Tax Incidence

Tax incidence can be defined as the study of how the burden of a tax is shared among economic participants. In other words, tax incidence is defined as the division of tax payment between the buyer and the seller. By calculating and analyzing tax incidence, it can be discovered whether the buyer or seller is likely to carry the cost of a tax. Tax incidence has become a critical tool for measuring the economic impact of various taxes. The study of tax incidence is important because, as a result of the different elasticities of demand and supply, the buyer and seller may not necessarily bear an equal share of the tax burden. This can impact the economic decisions of both the buyer and seller, which in turn can have an effect on the overall economy. Additionally, it can affect the overall tax revenue collected by the government.

For example, a government is considering implementing a new tax on gasoline. The government wants to know how this new tax will impact the economy and specifically, how the cost of this tax will be shared between the buyers and sellers of gasoline. To do this, the government would need to study the elasticities of demand and supply for gasoline and calculate the tax incidence of this new tax.

One formula is used for **consumer tax incidence**. This formula can be expressed as:

Consumer tax incidence = 100 * (Es / (Ed + Es))

Where:

Ed = the elasticity of demand

Es = the elasticity of supply.

This formula is used to determine what percentage of the tax burden is shouldered by the consumer. The other formula, which is used to determine seller or **producer tax incidence**, can be expressed as:

Producer tax incidence = 100 * (Ed / (Ed + Es))

This formula is used to determine what percentage of the tax burden is shouldered by the producer/seller.