MODULE – 2

PUBLIC REVENUE

Public Finance is the study of the financial operations of the State. According to Dalton, ***"public finance is concerned with the income and expenditure of public authorities and with the adjustment of one with the other".***

The subject matter of public finance includes **public revenue, public expenditure** and **public debt** and their impact on the economy. Public finance policies are implemented through the **Budget**.

Q.1 Discuss the various sources of public Revenue in India.

Public Revenue is an important concept of Public Finance. It refers to the income of the Government from different sources. Dalton in his "Principles of Public Finance" mentioned two kinds of public revenue. Public revenue includes income from taxes and goods and services of public enterprises, revenue from administrative activities such as fees, fines etc. and gifts and grants. On the other hand public receipts include all the incomes of the government received from formal sources.

The sources of public revenue have been broadly divided into:

(A) Tax Revenue (B) Non-Tax Revenue.

(A) Tax Revenue

Taxes are the first and foremost sources of public revenue. Taxes are compulsory payments to government without expecting direct benefit or return by the tax-payer. Taxes collected by Government are used to provide common benefits to all. Taxes do not guarantee any direct benefit for person who pays the tax. It is not based on "quid pro quo principle."

The Tax has been divided into two types such as Direct Taxes and Indirect Taxes.

(A) Direct Taxes:

Direct taxes are those taxes which are paid by the same person on whom it has been imposed. The impact and incidence of tax fall on the same person, because the tax burden cannot be shifted to others. Direct taxes include the following taxes.

i) **Personal Income tax** is a tax imposed on the excess income earned by an individual over and above the limit decided by the finance ministry form time to time. It is progressive in nature.

ii) **Corporate Tax** is a tax levied on the profits earned by registered companies.

iii) **Capital Gains Tax** is a tax imposed on the net profits earned through capital investment in stock market ,Rreal estate, Gold and Jewelry etc.

iv) **Wealth Tax (or) Property Tax** is a tax levied upon the property owned by individuals. The property includes Land, Building, shares, Bonds, Fixed Deposits, Gold and Jewelry etc.

v) **Other taxes :**These taxes include taxes like **Gift tax** and **Estate duty.**

(B) Indirect Taxes:

Indirect taxes are those taxes which are imposed on one group of people, but the ultimate burden will fall on another group of people. The impact of tax and incidence of tax are on different people. In case of Indirect taxes tax burden can be shifted. There are middlemen between the Government and the tax payer. The important Indirect Taxes are as follows:

i) **Excise Duty** is a tax imposed on the manufacturers as per the value of goods produced but the ultimate burden will fall on the final consumers.

ii) **Customs Duty** is a tax imposed on import and export of Goods. Customs duty may be specific or advalorem. Advalorem duty is a tax imposed on the basis the value of goods imported while specific duty is imposed as per the number of units imported.

iii) **Value Added Tax (VAT)** is a part of a sales tax imposed by the state government.

iv) **Sales Tax**revenue goes to the state government when sale or purchase takes place within the state. Sales tax revenue on interstate transactions goes to the central government.

v) **Service Tax** is tax imposed on services provided. The impact is on the service provider and the incidence of tax false on the customers. Service tax is the fastest growing tax in India.

vi) **Octroi**is a tax levied on transfer of goods from one state to another or from one region to another.

(B) Non-Tax Revenue:

These sources of revenue are classified as **administrative revenues, commercial revenues** and **grants and gifts**.

1) **Grants: Grants :**

are made by a higher public authority to a lower one, for example, from the Central to the State government or from the State to the local government. Grants are given so that a public authority is able to perform certain activities at the local level. There is no repayment obligation in case of grants.

2) **Gifts:**

Gifts and donations are voluntarily made by individuals, organizations, foreign governments to the funds of the government, e.g. Prime Minister's Relief Fund. Such gifts are usually made at the time of crisis like war or floods. Gifts cannot be considered a regular source of revenue.

3) **Fees:**

Fees are an important source of **administrative non-tax revenue** to the government.The government provides certain services and charges, certain fees for them. For example, fees are charged for issuing of passports, granting licenses to telecom companies, driving licenses etc.

4) **Fines and Penalties:**

Another source of administrative non-tax revenue includes fines and penalties. They are imposed as a form of punishment for breaking law or non-fulfillment of certain conditions or for failure to observe some regulations. They are not expected to be a major source of revenue to the government.

5) **Special Assessment:**

It is a kind of special charge levied on certain members of the community who are beneficiaries of certain government activities or public projects. For example, due to public park in a locality or due to the construction of a road, people in the locality may experience an appreciation in the value of their property or land.

6) **Surpluses of Public Enterprises:**
Most countries have government departments and public sector enterprises involved in commercial activities. The surpluses of these departments and enterprises are an important source of non-tax revenue. These revenues are in the form of profits and interests and are termed as **commercial revenues**.

7) **Borrowings:**When government revenue is not sufficient to meet the public expenditure government borrows either from internal or external sources. Borrowing is income of the government which creates liability because the government has to repay the borrowings with interest.

Q.2 Define Tax. Explain the canons of taxation. OR Characteristics of a Good Tax System.

A good tax system is one which is designed on the basis of an appropriate set of principles, such as equality and certainty. Different objectives of taxation often conflict with each other and a balance has to be struck. Therefore, usually economists select some important objectives and work out the corresponding principles on which the tax system should be based. The first of such principles were developed by Adam Smith. There are known as Canons of Taxation. These canons are still regarded as characteristics of a good tax system.

Taxes:
According to P.E. Tayler, "Taxes are compulsory payments to government without expectation of direct return or benefits to the tax payer".

Characteristics of a Tax:
i) A tax is a compulsory contribution to the State from the citizen (or even from alien subject to its jurisdiction for reasons of residence or property and this contribution is for general or common use. Seligman emphasizes that this contribution is enforced without reference to special benefits conferred).
ii) Another characteristics of tax is that the tax imposes a personal obligation. It means that it is the duty of tax payer to pay it and he should in no case think to evade it.
iii) The third characteristics is that the contribution, received from the tax payer, may not be incurred for their benefit alone, but for the general and common benefit.

Canons of Taxation:

1) **Canon of Equity:**
In the words of Adam Smith, "The subjects of every State ought to contribute towards the support of the Government, as nearly as possible, in proportion to their respective abilities, that is, in proportion to the revenue which they respectively enjoy under the protection of the State". According to the economists, Adam Smith was an advocate of the system of progressive taxation. It implies that the rich should be taxed more and the poor less.

2) **Canon of Certainty:**According to Adam Smith, the tax which an individual has to pay should be certain, not arbitrary. The tax-payer should know in advance how much tax he has to pay, at what time he has to pay the tax, and in which form the tax is to be paid to the government. In other words, every tax should satisfy the canon of certainty.

3) **Canon of Convenience:**According to Canon, every tax should be levied in such a manner and at asuch a time that it affords the maximum convenience to the tax-payer. The reason is that the tax-payer makes a sacrifice at the time of payment of the tax. Hence, the government should see to it that the tax-payer suffers no inconvenience on account of the payment of the tax.

4) **Canon of Economy:**According to this Canon, the tax should be such as to bring the maximum part of the collected revenue into the government treasury. In other words, the cost of tax-collection should be the minimum. If a major portion of the tax proceeds is spent on the collection of the tax itself then such a tax cannot be considered as a good tax.

5) **Canon of Elasticity:**According to this Canon, every tax imposed by the government should be elastic in nature. In other words, the income from the tax should be capable of increasing or decreasing according to the requirements of the country. For example, if the government needs more income at a time of crisis, the tax should be capable of yielding more income through an increase in its rate.

6) **Canon of Productivity:**According to this Canon, the tax should be of such a nature as to yield sufficient income to the government. If a tax yields poor income, it cannot be considered as a productive tax. According to this Canon, it is better to go in for a few productive taxes rather than to impose a large number of unproductive taxes on the people. A large number of unproductive taxes create difficulties not only for the people but also for the government because it gets no special increase in income from them.

7) **Canon of Variety:**The physiocrats advocated the imposition of one single tax, viz. a tax on land. But the modern economists do not agree with this view of the Physiocrats. According to them, the tax system should contain a large variety of taxes on persons as well as commodities. The reason is that if the government levies a single tax, it will become easier for the tax-payers to evade it. But if the government imposes a large variety of taxes, it will be difficult for the people to evade or to avoid them.

8) **Canon of Simplicity:**According to this Canon, every tax should be simple so that the tax-payer can understand its implications without the help of experts. If the tax is complex and complicated, the tax payers will have to seek the assistance of tax experts to understand its implication. Besides a complicated tax also increases the chances of corruption in the country.

9) **Canon of Flexibility:**What this implies is that the tax should be based upon certain well defined principles so that it may need no justification from the side of the government. In other words, the tax-payers should have no doubt about its desirability. From this point of view, the old taxes are considered to be better than new taxes because the people have already got accustomed to the old taxes.

Q.3 Discuss the merits and demerits of direct taxes. OR What are the advantages and disadvantages of Direct taxes?

According to Dalton "A direct tax is really paid by a person on whom it is legally imposed." So, a direct tax is one whose impact and incidence are on the same person, i.e. the tax payer is also the tax-bearer. The tax burden cannot be shifted on others and these taxes are to be paid directly to the government.

Merits of Direct Taxes:

1. **Equity:**They are considered just and equitable. The higher the income, wealth and property, the greater is the amount of direct taxes imposed by the government and vice-versa. For instance in case of income tax as the income of a person increases the tax rate also increases i.e. more tax is collected from rich and less from poor.

2. **Certainty:**Direct taxes are in accordance with the canon of certainty. The payers know about the amount of tax, different rates of tax, tax slabs well in advance. So all the direct taxes or certain.

3. **Elasticity:**Government can change the proportion of rates of direct taxes, as and when it is necessary. Therefore these taxes satisfy the canon of elasticity.

4. **Productivity:** Productive tax is a tax which gives more revenue to the government. Direct taxes like income tax, corporate tax give maximum revenue to the government. With the rise in income, wealth and property, direct taxes yield more and more revenue for the state.

5. **Economy:** The imposition and collection of these taxes require lessamount of expenses. Government requires only few persons for collections these taxes. The assessment and maintenance of these taxes is simple.

6. **Reduce Inequalities:** Direct taxes are progressive in nature. Therefore higher rates are imposed on larger incomes, wealth and property. So , direct taxes are the best devices for correcting the imbalances and inequalities among the people in their incomes, wealth and property.

7. **Civic Consciousness:** Direct taxes create and promote civic consciousness among the tax-payers. The tax-payers keenly observe the expenditure pattern of the government. The tax amount can not be misused by the government because people are directly paying these taxes and they have the awareness about the amount of tax.

8. **Checks Inflation:** Direct taxes are employed as anti-inflationary weapons. By rising the tax-rates the government takes away the excess of purchasing power from the community during inflation. These will reduce the purchasing power of people, demand and prices which lead to control of inflation.

Demerits of Direct taxes:

Even though direct taxes enjoy several advantages as explained above these taxes also suffer with many drawbacks as explained below:

1. **Inconvenience:** The completion of submission of income statements require technical knowledge. All tax-payers are expected to pay a lumpsum at a time. So people face several complications.

2. **Unpopularity:** It is not possible to shift the burden of direct taxes. Since governments takes away the excess amount of money from people directly it causes pain to the tax payers. So many people try to find out many ways to evade taxes and they are unpopular among the tax payers.

3. **Possibility of Evasion:** Direct taxes are said to be taxes on honesty. If the tax payers are dishonest and if they adopt unfair practices, it is difficult to collect these taxes. Most of the income tax payers don’t pay complete tax that they are liable to pay to government. So the tax evasion is very high incase of direct taxes.

4. **Injustice:** Direct taxes do not cover all sections in the community. These taxes are imposed only on those persons whose income or property exceeds a particular level. Therefore a large sections of the masses remain untouched under taxation. So it is no justice to tax some persons and leave others on the basis of income.

5. **Expensive:** The tax-authorities have to collect tax from every tax payer separately. So, elaborate arrangements have to be made for contacting the tax payers for the purpose of assessing their incomes. This is in huge expenses to the government.

6. **Disincentive effect:** Direct taxes may discourage saving and investment. All direct taxes are progressive and such taxes produce adverse effects on the people’s willingness to work hard.

Conclusion:

The extend of direct taxes should depend on the economic state of the county. However, direct taxes or an important aspect of modern financial system. A rich country has greater scope for direct taxation than a poor country.

Q.4 Examine the advantages and Disadvantages of Indirect taxes. OR
What are the positive and negative aspects of indirect taxes?

According to Dalton, "An Indirect tax is imposed on a person but paid partly or wholly by other owing to consequent change in terms of same contract or bargain between them". So, an indirect tax is one of which the impact and incidence are on different persons i.e. there is a shifting of the tax. The impact of tax falls on businessman and incidence of tax falls on the customer.

Merits of Indirect Taxes:

1. **Convenience:** People pay these taxes at the time of purchasing a commodity. People do not feel the burden in paying these taxes. These taxes are paid by people regularly and they don't find it difficult to pay. Moreover, people also enjoy goods and services as and when they pay indirect tax.

2. **Justice:** Ability to pay taxes is carefully considered by the Finance Minister, commodities consumed by the poor may be exempted from tax. Thus ability to pay is taken into account. Indirect taxes may be adopted on the basis of equity and justice.

3. **Elastic:** Some of the indirect taxes are elastic in nature. When government feels it necessary to increase its revenues, it increases these taxes. In times of prosperity indirect taxes produce huge revenues to the government.

4. **Progressive:** Indirect taxes are said to be progressive in nature as heavy taxes are imposed on luxuries and comforts. The incidence of indirect taxes on necessaries will be less. Hence more burden falls on rich people and less on poor.

5. **Wide Coverage:** Indirect taxes covers each and every section of the community. Indirect taxes increase the scope of the tax system. There is no individual who is not paying indirect taxes. So the percentage share of indirect taxes out of total tax revenue is more than direct taxes.

6. **Productivity:** Indirect taxes are highly productive. Each item yields considerable amount of revenue. Indirect taxes like excise duty, customs duty are comparatively yielding more revenue than any other indirect tax. In the recent years service tax is increasing faster than any other indirect tax.

7. **Difficult to evade:** Indirect taxes are difficult to evade as they are included in the prices of commodities purchased. People can evade these taxes only when they give up the purchase of commodities.

8. **Restrict consumption:** These taxes can be used to curtail consumption of harmful commodities like alcoholic drinks, cigarettes, harm full drugs etc. by imposing heavy tax on them. Thus such taxes serve as instrument of social reforms and improve the social welfare.

9. **Complementary to direct taxes:** Indirect taxes can serve as complementary to direct taxes. If a person escapes direct taxes, he will be caught through indirect taxes. When people don't pay direct taxes their disposable income will increase and it also creates more black many. It leads to increase in expenditure on luxuries. An increase in indirect taxes on luxuries will put more burden on rich people.

Demerits of Indirect Taxes:

Even though Indirect taxes enjoy several advantages as explained above these taxes also suffer with many drawbacks as explained below:

1. **Regressive:** Indirect taxes are criticized on the ground that they are regressive in nature. Their incidence is more on poor people and less on rich people. This leads to more economic inequalities in society.

2. **Uncertainty:** The yield from indirect taxes is always uncertain. The yield of indirect taxes depends on demand conditions. If demand is elastic, increased taxation will lead to a rise in price and fall in demand. It will lead to a fall in revenues.

3. **High cost of collection:** The administrative cost involved in the assessment and collection of indirect taxes is very high. Indirect taxes like Excise duty, Customs duty, Sales tax, Service tax etc. are having separate department and each department the administrative expenditure on collection of tax is very high.

4. **Discourage savings:** It is argued that indirect taxes discourage the savings of the people especially of lower income people as incidence of indirect taxes in high on essential goods. As a result the saving capacity of the poor will be reduced.

5. **Tax evasion:** Commodities are smuggled and sold do not come under taxation. Ad-Valorem duties also give room for tax evasion. Some importers of goods and manufacturers of goods may keep false accounts to evade tax payments.

6. **No civic consciousness:** As these taxes are not paid directly to the government. They fail to create civic consciousness. Indirect taxes or included in the price of goods and services. So people know the amount of tax neither before paying tax nor after paying the tax. So there is no awareness amount people about indirect taxes.

7. **Inflationary:** Indirect taxes prove to be inflationary when too much reliance is placed on them. Excessive taxation on commodities of mass consumption may lead to rise in price and aggregate the price situations.

Conclusion:
The above analysis of merits and demerits of indirect taxes makes it's clear that these taxes have both positive as well as negative effects on people as well as the economy.

Q.5 What is the role of Direct and indirect taxes in economic development? OR
Examine the role of direct and indirect taxes in a country like India.

In developing economics, the government has to play a very active role in promoting economic growth and development because private initiative and capital are limited. Fiscal policy or the budget has become an important instrument in promotion growth and development in such economies. Taxation is an important part of fiscal policy which can be used effectively by governments of developing economics.
Let us examine the role of direct and indirect taxes in performing the above functions in a developing economy.

ROLE OF DIRECT TAXES:
Direct taxes have a limited role to play in a developing economy. Only a small proportion of population pays such taxes. Direct taxes are primarily used in such economies to reduce inequalities of income distribution. Progressive taxes on income and wealth are used to impose greater economic burden on the rich. Taxes on incomes of large corporations help in some way to reduce concentration of economic power. Wealth tax and estate duties are imposed to take away resources from the idle rich. The resources collected through taxation are redistributed among the weaker section of society in the form of subsidies and development programme.

DRAWBACKS (LIMITATION):
However, in developing countries, direct taxes are highly progressive. This discourages savings done by the high income groups and adversely affects investments and capital formation. In the absence of adequate domestic savings, external borrowings have to be made. This leads to burden of debt repayment. Highly progressive taxation also leads to tax evasion and black money. This further increases inequalities and causes inflation. It is usually the middle class that bears the maximum burden of direct taxes.
Thus we have seen that direct taxes have a limited role to play in developing countries.

ROLE OF INDIRECT TAXES:

Due to limited role of direct taxes developing countries have resorted to extensive use of indirect taxes. The role of indirect taxes in a developing country are:

1. **Development funds:** Such taxes have become an important source of development funds in developing countries. Many developing economies that have adopted economic planning use indirect taxes as an important source of funds.

2. **Wider coverage:** Indirect taxes are found to be better suited in developing countries because they have a much wider coverage as compared to direct taxes. Both rich and the poor pay indirect taxes in form of commodity prices. Thus the problem of limited coverage of direct taxes in case of developing countries is made up by the coverage of indirect taxes.

3. **Reduce consumption and promote savings:** They are useful for reducing current consumption and promote savings, as they tend to raise prices of goods and services. In developing countries a large proportion of national income tends to be diverted to current consumption instead of being productively invested.

4. **Help to meet socio-economic objectives:** Though indirect taxes are regressive in nature, in developing countries they can be used to meet certain socio-economic objective. High rate of taxes on luxury goods will take away resources from the rich and such resources can be redistributed among the poor in the form of subsidies. Besides taxes on products like alcohol, cigarettes, etc. can have a beneficial effect on consumption pattern.

5. **Diversion of resources to desired areas:** Indirect taxes can be used to divert resources from the less desired use to the more desired ones in developing countries. Taxes on goods considered to be luxuries will make them more expensive, lower their demand and profitability. This will divert resources from the production of these goods to more essential ones.

6. **Promote domestic industries:** Taxes on imports have been used by developing countries for reducing imports and promoting domestic industries. India actively followed the policy of import restrictions with the help of heavy import duties.

LIMITATIONS OF INDIRECT TAXES:

Despite the above benefits of indirect taxes in developing countries, there are certain problem associated with them.

(1) Raise prices of essential goods: In order to raise development finance, the governments must tax commodities whose demand is inelastic in nature. Even when prices of such commodities rise their demand will not fall significantly and the government will be able to raise sufficient revenue. But such commodities are essential commodities that are consumed by the masses.

(2) Loss of welfare: Tax on these commodities will result in loss of welfare to society. Besides, commodity taxes can and have caused inflation in developing economies. Therefore, the government has to very cautiously impose these taxes, keeping in mind their benefits and harmful effects.

(3) Inefficiency: Heavy import duties to promote domestic industries can lead to inefficient domestic industries, lack of competition, shortage and less choice and high prices of commodities.
Therefore, the government has to very cautiously impose these taxes, keeping in mind their benefits and harmful effects.

Q.6 Give a brief note about Impact and Incidence of taxation. OR
What is meant by impact and incidence of taxation?

The incidence of tax refers to the final money burden of a tax. According to Findlay Shirras, "the problem of incidence is the analysis to determine who pays the tax, i.e., on whom the money burden of the tax falls or rests". In order to understand the meaning of impact and incidence let us look into different concepts of incidence given by economists.

IMPACT, SHIFTING, INCIDENCE AND EFFECTS :

They are the terms very often used in the discussion of impact and incidence and therefore, we explain below the meaning of these terms.

1. **Impact:** Impact of a tax is felt at the point where the tax first comes into contract with the tax payers. It is always on the person who is statutorily liable to pay the tax to the government. Impact of a tax refers to initial stage of tax burden. The person who pays the tax first bears the initial burden of tax.
   In case of indirect taxes, initially producers or traders pay them to government, say sales tax, but finally consumers bear the burden. Hence, when sales tax is levied, impact (initial burden) is on the trader and final burden is on the consumer. But in case of direct taxes say income tax, an individual who pay it cannot shift the burden. In this case impact and final burden fall on the same individual.

2. **Shifting:** It is the process of passing the money burden of a tax to some other person. The purpose of shifting is to escape the burden of taxation. The shifting is possible only through the process of exchange i.e. through sale and purchase. The shifting of tax normally takes place in the form of a price change.
   Shifting is of two kinds:

(i) Forward Shifting and (ii) Back-Ward Shifting.

(i) Forward Shifting: In this case the tax burden is shifted from the producer to the consumers in the form of a rise in price of the commodity either by full amount of the tax or less than the full amount. For e.g. excise duty. The producers may also shift the tax burden by reducing the quality or quantity of the taxed commodity. Here the tax is shifted through a sale transaction.

(ii) Backward Shifting: This occurs when a tax on the commodity is shifted back to the agents of production. Here the tax is shifted through the purchase transaction. For instance, the producer may force the suppliers of raw materials or other factors to accept lower prices or force his workers to accept lower wages. Thus, backward shifting of a tax takes place when the price of a commodity taxed remains the same and the burden of tax is borne by the seller or producers of raw materials and other inputs or the factors of productions and not by the final consumers.

(iii) Combination of both: A combination of both may take place when a producer of taxed commodity is able to transfer money burden of a tax through a partial rise in price and through a partial reduction in remuneration of factors of production. But generally shifting takes by forward shifting.

(iv) Single-Point and Multi-Point Shifting: Shifting may be single-point of multi-point shifting. When a tax is shifted directly from manufacturer of producer to the consumer it is termed as single-point shifting. On the other hand, when the burden of a tax is shifted from one point to several points, it is known as multipoint shifting. For example, when the government imposes an excise duty on a good, it may be paid in the first instance by the producer. But the producer may shift the burden to the wholesaler who, in turn, may shift it to the retailers who may finally pass it to the consumer. This is a multi-point shifting.

3. **Incidence:** Incidence of tax refers to the point where the ultimate burden of a tax actually settles. It is not possible to shift the burden after this point. Thus incidence refers to the ultimate resting place of a tax.

4. **Difference between Impact and Incident:**
   The incidence of a tax is different from its impact in the following ways:

(i) Impact refers to initial burden of a tax, whereas incidence relates to ultimate burden of a tax.
(ii) Impact is at the point of tax imposition, whereas incidence is at the point of final source from which the money comes.
(iii) Impact falls upon those who have first responsibility of paying it to the government,while incidence falls upon those who pay the tax ultimately.
(iv) If original tax payers are able to pass money burden on others impact can be shifted but incidence cannot be shifted. If individual who pays the tax in the first instancefinds that he cannot transfer the burden to others, the impact as well as incidence will fall upon the same individual. This will commonly be the case with direct taxes upon income. On the other hand, impact can be generally shifted in case of indirect taxes such as excise duty.

5. **Effect of a tax:** Effects refer to the economic consequences of imposition of tax. Imposition of a tax may lead to some beneficial and harmful economic consequences on production, saving, investment, allocation of resources, distribution of income and wealth, etc. These consequences taken collectively are called the effects of taxation. Effects can be the result of tax imposition, change in tax rate, and they could also follow from the process of shifting impact and incidence.

Q.7 What are the Factors Influencing incidence of taxation? OR
Examine the determinants of incidence of taxations.

The concept of incidence of a tax is of great significance as it explains the ultimate burden on taxation. Understanding of factors influencing incidence of taxation is important for tax authorities to know the tax shifting and tax sharing. Change in price reflects tax shifting or tax sharing. The main factors influencing the price changes and hence the incidence of taxation are explained Below:

1. **Changes in Prices:** Taxes are shifted through the prices. Price changes from wholesaler to retailer indicates the shifting of tax. If the changes in prices are caused by variations in the demand and supply of a commodity there is no scope for transferring of tax. The shifting of a tax may be forward or backward. The forward shifting of a tax takes place when prices rise which depends on the elasticity of demand. The greater the inelasticity of demand, the greater will be the proportion of the tax shifted to the buyer.

2. **Elasticity of Demand and Supply:**The incidence of tax can be shifted only through sale or purchase transactions and through a change in the price. A change in price is determined by the relative elasticities of demand and supply. Therefore a tax can be shifted only through a shift in the demand and supply curves. The sharing of the incidence between the sellers and buyers is determined by the demand and supply elasticities.
   Other things remaining the same, the grater the elasticity of demand, the higher the incidence of the tax on the sellers and the greater the inelasticity of demand for the taxed commodity, the higher will be the incidence of tax on the buyers.
   Likewise, there may be some commodities whose supply may be elastic and hence taxes can be shifted easily. Hence in the case of commodities having inelastic supply, the tax imposed on them cannot be easily shifted to the buyers and in the case of commodities having elastic supply, the shifting of the tax is relatively easier.

3. **Nature of Demand for Commodity:** The demand for different types of commodities like necessities or luxuries burden will be different. The demand for necessities is inelastic and the demand for luxuries is elastic. So the relative incidence of a tax on different commodities would be different. In the case of necessities, the total burden of a tax would be higher on a buyers than on the sellers. In the case of luxuries, the demand being elastic the burden of the tax will be more on the sellers because it cannot be easily shifted to the consumers.

4. **Nature of supply of Commodities:** The nature of supply of commodities is governed by various conditions. The burden of the tax will be shifted to the buyers and that will be forward shifting. In case the supplier finds forward shifting difficult, he may shift it backward on the factors or services which he employs in the production of the commodity. In the backward shifting the price of the factors of production is reduced by the amount of tax and in forward shifting the price of the commodity is raised by the amount of the tax.

5. **Tax Area:** A very important factor in the process of shifting of a tax is related to the area to which a tax is applicable. For example, it is not easy to shift a purely local tax, if it is relatively heavy. If it is light it can be shifted easily. Shifting of a local tax also becomes difficult because the people living in the locality may purchase the commodity from outside in order to avoid tax.

6. **Effect of Time on Shifting:** In general during the short period, it is not easy to shift a tax since the supply of the commodity is more or less inelastic. But in the long period the supply will be relatively elastic since the manufacturers would be able to reduce the output. Therefore, in the short period, shifting of a tax is difficult and in the long period it is easy.

7. **General Business Conditions:** During periods of rising prices and prosperity it is easy to shift taxes on to the prices than during periods of depression or falling prices.