alternative name is (olchorro is a synonym of enkong'u). Ngong is the anglicization of Seemingly the British found enkong'u e muñ too difficult to pronounce. A widespread false etymology is linked with the knuckle shape of the hills. The Ngong Hills, (known to the Maasai as 'Oloolaiser") from the eastside slopes, overlook the Nairobi National Park game reserve and, off to the north, the city of Nairobi. The Ngong Hills, from the westward slopes, overlook the Great Rift Valley dropping over 4,000 feet below, where nomadic Maasai live. As of 2019, the population of Ngong Town consisting of Enchorro-Emunyi and Ngong Township locations is 25,866. The elevation of Ngong Town is 1,961 meters in altitude, but the altitude of the hills is about 2,460 meters above sea level. Ngong was the central town of Ngong division while Kajiado County was a district.

## 1.1 Problem Statement

Despite that rental business has been largely operating as an informal segment, there is rapid growth in the real estate business adding to informal sector. Informal sector comprises economic activities not regulated by laws such as environmental, labor, or taxation, but is subject to the regulations of the local authorities. In addition, with the tremendous growth in real estate sector over the past few years, the corresponding tax collection from the sector has remained very low. Kenya Revenue Authority did not meet the rental income tax Target in 2022/2023 Financial Year. Despite a 6.7 percent rise in collections to Sh2.166 trillion, the taxman missed its Sh2.273 trillion targets by Sh107 billion KRA, (2023). KRA did not meet its target hence affecting infrastructure development and social services.

Due to KRA's missing target, 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 thus has raised a concern as the Government aims to achieve its targets hence the need for this study. However, a large number

of housing sector which accounts for the largest portion of the country's GDP remains non-compliant. The tax compliance in this sector is low despite its productivity. This study, therefore, sought to determine the effect of dispute resolution mechanism reforms on rental income tax compliance among property owners in Ngong Town, Kenya.

## 2. Literature Review

### 2.1 Theoretical Review

#### 2.1.1 The Ability to Pay Theory

Adam Smith in The Wealth of Nations (1776), stated that such things as defending the country and maintaining the institutions of good government are of general benefit to the public. Thus, it is reasonable that the population as a whole should contribute to the tax costs. It is also reasonable to demand certain other things of a tax system for instance, that the amounts of tax individuals pay should bear some relationship to their abilities to pay. The ability to pay theory indicates that every person should pay taxes to the government depending on his or her ability to pay (Zolt & Bird, 2003; Rai, 2004; Chodorow, 2008; Batt, 2012). The insinuation in this theory is that the wealthy class people should pay higher taxes to the government because without the protection of the government authorities, they could not have enjoyed the income that they earn. Adam Smith argued that the taxes should be proportional to the income (Zolt & Bird, 2003; Rai, 2004; Chodorow, 2008; Batt, 2012). It can therefore be argued that this is one of the critical principles of tax because it advocates for tax to provide equity in its application, wherein those who have the financial resources should make the payment.

This theory propagates that people should be asked to pay taxes according to their ability to pay and an assessment of their taxable competence should be made based based on income and property. The most popular and accepted principle of equity or justice in taxation is that citizens of a country should pay taxes to the government in accordance with their ability to pay (Limerick, 2013). It can therefore be argued and appears reasonable and just that taxes should be taxed based on the taxable capacity of a person and in using this principle it can be stated that if the taxable capacity of one individual is greater than that of the other person, that a person who earns more should be asked and expected to pay more taxes in comparison with the one who earns less.

The Ability to Pay Theory in the context of rental income tax compliance is a concept rooted in the idea that taxes should be levied based on an individual's or entity's capacity to pay, i.e., their income or wealth. When applied to rental income tax, this theory suggests that landlords and property owners should be taxed according to the rental income they generate, with those earning more being required to contribute more in taxes.

#### 2.1.2 Conflict Resolution Theory

The conflict resolution theory was first introduced by Burton in 1962. Kelman (1993), Schellenberg (1996), and Hansen (2008) are among key proponents of the theory. One of the assumptions of the theory is that the most effective way to resolve conflict is to effectively solve problems together. It also compares conflict resolution to a competitive process in which warring parties compete to see who wins and who loses. Respect, accountability, honesty, empowerment, and loving behavior toward friends or other group members are all norms that apply to cooperative behavior (Deutsch, 2011).

Dishonesty violates cooperative norms, so be open and honest. It's best not to express any suspicions, fears, doubts, or feelings of weakness because it could be harmful to the relationship. Finally, as the other party is a member of one's moral community, remain a moral person throughout the conflict by demonstrating concern, care, and love. Sandole (1993) stated that conflict resolution requires problem-solving methodologies, direct involvement of conflict parties in the design of joint solutions and support from third parties who are experienced in conflict resolution processes. He also mentioned that there are cultural and social gaps. In cultural conflict, the parties introduce significant value differences into their relationship, whereas structural conflict involves an imbalance of power between one or both parties in an organization, community, state, or territory that prevents them from fulfilling their requirements. Several critics have panned the conflict resolution theory.

According to Schellenberg (1996), conflict resolution can occasionally result in the victory of one party over the other. This indicates that one of the conflicting parties is dissatisfied with the outcome. The concept has also been critiqued for prioritizing change above social stability. Some 16 opponents acknowledge that cultures are always changing, but contend that much of the change is moderate or incremental rather than revolutionary. The conflict resolution theory is pertinent to this study since it highlights the necessity of collaborative problem-solving. In the case of a tax dispute situation, conflicting parties can agree to cooperate and come up with a solution.

## 2.2 Empirical Review

### 2.2.1 Dispute Resolution Mechanism Reforms

According to Walpole and Trans-Nam (2022), in Australian Tax Office (ATO), a taxpayer together with his representative or agent, must spend time learning on the alternative dispute resolution process, apply to the said dispute, to prepare documents, seek for professional assistance where required, engage in a discussion with his or her accounting or legal advisor and also travel and appear for the ADR process. Taxpayers who use lawyers and accountants find themselves spending more time with the advisers while the ones who do not engage an advisor find themselves spending more time learning about the ADR process and also preparing for the case.

According to Jones and Melinda (2020), a disputes procedure that is accessible to taxpayers is critical to the proper functioning of the tax system. Tax compliance research indicates that the factors that may influence taxpayers' level of compliance include their perceptions of the fairness of the tax system in decision-making and the perceived treatment a taxpayer receives from a decision-maker. In the context of New Zealand, if small tax disputes are not being heard due to the costly and cumbersome nature of the resolution process, the taxpayers perceive that the Inland Revenue (tax system) or dispute resolution mechanism, is not treating them fairly which ultimately impacts on the level of the taxpayer's compliance.

Omar (2019) states that the government through KRA has tried to encourage higher tax compliance by coming up with various options for handling tax disputes for purposes of achieving dispute resolution faster and thus enabling the authority to collect taxes that are mostly held up in cases for many years. One of the ways that KRA has tried to achieve this is through setting up an Alternative Dispute Resolution (ADR) office effective from 1 July 2015, as a way faster alternative to settling tax disputes as compared to the Tax Appeal Tribunal

(TAT) and the formal court system that would take months and sometimes years before closing a case.

### 2.2.2 Rental Income Tax Compliance

Property owners, residential owners, and commercial owners are required to declare the size of income generated from renting the property for appropriate rental income tax calculation (Berhane & Yesuf, 2017). Paying rental income tax calls for voluntary payment without being compelled by the tax authority. Voluntary tax compliance entails, declaring size of income and paying taxes as required by taxation laws of the country (Adeniran, 2011).
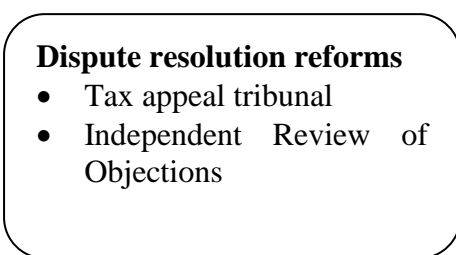
However, for taxation purposes, tax rate under this special category is 10 % of monthly rental income. On the other hand, for commercial occupation, the total collection of the residential rental income is over kshs 10 million per year. It is irrespective of whether the rent is from one building or many buildings. It is also irrespective of whether the buildings are permanent or temporally structures, the construction materials used, and the age of the buildings. The landlords pay income tax under the normal income tax rate structure. The tax rates are 30 % for residents and 37.5 % for non-residents (Income Tax Act, cap 470).

In Kenya, taxes are charged on rental income at a flat rate of 10% and taxes must be filed online on the website of the KRA (KRA, 2015). Such taxes charged on rental income are such that the income does not go beyond Kshs. 10 million (The Finance Act, 2015). It is simple to determine the amount of rental income to pay as the computation is done based on the gross rental income charged by landlords (KPMG, 2015). Several benefits are associated with rental income taxes including the fact that its computation is very simple and records are not required on the side of the landlord's sob as to give an account of the expenses incurred (KPMG, 2015).

### 2.3 Conceptual Framework

A conceptual framework shows different variables based on hypothesized interactions (Cooper & Schindler, 2014). Different types of variables form the basis of a study. The independent variables are those factors that influence others while the variable influenced is known as dependent variable. This current study has one independent variable dispute resolution reforms and dependent variable was Rental income tax compliance.

**Independent Variable**                    **Dependent Variable**
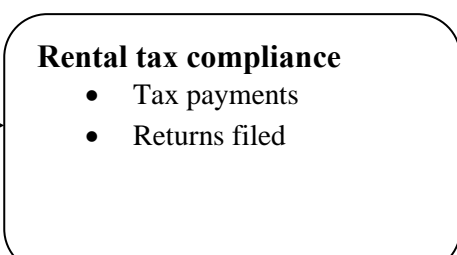
**Dispute resolution reforms**
- Tax appeal tribunal
- Independent Review of Objections

→

**Rental tax compliance**
- Tax payments
- Returns filed

**Figure 1: Conceptual Framework**

**Source: Researcher (2024)**

## 3. Methodology

According to Kothari (2004), a research design informs decisions concerning research study and arrangement of conditions for collection and analysis of data to combine relevance to the research purpose with the economy. The study utilized an explanatory research design. This design was the most suitable for the study as it sought to clarify the nature of specific relationships and explore the causal connections between variables. Blumberg et al. (2003) define the target population as the whole gathering of individuals or articles that a study centers on as the subject of research. Target population was 2,468 rental income tax compliance among property owners in Ngong town, Kenya while the sample size was 344 respondents. Out of a total of 344 issued questionnaires, 251 individuals correctly filled their questionnaires and submitted them resulting in a response rate of 73%.
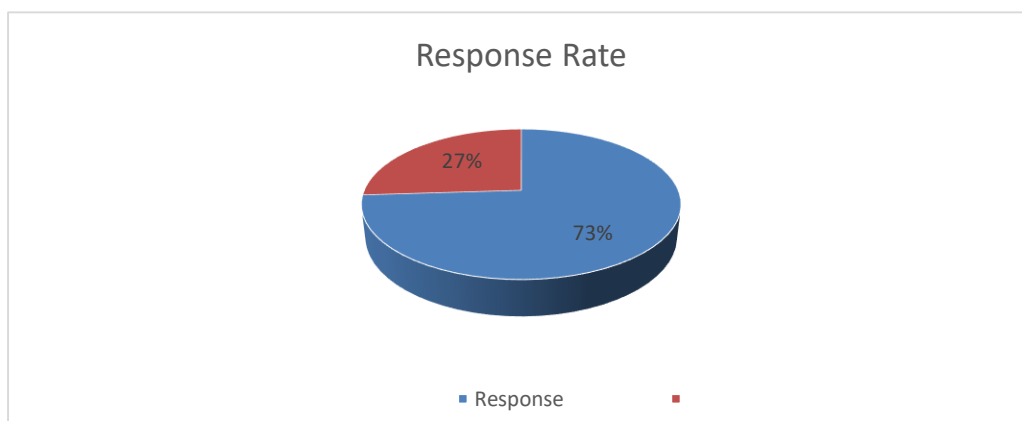


**Figure 1: Response Rate**

**Source: Researcher (2024)**

Reliability is how well a test measures what it should (Tavakol & Dennick, 2011) or the degree to which measures are free from error. For the study, Cronbach's alpha coefficient value was computed. Table 1 showed that the construct on Rental Income Tax Compliance demonstrated a reliability with a Cronbach's alpha value of .900 across five items. Similarly, the Dispute Resolution Mechanism Reforms construct exhibited high reliability with an alpha value of .902 for its five items.

**Table 1: Test of Reliability of Questionnaire**

| Factor | Number of Items | Cronbach Alpha score | Conclusion |
|---|---|---|---|
| Rental Income Tax Compliance | 5 | 0.900 | Reliable |
| Dispute Resolution Mechanism Reforms | 5 | 0.902 | Reliable |

**Source: Researcher (2024)**

## 4. Results and Discussion

### 4.1 Descriptive Analysis

### 4.1.1 Descriptive Statistics Dispute Resolution Mechanism Reforms

Table 2. shows that for the statement I find the Dispute Resolution process fairly shorter compared to the Tax Appeal Tribunal and court system," the mean response was 3.91 and standard deviation was 1.117. The statement I am aware of channels for raising customer complaints if displeased with the ADR process had a mean response of 4.00 and standard deviation was 1.038. For the statement, I find it easy to use KRA systems/processes, the mean response was 3.82, and standard deviation was 1.145. The statement The DR process makes it easy for me to settle a tax case fairly and would thus recommend it to others" had a mean of 4.00 and a standard deviation was 1.073. For the statement I find legal/agent fees affordable compared to using the Tax Appeal Tribunal and court system, the mean response was 4.02, and standard deviation was 0.980.

**Table 2: Descriptive Statistics Dispute Resolution Mechanism Reforms**

|  | N | Mean | Std.Dev | Skewness | Kurtosis |
|---|---|---|---|---|---|
| I find the Dispute Resolution process fairly shorter compared to Tax Appeal Tribunal and court system. | 251 | 3.91 | 1.117 | -.606 | -.770 |
| I am aware of channels for raising customer complaints if displeased with the ADR process. |  | 4.06 | 1.038 | -.697 | -.803 |
| I find it easy to use KRA systems/processes. |  | 3.82 | 1.145 | -.474 | -1.040 |
| The DR process makes it easy for me to settle tax cases fairly and would thus recommend it to others. |  | 4.00 | 1.073 | -.724 | -.628 |
| I find Legal/agent fees affordable compared to when using Tax Appeal Tribunal and court system. |  | 4.02 | .980 | -.872 | .038 |
| **Mean** |  | **3.96** |  |  |  |

**Source: Author (2024)**

### 4.1.2 Descriptive Statistics for Rental Income Tax Compliance

The rental income tax compliance response descriptive statistics were summarized on Table 3. The study shows that the statement "I have registered for Rental Income Tax Compliance" had a mean response of 3.93 with a standard deviation of 1.100. For "I file Rental income tax returns on time," the mean response was 4.00 with a standard deviation of 1.062. The statement "I pay the tax liability that arises from my Rental Income Tax Compliance obligation without failure" had a mean response of 3.83 with a standard deviation of 1.115. For "I compute and pay my Rental Income Tax Compliance correctly and in good time as stipulated by the law," the mean response was 4.03, with a standard deviation of 1.065. Lastly, "I pay the correct amount of Rental Income Tax Compliance" had a mean response of 4.04 with a standard deviation of 1.023.

**Table 3: Rental Income Tax Compliance**

|  | N | Mean | Std.Dev | Skewness | Kurtosis |
|---|---|---|---|---|---|
| I have registered for Rental income Tax Compliance | 251 | 3.93 | 1.100 | -.638 | -.672 |
| I file Rental income tax returns on time. |  | 4.00 | 1.062 | -.646 | -.892 |
| I pay the tax liability that arises from my Rental income Tax Compliance obligation without failure. |  | 3.83 | 1.115 | -.502 | -.987 |
| I compute and pay my Rental income Tax Compliance correctly and in good time as stipulated by the law. |  | 4.03 | 1.065 | -.784 | -.517 |
| I pay the correct amount of Rental income Tax Compliance. |  | 4.04 | 1.023 | -.871 | -.176 |
| **Mean** |  | **3.97** |  |  |  |

**Source: Author (2024)**

### 4.2 Correlation Analysis

In this investigation, the Pearson product-moment correlation coefficient was used. (Creswell, 2009) states that correlations are used to assess the strength of a two-variable linear connection. Table 4 shows the correlations between independent variable and dependent variable. Resolution Mechanism Reforms had a positive and significant correlation with Rental income Tax Compliance (r = 0.671). This suggests that improvements in dispute resolution mechanisms are associated with higher levels of compliance with rental income tax.

**Table 4. Correlations Statistics**

|  | Rental income Tax Compliance | Dispute Resolution Mechanism Reforms |
|---|---|---|
| Rental income Tax Compliance | 1 | 0.671[**] |
| Dispute Resolution Mechanism Reforms | 0.671[**] | 1 |

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

**Source: Author (2024)**

### 4.3 Regression Analysis

The results in Table 5 indicated that dispute resolution mechanism reforms had a positive correlation with rental income tax compliance up to 67.1% or (R= 0.671). According to study findings, the model accounts for dispute resolution mechanism reforms for 45% (R-Square, 0. 450) of variation in rental income tax compliance. This implies that the remaining 55 % of the change was caused by other factors not included in the model. The results further reveal that even if the study adjusts, the model would still account for 44.3% (Adjusted R Square, 0. 443) on rental income tax compliance.

**Table 5: Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .671ª | .0.450 | .443 | .43780 |

a. Predictors: (Constant), dispute resolution mechanism reforms _mean

**Source: Author (2024)**

Further ANOVA tests were conducted to determine whether the model works in explaining the relationship among variables as postulated in the conceptual model. The findings from Table 6 show an F value of 378.792 with a significance level of 0.000 which is far lower than the confidence level of 0.05, hence establishing the model is statistically significant.

**Table 6: Analysis of Variance**

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 93.183 | 1 | 93.183 | 378.792 | 0.000 |
| | Residual | 61.478 | 249 | 0.246 | | |
| | Total | 154.661 | 250 | | | |

a. Dependent Variable: rental income tax compliance
b. Predictors: (Constant), dispute resolution mechanism reforms

Table 7 shows that unit change in dispute resolution mechanism reforms caused a 0.568 increase in rental income tax compliance. The study found that dispute resolution mechanism reforms had a positive and significant effect on rental income tax compliance β =0.568 p-value =0.000<0.05. The hypothesis was rejected.

**Table 7: Regression Coefficient analysis**

| Variable | Standardized β | Std. Error | t-Statistic | Unstandardized β | Prob. |
|---|---|---|---|---|---|
| Constant | 0.601 | 0.202 | 2.975 | | 0.003 |
| Dispute resolution mechanism reforms | 0.568 | 0.046 | 12.348 | 0.328 | 0.000 |

**Source: Author (2024)**

### 4.4 Discussion

The study was to determine the effect of dispute resolution mechanism reforms on rental income tax compliance among property owners in Ngong Town, Kenya. The correlation matrix found that dispute resolution mechanism reforms had a significant and positive correlation with rental income tax compliance at 67.1%. This suggested that advances in dispute resolution mechanisms were associated with higher levels of compliance with rental income tax by property owners. Further, the study coefficient analysis found that dispute resolution mechanisms reforms had a positive and significant effect on rental income tax compliance (β = 0.568, p = 0.000). This underscores the positive impact of efficient dispute resolution mechanisms on enhancing compliance with rental income tax. The findings concurred with Omar (2019) who highlighted the efforts of the Kenya Revenue Authority (KRA) in

implementing alternative dispute resolution (ADR) mechanisms to resolve tax disputes faster, ultimately enabling higher tax compliance.

## 5. Conclusion

The study concluded that dispute resolution mechanism reforms have a significant and positive impact on rental income tax compliance among property owners in Ngong Town, Kenya. The findings suggest that when dispute resolution mechanisms are improved, property owners are more likely to comply with rental income tax obligations. This underscored the importance of accessible and efficient systems for resolving tax-related disputes, which in turn, encourages compliance. Therefore, enhancing dispute resolution frameworks was crucial for promoting adherence to tax regulations among rental income earners.

## 6. Recommendations

It is recommended that the government ought to prioritize enhancing dispute resolution mechanisms. The significant positive effect of these mechanisms on rental income tax compliance suggests that improving them can lead to better tax compliance rates. Future research could explore the effects of socioeconomic factors on rental income tax compliance.

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