

FACULTY OF COMMERCE DEPARTMENT OF FINANCE BACHELOR OF COMMERCE HONOURS DEGREE IN FINANCE & BACHELOR OF COMMERCE HONOURS DEGREE IN FISCAL STUDIES PART II – 2nd SEMESTER FINAL EXAMINATION – APRIL/MAY 2014 <u>ECONOMICS OF TAXATION [CFS 2203]</u> TIME ALLOWED: THREE HOURS

INSTRUCTIONS TO CANDIDATES

- 1) Answer any FOUR (4) questions
- 2) Start the answer to each full question on a fresh page of the answer booklet.
- 3) All rough work must be crossed out and attached to the end of the answer booklet.
- 4) Read questions carefully and address all parts of the question.
- 5) Questions may be written in any order, but must be legibly numbered.

ADDITIONAL INFORMATION FOR CANDIDATES

- 1) The paper contains SIX (6) questions.
- Marks for each question are shown in parentheses brackets () and square brackets [] at the end of each part of the question and full question respectively.
- 3) All questions carry equal marks [25 marks].

QUESTION ONE

Governments often adopt certain fiscal policies in order to promote desired behavior among their citizens. For each of the following policies, determine what the incentive is and what behavior the government wishes to promote. In each case, why do you think that the government might wish to change people's behavior, rather than allow their actions to be solely determined by individual choice?

- a) A tax of \$5 per pack is imposed on cigarettes. (5 marks)
- b) The government pays parents \$100 when their child is vaccinated for measles. (5 marks)
- c) The government pays college students to tutor children from low-income families. (5 marks)
- d) The government imposes a tax on the amount of air pollution that a company discharges. (5 marks)
- e) The government charges a higher land tax for low-density suburbs (more affluent) than high density suburbs (poor residents).
 5 marks) TOTAL
 [25 MARKS]

QUESTION TWO

- a) Designing a new tax system is a different process from changing an existing one to a different approach. Discuss this issue in the context of a move from an income tax to a consumption based tax. (5 marks)
- b) How the design of a tax system would differ from a developed to a developing economy and are there common themes as well? (5 marks)
- c) How would potential avoidance and evasion activities impact the design of a tax system? (5 marks)
- d) Economists often concentrate on issue of economic efficiency in analyzing tax systems. What other factors might impact real world tax decision-making in addition to efficiency? (10 marks)

TOTAL [25 MARKS)

QUESTION THREE

You are given the following information about the market for motorcycles. Market Demand: P = 400 - 4Q Market Supply: P = 4Q
a) Find the equilibrium price and quantity in this market. (2 marks)

b) Suppose that the government decides to impose an excise tax of \$80 per motorcycle on producers in this market. Illustrating with the aid of a diagram,

what will be the price and quantity of motorcycles sold in this market once this tax is imposed? (5 marks)

- c) Given the tax described in part (b), what will be the tax incidence on consumers? (10 marks)
- d) Given the tax described in part (b), what is the value of the deadweight loss from the tax?
 (8 marks)

TOTAL (25 MARKS)

QUESTION FOUR

- a) The Haig-Simons approach is widely used as a guide for defining wealth income.
 - i) What would be the administrative problems in attempting to use this approach in the real world? (2 marks)
 - ii) Why might people disagree with the use of the Haig-Simons definition? (2 marks)
 - iii) Discuss the options that might be available to reduce the inefficiency from taxation? How might these approaches impact equity issues?

(12 marks)

 b) Potential mobility of the tax base is an important issue in the economy for both local taxation and international taxation. Explain how this may impact decision-making in regard to tax policy. (9 marks)

TOTAL (25 MARKS)

QUESTION FIVE

- a) Given the current budgetary constraints in Zimbabwe, the government needs to raise money, and the Ministry of Finance has a choice of imposing an excise tax of the same amount on one of two previously untaxed goods: the government can tax sales of either airline fares or fuel. Both the demand for and the supply of airline fares are more elastic than the demand for and the supply of fuel.
 - (i) If the Ministry wants to minimize the deadweight loss caused by the tax, which good should be taxed? (4 marks)
 - (ii) For each good, draw a diagram that illustrates the deadweight loss from taxation. (2 marks)
- b) The government eventually decided to impose an excise tax on the sale of all airline tickets. Before the tax was imposed, 3 million airline tickets were sold every year at an average price of \$500 per ticket. After the tax is imposed, only 1.5 million tickets are sold yearly; travelers pay \$550 per ticket, \$450 of which the airlines receive. Using illustrative diagrams, determine:
 - (i) Whether the incidence of the tax falls more heavily on consumers or producers, (6 marks)
 - (ii) Why government revenue raised from the tax is not a good indicator of the true cost of the tax, and (3 mark)

(iii) How much deadweight loss (excess burden) of the tax arises as a result of the tax? (10 marks)

TOTAL [25 MARKS]

QUESTION SIX

- a) Explain the differences between relief from double taxation by credit and exemption in relation to international taxation. (4 marks)
- b) What are the advantages of each method? (4 marks)
- c) Why may some countries prefer one method rather than the other? (2 marks)
- d) Robert, aged 55, was born in Zimbabwe to married parents both of whom were South African nationals. Robert, having been born, brought up and educated in Zimbabwe has a Zimbabwean passport and considers Zimbabwe to be his home. He has lived and worked in Zimbabwe all his life. As a child, Robert visited South Africa every summer with his parents for a month, staying in a property kept by Robert's parents in anticipation of returning to South Africa in their later years. Robert's father died a number of years ago, and although Robert's mother, Janet, continued to return to the South Africa property every year, she kept putting off returning permanently as she enjoyed being a grandmother to Robert's children back in Zimbabwe. Janet died recently and Robert went to South Africa to settle his mother's South Africa affairs with the help of executors based in Johannesburg. Janet's will was written 35 years ago under Roman Dutch law, the same law as applied in Zimbabwe and leaves everything to Robert as her only child. Janet left the following assets:
 - A house in South Africa which is rented out;
 - An apartment in Zimbabwe, also rented out;
 - A portfolio of shares listed on the Zimbabwe Stock Exchange;
 - Bank accounts in both Zimbabwe and South Africa.

You are required to advise Robert on the Zimbabwean Tax position of his mother's estate with reference to case law in terms of whether "source jurisdiction or residence jurisdiction base applies for each of the estate items. Justify your answers. (15 marks)

TOTAL [25 MARKS]

END OF EXAMINATION PAPER