KENYATTA UNIVERSITY

SECOND SEMESTER 2019/2020 EXAMINATIONS FOR BACHELOR OF ECONOMICS BACHELOR OF ECONOMICS AND FINANCE AND BACHELOR OF ECONOMICS AND STATISTICS

EAE 301: TAXATION ECONOMICS AND POLICY

ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS

QUESTION ONE (COMPULSORY)

(a) Distinguish between the following concepts

(i)	Equitable and Optimal taxation	2 marks
(ii)	Equal absolute sacrifice and equal proportional sacrifice	2 marks
(iii)	Direct tax and Indirect tax	2 marks
(iv)	Tax effort and tax shares	2 marks
(v)	Income and substitution effects of income tax	2 marks

(b) Use appropriate illustrations to explain how price elasticity of demand influences the tax incidence of a commodity tax 10 marks

(c) The Government of Kenya in the recent years have been implementing massive infrastructure development projects mainly financed by debt. The alternative would have been to increase taxes or sale of public assets (privatization). Explain the main reasons for using debt for such development projects 10 marks

Question two

a) Tax reform proposals should be evaluated in order to ascertain their soundness and overall effects on the economy as well as on the entire tax system. Identify and briefly explain five factors under which tax reform proposals should be based (10 Marks)

b) If a social welfare function is adopted to represent the states preferences, the problem of optimal commodity taxation can be rephrased as that of choosing the commodity tax rates to maximize social welfare subject to the revenue constraint. Discuss the following theories as the solutions to this problem

a)	Ramsey rule	(4 Marks)
b)	The inverse elasticities rule	(3 Marks)
c)	The Corlett-Hague Rule	(3 Marks)

QUESTION THREE

a) Kamau wanted to accumulate savings in the year 2019. He discovered that the amount he was going to save was to depend not only on his income in the year in question but also on the income that he expects in future and the income received in the past. Explain the life cycle model with an illustration. (10 marks)

b) For goods that are not related in consumption, for efficiency, the proportional rates of tax should be inversely related to the price elasticity of demand of the good on which they are levied. Explain this rule using an illustration (6 marks)

c) Differentiate between the following terms
   i. Tax avoidance and tax evasion (2 marks)
   ii. Substitution effect and income effect in labour supply (2 marks)

QUESTION FOUR

(b) The demand and supply function of a commodity and given as follows:-
$Qd = 240-2p$, and $Qs = -40 + 3p$
The government imposes a unit tax of Sh 5 per unit

Required

i. The equilibrium price and quantity before tax **(4 marks)**
ii. The equilibrium price and quantity after the tax **(4marks)**
iii. The size of excess burden created by the tax **(4marks)**
iv. The distribution of tax burden between the buyer and supplier **(4marks)**
v. The amount of tax revenue the government will generate **(4marks)**

QUESTION FIVE

(a) With reference to Kenya elaborate why tax effort differs from the following sectors
(i) Agriculture **(3 marks)**
(ii) Manufacturing **(3marks)**
(iii) Mining **(3marks)**
(iv) International trade **(3marks)**

b) Discuss how the following factors determine the taxable capacity of a country
(i) Distribution of income **(2 marks)**
(ii) Nature of the tax system **(2marks)**
(iii) Size of population **(2marks)**
(iv) Political conditions **(2marks)**