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Incidence & Shifting of taxation

(Incidence, impact, shifting, effect of taxation, process of shifting,theories of shifting, market condition)

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(Hons.)

Incidence of taxation

- Incidence of tax refers to a final money burden on a person who ultimately bear it
- Under tax incidence, the problem arises as on whom actually money burden falls

Incidence of tax

I. Money burden.

1• Direct money burden

- Burden of taxation lies on a person on which tax is levied in terms of money.
- The one who pay taxes bear burden also.

2• Indirect money burden.

- the burden transfer to someone. else like rice in the price of. sugar.

II.Real burden

1• Real direct burden

- It is the sacrifice of economic welfare

2• Indirect real burden

- It is the reduction in the consumption of goods by taxpayer.

Impact of taxation

- Immediate burden of tax
- The person who pay it in the first instance
- Impact and incidence of tax mad not fall on same person
- Impact of taxation is on producer while incidence is on consumer
- Impact doesn't reduce the income of producer, through its puts pressure on him for a short period

Effect of taxation

- effect of taxation referred to consequences which fall on person directly or indirectly due to imposition of tax
- when a tax is levied,it influence the economy in various form
- It affects production, consumption, saving , investment growth & reasonable imbalances etc.
- It adversely bring reduction in disposable income
- The effect of taxation may be both beneficial and harmful
- Harmful effect like increase in unemployment, reduction of production.

Shifting of taxation

- Shifting of taxation is a process by which the money burden of tax is transferred from one person to another
- When a person wants to save himself from burden of taxation,he shift their burden to someone else

Two types:

1• single point shifting:-

burden of tax from producer to consumer in the shape of higher price.

2•Multi point shifting:-

shift burden of taxation from one point to several point

Eg:- excise duty

Producer-wholesale- retialer- consumer

Process of tax shifting

1• Shifting through price.

- It is done through price.
- A seller always try to shift tax burden. by rising price.

Eg: Producer-wholesale-retialer-consumer.

2• Shifting through tax capitalism

•This type of shifting occurs when goods are durable and they are subject to series of successive annual taxes during its lifetime

- Whole series are to be shifted backward at time of purchase of capital group
- Further tax should be capitalised and dedicated in the lump sum from the price of a for capitalisation
- Example: suppose a person wishes to purchase a house to have Andy return of 10% on his capital investment
- So house gives gross annual product of ₹1000
- annual property tax₹200
- Product would be ₹800
- Buyer will prepare to pay₹800

3•Shifting of tax: forward & backward shifting

- Forward shifting: •Tax shifting place when a producer shift the money burden to middleman wholesaler retailer and customer
- Price of so raise or quality are reduced

Backward shifting:•it occurs when taxes shift backward to factor of p production

- Price remain unchanged and tax burden is borne by factor input
- Suppose a tax imposed on wholesaler, wholesaler not secure higher price but tax induce to accept lower wages eg:- producer to labour.

Theories of Shifting

1• Concentration theory:

- This theory advance by physiocrats
- Physiocrats believed that only agriculture was productive other classes of people did not generate any net produce
- Other class doesn't pay taxes
- All taxes levied on non agriculture must be shifted to other
- Only tax on agriculture could not shift
- According to them,any tax ultimately has tendency to concentrate upon one particular class of tax payer

2• The diffusion theory:

- This theory propounded by French economist N. F. Canard
- The theory asserted that all taxes are defused among the members of the community
- Taxes did not concentrate on one particular class
- All taxes are equitably diffuse all over the society and shifting of tax burden would go on until it is reaches every section

3• Modern theory of demand & Supply

- This approach also believe that a tax can be paid only of a surplus
- If there is no surplus it will tend to be shifted
- Given by Dalton
- The theory accepts the fact that all taxes should be imposed directly upon the taxable economic surplus
- Tax forms a part of cost of production and enter into prices
- Incidence and shifting of tax depend upon the process of pricing

Factor determining the nature of tax shifting and incidence

Elasticity of demand

Perfect elastic
No change in price entire tax burden will be upon the seller.

Perfectly inelastic.
with the change in price entire tax burden will upon buyer.

Greater than elastic
more burden upon seller with change in price their is more change in demand so burden is upon seller.

Elasticity of Supply

Perfectly elastic.

- Shifted to buyer because demand of good does not change with respect to change in price.

Inelastic supply.

entire burden of taxation. is on seller.

More elastic

more will be on buyer.

Incidence of tax under market condition

Perfect market

- Numerous buyer and seller
- Homogeneous good
- Demand curve is perfect elastic
- No firm can shift tax burden upon buyer,if they do so they will lose all his buyer
- Also firm can not shift tax backward by paying less to factor of production.

Monopoly

- Single firm
- Demand is perfectly inelastic
- No close substitute
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- Monopolies maximize where MR=MC
- Monopolist cannot shift tax backward or forward

Monopolistic

- Product differentiation
- Price also widely differ
- Each firm can affect output and pricing decision of other firm.
- Big firm bear whole or bigger part of burden only of tax so that they may not lose their consumer
- Small firms are not capable to shift the tax burden & they are compelled to withdraw from the competition & close their business operations

Oligopoly

- There exists only few firms or single firm may acts as a leader firm
- If the demand is inelastic,tax will be shifted
- If the firm is following an independent pricing policy And volume of tax is small then tax is not shifted but if volume of tax is large then tax shifted to the consumer.