Tax incidence

The relative burden, or incidence, of an indirect tax is determined by the price elasticity of demand (PED) of the consumer in response to a price rise. If the consumer is unresponsive, and PED is inelastic, the burden will fall mainly on the consumer. However, if the consumer is responsive to the price rise, and PED is elastic, the burden will fall mainly on the firm.

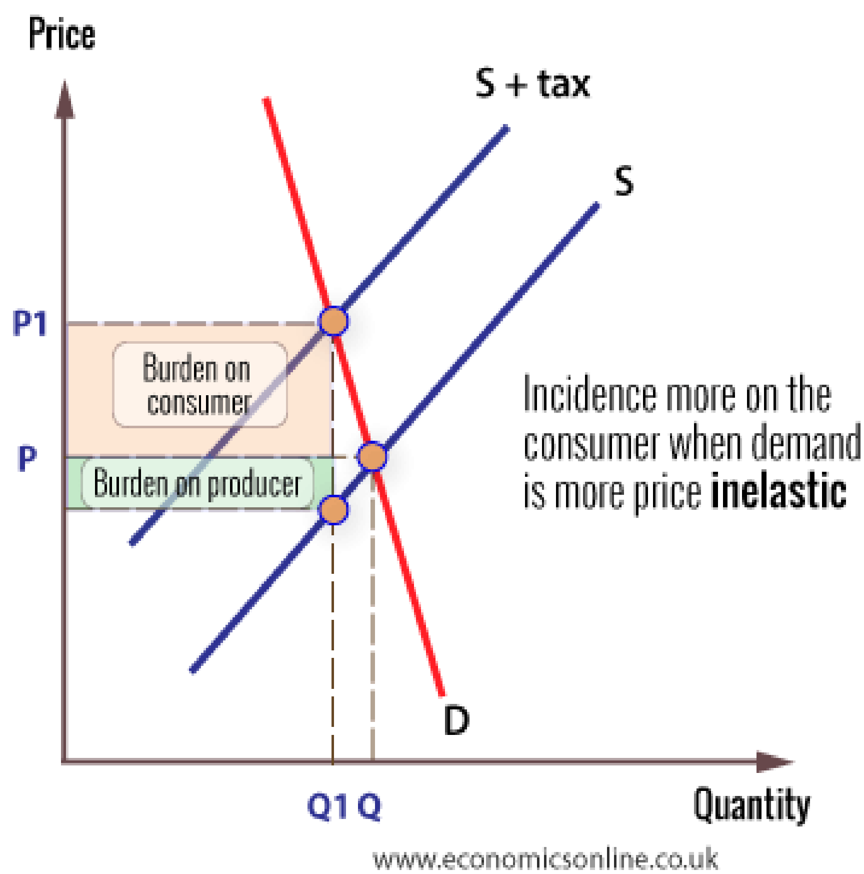
The incidence of a tax refers to the extent to which an individual or organisation suffers from the imposition of a tax – it may fall on the consumer, the producer, or both. The incidence is also called the ‘burden’ of taxation.

However the incidence falls depends upon the price elasticity of demand.

Tax burden on the consumer

When demand is inelastic the tax burden is mainly on the consumer.

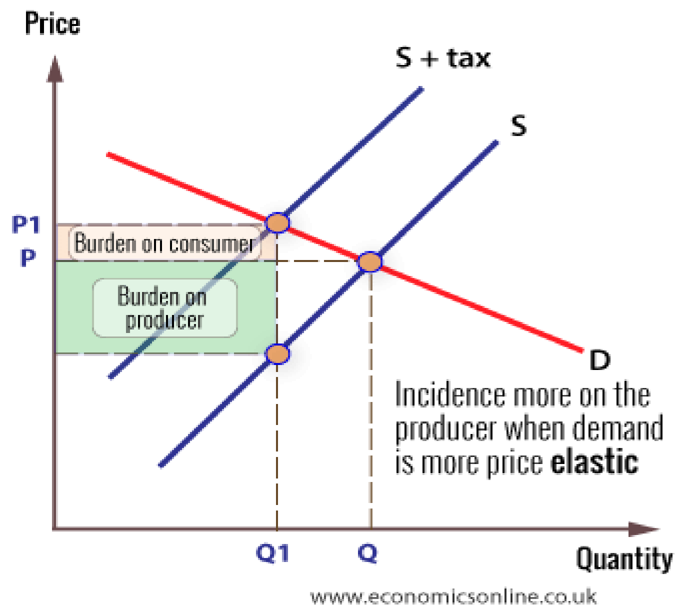
Incidence more on the consumer



Tax burden on producer

When demand is elastic, the tax burden is mainly on the producer.

Incidence more on the producer



Tax burden evenly split

In this case, the tax burden is split evenly between the consumer and producer.

Incidence evenly split