KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF ECONOMICS

EAE 301: TAXATION ECONOMICS AND POLICY

DATE: **Monday, 15th May 2017** **TIME: 8.00 a.m. - 10.00 a.m.**

INSTRUCTIONS:

Answer question ONE (Compulsory) and any other TWO Questions. Question one carries 30 marks and the rest carry 20 Marks each

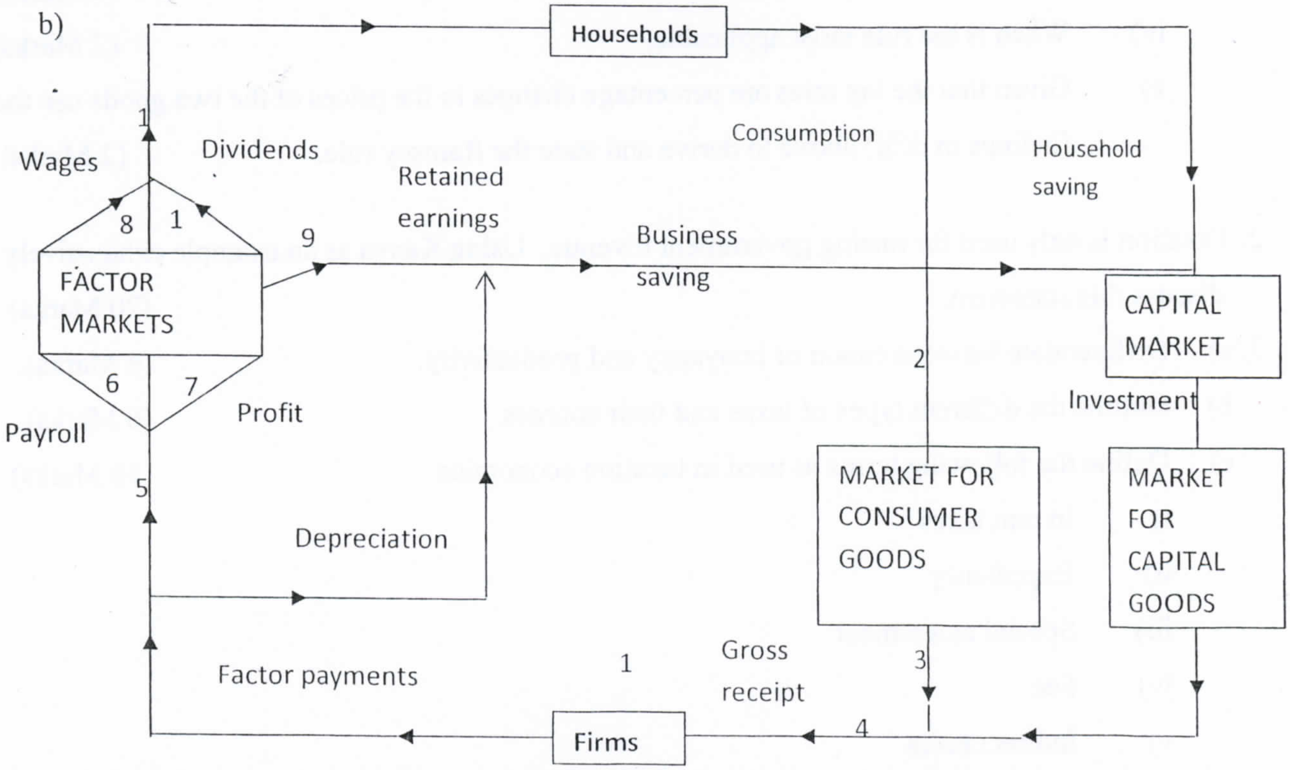
Question One

a) Define the following as used in public sector economics. (3 Marks)

i) Taxable capacity
ii) Sinking Fund
iii) Lumpsum taxes.

Figure 1: Tax Impact points and the Circular Flow of income

b)



i) Using relevant examples from Figure 1, explain any four stylized facts on taxation. (8 Marks)

ii) What types of taxes are associated with tax impact points 1, 2, 7 and 8. (2 Marks)

c) The benefit principle is an approach to taxation.

i) When is it feasible? (2 Marks)

ii) What macroeconomic policy objectives might not be achieved using this principle? (3 Marks)

d) Consider a taxing authority who wishes to minimize excess burden subject to a particular level of tax revenue. If the authority is taxing two goods x and y whose prices are p_x *and* p_y t_x and t_y respectively.

i) What are the mathematical expressions of the revenue raised and excess burden minimized by the taxing authority given the Q_x and Q_y are the quantities demanded of good x and y respectively and that the price elasticity of demand for good x and y are ε_x an d ε_y respectively. (2 Marks)

ii) State, formally, the objective of the taxing authority given the expressions in d(i) above. (2 Marks)

iii) Derive the inverse elasticities rule given the authority's objective in d(ii) above. (4 Marks)

iv) When is the rule most applicable. (2 Marks)

v) Given that the tax rates are percentage changes in the prices of the two goods use the findings in d(iii) above to derive and state the Ramsey rule. (2 Marks)

2. Taxation is only used for raising government revenue. Using Kenya as an example exhaustively discuss this statement. (20 Marks)

3. a) Differentiate between canon of buoyancy and productivity. (4 Marks).

b) Outline the different types of taxes and their sources. (6 Marks)

c) Define the following terms as used in taxation economics. (10 Marks)

i) In rem taxes

ii) Expediency

iii) Special assessment

iv) Fee

v) Indirect taxes.

4. a) With aid of a well labeled diagram. Illustrate and explain the concept of Excess Tax Burden of an increase in tax. Use the compensated demand approach. (10 Marks)

b) The government of Kenya is considering increasing every tax payers' tax liability by 30 per cent. It argues that the proposal will make tax system more progressive. As tax analysts you have been asked to critically evaluate this proposal. Illustrate how you would carry out the analysis to arrive at your verdict. (10 Marks)

5. a) Differentiate between the concepts tax incidence and tax shifting. (2 Marks)

b) Using appropriate illustrations clearly discuss factor influencing tax incidence. (8 Marks)

c) Following the Kenya 2010 Constitution, Kenya has implemented a decentralized form of government. What are some of the advantages and disadvantages of this decentralized form of government?. (10 Marks)