

## CHAPTER-II

### ECONOMICS OF ENTERTAINMENT TAX

#### 2.1 Introduction :

With decline of the Police State and emergence of the 'Modern Social Welfare State', the functions of the State increased both intensively and extensively. Government became a regular, palpable and influential factor in the functioning of the economy. The classical laissez-faire policy implying minimum role of the Government in the economy - least possible expenditure and least possible taxation - has now become a faint memory. Growth of State functions and consequent growth of public expenditure has made it unavoidable to increase taxation by greater progression, higher rates and wider coverage occasionally coupled with new handles of taxation.

Increasing public expenditure is financed by taxation, surpluses of public enterprises, fees, stamps etc., borrowing (internal and external) and sometimes (in underdeveloped countries almost always) by deficit financing. However irrespective of the stage of development, taxation constitutes the single most important source of public revenue. Under taxation come normally different direct and indirect taxes. Income tax, corporation tax, wealth tax, gift tax, estate duty etc. come under direct taxes. Custom duties, excise duties, sales taxes and other taxes like tax on motor vehicles, electricity duty, entertainment tax etc. come under indirect taxes. In other

words the broad term taxation covers a broad spectrum of taxes leading to a direct or indirect reduction in the income of the people.

## 2.2 Nature of the Tax :

E.R.A. Seligman<sup>1</sup> defines a tax "as a compulsory contribution from the person to the Government to defray the expenses incurred in the common interest of all, without reference to special benefits conferred". Many other eminent authorities have tried to define tax in a more precise or elaborate manner. A comparative study of all these definitions, however, bring out two essential characteristics of tax - (i) it is a compulsory contribution by a person to the State for collective use and (ii) it may or may not lead to a certain equivalent benefit to the payer of the tax. Indian Taxation Enquiry Committee<sup>2</sup> (1924-25) makes this clear when it defines taxes as 'compulsory contributions made by the members of a community to the governing body of the same towards the common expenditure without any guarantee of a definite, measured service in return'. According to the International Encyclopedia of social sciences,<sup>3</sup> "Taxation is the general concept for devices used by Governments to extract money or other valuable things from people and organization by the use of law."

Thus it can be said that taxes have following main characteristics :

**2.2.1 It is a Compulsory Levy :**

Tax is a compulsory levy in the sense that once the Government makes the necessary legislation defining the base, the rate and the coverage of the tax, every person who comes within the provisions of the said legislation has to pay the tax unless of course, he has intentions to violate the law. In a sense wherever the legally defined tax base exists, the tax becomes inevitably effective.

**2.2.2 Utilization for the Common Purpose :**

The revenue or the proceeds of a tax become a part of the general revenue of the Government. The Government finances different types of public expenditures - defence, law and order, police, public health and sanitation, general education etc. with the help of the general revenue. Most of these public services satisfy collective needs of the society which are mostly of social or merit want type. In such cases even people who escape taxation legally also can and do avail of the benefits of the particular public expenditure.

**2.2.3 Absence of quid pro qua :**

Payment of a tax unlike the price in a market does not necessarily entitle the tax payer to a proportionate return in the form of a good or service from the Government. The composition of the public expenditure which is financed by tax revenue in a modern social welfare state is such that certain

benefits will accrue mostly to non-tax paying people or the benefits will be greater than the taxes paid by most of the people whereas in case of a small number of tax payers the benefits will not be available or are less than the amount of taxes paid. It is very rarely that the children of the rich people go to publically financed schools and some of those who attend these publically financed schools rarely pay taxes enough to pay the direct cost of education. It is also common knowledge that most of the direct and indirect taxes are paid by people belonging to middle and higher income groups whereas many welfare schemes of the Government cater mainly to the needs of the people belonging to the lower income group whose contribution to tax revenue is very little.

#### 2.2.4 Regulatory nature of the Tax :

With the evolution of the tax system the functions to be performed by a tax went on changing and alongwith the objective of collecting revenue, some of the taxes got assigned the role of regulatory instruments. For example, certain customs duties are mainly imposed to restrict imports rather than to collect revenue. Similarly taxes on production and consumption of liquor, if not fully, atleast partially, aim at restricting both production and consumption of liquor. Such taxation is sometimes known as sumptuary taxation. Another purpose of regulatory taxation is, sometimes, the diversion of resources from a socially or economically unwanted activity to

a socially or economically more useful activity. This kind of diversion of resources is made possible by tax induced increase in relative prices of the product or services of the unwanted economic activity in comparison with more economic activity which is left untaxed or less taxed.

Essentially speaking a tax leads to a direct or indirect reduction in the economic power of the person or the organisations paying the tax and thus reorganises the distribution of economic power (in conjunction with public expenditure) in a manner which suits the overall socio-economic policy of the State.

### 2.3 The Meaning of Entertainment :

In the first Chapter we have made a passing reference to some of the definitions of the term entertainment. As it constitutes the base of the tax under consideration, it is necessary to understand the exact meaning of the term entertainment. We give below a list of some additional definitions of the term entertainment for this purpose. The Standard Dictionary of English Language<sup>4</sup> defines entertainment as a source or means of amusement, a diverting performance especially a public performance as a concert, drama or the like. Alternatively it defines entertainment as pleasure afforded by an amusing act or spectacle amusement. The new Webster's Dictionary of the English Language<sup>5</sup> defines entertainment as

the act of entertaining, the receiving and accomodating of guests, and something that serves for amusement as a dramatic performance. Entertainment sometimes, is taken as a public performance or exhibition intended to interest or amuse. In modern use it often denotes an assemblage of performance of varied character like when music is intermixed with recitations, feats of skills etc. Prior to revolutionary technological change which occurred in the beginnings of this century, entertainment was mainly direct and of a personal type wherein artists or entertainers performed in person before an audience of a strictly private group or a public assembly. With the introduction of cinematograph, radio receiver, television and later the electronic gadgets, entertainment has assumed a more public character and has become distant and indirect in nature, however, at the same time individually more accessible. In other words, the broadening of the public scope of entertainment made possible by technological change, has rendered it more and more amenable to taxation by the State. It should be noted here that entertainment programmes of a private nature are not generally subject to entertainment taxation.

In short, for the purpose of entertainment taxation following conditions have to be fulfilled before that particular entertainment becomes taxable. (i) The entertainment must be public, (ii) The admission to the place of entertainment must be priced, (iii) The purpose of entertainment for the proprietor who manages the entertainment must be commercial.

If we take into consideration the provisions of entertainment duty acts of different States, it is seen that cinema shows, theatre performances, musical nights, professional games (Football, Cricket, Hockey, Boxing etc.) horse racing, circus are some of the major types of entertainment which are subject to this tax. However, in India, State Governments are not given powers to tax the entertainment which people derive from the television and the radio because these are included in the Central List.

Cinema has become a predominant form of entertainment for the majority of the people in a country like India, where almost 50% of the population lives below the poverty line. The means of private entertainment like television, radio, clubs, playgrounds or private performances of the artists are out of the reach of the common people. Consequently, the only form of entertainment to which a common man can have occasional access is the cinema-show, mainly because the relative price of cinema is occasionally manageable and it does not require a sizable investment in the purchase of the instruments of entertainment. For the large majority of the poor people, a means of cheap, regular and locally accessible and escapist entertainment is provided by the cinema-shows. Moreover, the cinema-shows bring into their reach things, events, persons, places and sometimes literature which normally would have been distant for them. On the other hand, for the rich people it is a convenient passtime and at the same time an opportunity to

bask in the glory of their own style of living or to feel sympathetic towards the deprivations of the harsh life of poverty which is depicted in some of the so-called surrealistic films.

#### **2.4 Justification for Entertainment Tax :**

Generally the introduction of a new tax follows the increasing revenue needs of the State. Theoretically, it can be said that the Government can impose any tax without any specific justification apart from its prerogative to tax the people. However, every time a new tax is imposed the Government comes-up with a statement of objectives and reasons for the introduction of the tax. In the case of entertainment tax there are certain justifications which are peculiar to it and others, which are common to all taxation. We examine these reasons in the order of their decreasing specificity with regard to the entertainment tax.

##### **2.4.1 Non-essential nature of the want :**

It will be farfetched to consider entertainment as a primary or essential want of the human being. It is only when a man satisfies the primary needs like food, clothing and shelter that he thinks about comforts and luxuries. Thus entertainment is a secondary type of need which can be included in comforts or luxuries. It is true that after adequate satisfaction of the basic needs some occasional entertainment becomes necessary but



not, really speaking highly essential. If the frequency of spending money on cinemas increases it shows either sufficiently high level of income or an increasing level of income or a distorted allocation of limited income from the point of view of the particular person implying that he is spending more on entertainment relative to the spending on basic needs. It will be of both individual and social benefit if spending on entertainment is restricted at least a developing economy mainly because it is a non-essential want. In a developing country, particularly, in the case of low income group people there is a tendency for the marginal rate of consumption to increase with the increasing levels of income which hinders the possibility of the increased rate of savings. Moreover, to the extent, spending on entertainment reduces spending on health and education (sometimes even food) it is really very important to tax entertainment expenditure heavily.

#### 2.4.2 Sumptuary Taxation :

By definition a sumptuary tax is one that is levied on the production, sale or consumption of a commodity or service with the expressed intent of reducing its final consumption relative to other goods and services in the economy. Levies on alcohol, tobacco, lottery tickets, horse and dog-racing, playing cards, pooltables and numerous other goods find their origin in this purpose, if not fully atleast to a certain extent. The commodities and services mentioned here are

generally considered undesirable items of final consumption for a significant proportion of the people. However, there is always a sizable demand for such commodities and services. Therefore, to restrict this demand, taxation, becomes a more feasible and democratic approach compared to direct control. Entertainment even of the cinema type can be included in the group of these commodities and services, though, it should be remembered that it is not such a totally undesirable expenditure item. Thus, when a tax is levied, the proprietors of the cinemas increase the price of the admission ticket whereby it is expected that the frequency of cinema enjoyment will be reduced.

#### **2.4.3 To Increase the Tax Revenue for the State :**

"Taxation was believed to arrive solely out of the financial needs of Governments rather than from a public objective of reducing citizens' spending power."<sup>7</sup> Even though the current public finance theory may not accept such a restricted rationale, it is evident that explicit or implicit additional revenue is definitely a relevant consideration in the introduction of every new tax. In the recent decades there has been a universal extensive and intensive increase in the functions of the State leading to rapidly increasing public expenditure. Though there are other ways of increasing revenue such as surpluses of the public enterprises, public borrowing, deficit financing, it is always taxation which constitutes the major source of revenue and it is considered the most effective

and perhaps the least harmful way of financing increasing public expenditure.<sup>8</sup> Of course, apart from revenue productivity the taxing authority endeavours to justify a new tax on the grounds of its effects which may serve objectives of restraining consumption, better allocation of resources, stability, more egalitarian redistribution and compensation for the social costs due to the nature of the taxed activity. A cursory glance on the figures for the revenue from entertainment tax for the year 1960-61 and 1980-81 show that this tax has quite a large increasing revenue - significance for the Government. In case of All-States the revenue was only Rs. 1311 lakhs in 1960-61 which increased to Rs. 25395 lakhs in the year 1980-81. The same trend is witnessed in case of the other States under study.

#### 2.4.4 To Cover Some of the Social Costs :

Every economic activity undertaken by private individuals or group of individuals has both its private and social benefits and costs. From the private point of view the immediate measurable, costs and revenues are considered and the profitability is determined. However, the private entrepreneur very rarely, and on his own, considers social costs of his economic activity. Sometimes he does think about the social benefits of his economic activity and may even try to get some compensation for the same from the Government. In case of cinema-show business there do arise certain social costs which will have to be covered by tax revenue. For example, cinema-shows generally in towns and

and cities and more particularly in big individual cities create problems of traffic jams, crowds, black-marketing, pick-pocketing etc. apart from the alleged destructive or undesirable demonstration effect on the cinegoers which may lead to socially harmful behaviour. This necessarily increases, mainly, the expenditure on law and order administration. It is such social costs which may be a partial justification for the taxation of commercial entertainment.

#### 2.4.5 Resource Reallocation :

Taxation of entertainment like any other tax, initially reallocates a certain amount of resources, from the private sector to the public sector. To the extent the revenue from entertainment tax helps directly or indirectly the process of capital formation in the public sector or finances a part of increasing current account development expenditure, it serves the purpose of developmental reallocation of resource. Moreover, taxation of entertainment may act as a force in diverting scarce national resources from socially less desirable economic activity to other activities which are socially more desirable. This becomes a very important consideration when the general quality of the films shown is substandard and such films highlight a mode of living which is not conducive to habits of saving, accumulation and hard work on which depends the process of economic development.

#### **2.4.5 Inelastic Nature of the Demand for Entertainment :**

On a practical level there is one more justification for the taxation of entertainment. 'A priori' it seems that the demand for entertainment is price-inelastic and income elastic. It is the common experience that demand for cine-shows has not positively decreased even after frequent increases in the price of the ticket exclusive of the tax or increase in the price of ticket due to increased taxation. Increasing number of films produced every year, the increasing length of the queues at the counters and many other things do indicate that demand for entertainment in general and particularly cine entertainment is price-inelastic. This makes the tax on entertainment both a convenient and a certain (also an increasing) source of revenue. On the other hand, it can be said, again 'a priori' that, with increasing income the demand for entertainment will tend to increase. In other words the demand for entertainment is more income elastic positively but it may not be so elastic negatively. It is this twin characteristic of the elasticity of demand for entertainment, which makes it an eminently suitable tax handle.

#### **2.5 Entertainment Tax - An Indirect Tax :**

It is evident that entertainment tax is an indirect tax. An indirect tax is defined as a tax which is demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another.<sup>9</sup> In a more general manner a tax on a specific expenditure is regarded as an

indirect tax. In other words a tax the burden of which is shifted from one who bears the impact to somebody else is an indirect tax. In the case of entertainment tax this shifting of the tax burden is very much evident and immediate because the relevant law provides for collection of the tax amount from the proprietor of the cinema and the proprietor increases the price of admission ticket more or less to the extent of the tax amount. It is, therefore, clear that entertainment tax is basically a tax of an indirect nature imposed on one of the expenditure heads of the individual. Secondly, it partakes the nature of sales tax to a certain extent. The proprietor of the cinema sells a kind of a service from which the customers derive the satisfaction of entertainment. Entertainment tax has some additional features from the administrative point of view.

(i) It is a convenient tax because it is imposed at the time of the purchase of admission ticket to the place of entertainment. (ii) It is included in the price of the admission ticket and as such apparently it becomes hidden. It, therefore, has the characteristic of a fiscal illusion because even when a tax is being paid the tax payers do not feel it as positively as they should. (iii) As the amount of entertainment tax is inseparably included in the price of the admission ticket, it cannot be avoided. In the given legal framework the only way to avoid the tax will be to avoid the entertainment itself. Ofcourse, evasion of this tax is possible from the side of the proprietor, in which case the cinegoers may willingly or

unwillingly assist. (iv) Entertainment tax is a productive tax because revenue from it can be increased by increasing the rates as the demand for entertainment is price inelastic and income elastic. (v) Entertainment tax has a broad coverage irrespective of the levels of income of different sections of the society. In a sense, film entertainment is perhaps the only type of entertainment which even the poorest of the people manage to pay for. If this fact is taken into consideration, it can be said that even the poorest of the people contribute to the finance of the State in the form of entertainment tax.

## 2.6 Is Entertainment Tax - a Tax on Luxury ?

Basically entertainment is a psychological need of the human being. It is quite natural that after a week of hardwork, tensions, worries and a host of other problems, a person needs some leisure and entertainment in which the stresses and strains of living can be relaxed. But it also has to be realised that in a modern society entertainment particularly, if not the personal leisure, is becoming more and more commercial and costlier. The priority of entertainment will always, or rather should, be at the lower end of the list of wants and preferably below the wants like food, clothing, shelter, education and health. In other words, expenditure on entertainment should constitute a relatively insignificant percentage of the total expenditure and as far as possible it should remain stable. However, it is observed that it may not be so because people

from lower income groups spend more on cinema as compared to the people belonging to higher income groups. In this case the more money spent on cinema means a reduction in the expenditure on other higher priority needs (e.g. education, medicine, proper sanitation etc.) If this is true then cinema particularly and any other type of entertainment generally should be considered as an item of luxury consumption beyond a certain limit and to that extent it should invite taxation. On the other hand, in the case of middle income group and rich people, expenditure on entertainment is relatively a small portion of total expenditure. For most of these people it is not exactly the entertainment that they get but also the social prestige and the fashion satisfactions which they derive are also the factors which count. In this sense cinema is definitely a cheap luxury for the better off people and costly luxury for the rest.

#### **2.7 Shifting, Incidence and Effects of Entertainment Tax :**

According to Dalton a tax which is passed on wholly or partially is an indirect tax.<sup>10</sup> It is common knowledge that entertainment tax is generally included in the price of the admission ticket to the place of entertainment, and as such full shifting of the tax burden takes place. Initially the amount of the tax is paid by the proprietor of the cinema. The proprietor subsequently collects the tax amount from the cinegoers. So it is clear that shifting of the burden of entertainment tax is



be practicable. In general, in the case of entertainment tax, forward and full shifting will be the normal phenomenon. Only when tax rates become excessively high there might take place a reduction in the demand for cinema-shows temporarily but subsequently demand will again pick-up. Thus the incidence of entertainment tax is finally borne by the cinegoers. One thing is clear that there seems to be a very weak and perhaps no link between entertainment tax and production of films. The growing number of films released every year alongwith increasing rates of entertainment tax, is the proof for this. Similarly, the vevary day phenomena of the increasing crowds at the cinemas at every show also proves the fact that the demand for entertainment is price-inelastic. Thus, it is clear that the formal incidence of entertainment tax is borne by the cinegoers. If we look at the problem of incidences of entertainment tax in the Musgravian manner the specific incidence of entertainment tax is definitely on the cinegoers whereas the differential incidence, that is the change in the income distribution of those who pay the tax, will tend to be more and more regressive with higher and higher rates of entertainment tax because increasing expenditure on entertainment will constitute a decreasing proportion of increasing income.

Considering the fact that in most of the places the number of cinemas is very small, one or two, and in bigger cities the number increases but still remains a small figure, whereas the population served by them is disproportionately

large, the cinemas remaining unpatronised to an effective extent is a remote possibility. Naturally the supply of cinema entertainment remains more or less imperfect or oligopolistic in nature. This again makes forward shifting easier to attempt. In this case one has to take into consideration the differences in the prices of tickets due to the differences in the standard or quality of service given by different cinemas in the same place. These differences in the prices lead to differences in the amount of tax paid by the cinegoers which however, do not lead to a significant reduction in the attendance at the cinemas having higher prices. If at all there are significant differences in attendance at different cinemas they will be related mainly to the locational aspect, the transport facilities and the nature and popularity of the film being shown.

We have to take into consideration one more aspect of the problem. Every cinema has a given audience capacity. That is the number of seats, total and classwise are fixed. However, it is a fact that most of the cinemas on an average will have less than fullhouses and to that extent their per seat earnings will be less than the optimum. But as the amount of entertainment tax is not related to the seating capacity and is related to the number of seats actually sold this factor does not make any difference. It can, however, be said that with less than full capacity sold, the proportion of entertainment tax paid to the net earnings of cinema owner will be greater.

So far as the general effects of this tax are concerned following points can be raised for discussion :

- i) Does entertainment tax lead to a diversion of resources from (a) the film industry, (b) distribution of films, (c) the construction of cinemas ?
- ii) Does entertainment tax lead to a reduction in consumption of more essential goods and services by the people ?
- iii) Does entertainment tax lead to some effects on employment front ?
- iv) In what way does entertainment tax affect the savings decisions of the parties involved ?
- v) What are the other social and cultural effects of entertainment tax ?

Regarding the first question, it seems that the producers of the film, the distribution agencies as also the cinema owners, make a lot of hue and cry whenever rates of entertainment tax are increased or whenever they try to argue for a reduction in the current rates. Regarding the complaint of the film producers it is really very difficult to establish a close and direct relationship between the entertainment tax and the rate at which the films are being produced. The historical experience indicates that despite entertainment

tax and increases therein, the number of films produced every year has shown a rising secular trend. Moreover, to the extent rate of film production is related to the price of entertainment and related demand schedules, we know that the demand for entertainment is price inelastic. Naturally to say that the introduction of entertainment tax and gradual increases in it will reduce the rate of film production will be farfetched and empirically untenable.

Regarding the second question, the diversion of expenditure by the people from more essential goods to entertainment which is a non-essential want seems, atleast, theoretically warranted. As demand for cinema entertainment is price inelastic, with increasing taxation the proportion of expenditure on entertainment will increase which means there has to be some reduction in expenditure on other more essential items. Moreover, in the case of a significantly large number of people, frequent visits to the cinema almost becomes an addiction. More so, in the case of lower income group people for whom other sophisticated types of entertainment are either not available locally or not affordable economically or also culturally. However, in the case of middle income group and high income group people, this effect may not be so serious.

Regarding the third question its very difficult to make any definite statement considering the price inelastic

and income elastic nature of the demand for entertainment. It can be said that even with increasing entertainment taxation there may not be any significant reduction in employment in any activity related to cinema industry. Similarly with regard to distribution sector, employment effect of entertainment tax must be considered totally non-operative. In case of film production also the effect on employment of entertainment tax cannot be direct. If increased entertainment tax leads to a significant and secular decrease in the demand for cinema shows, then perhaps, employment generation in film production may be adversely affected. However, this again may not be empirically supported. Moreover, a large part of investment in film production sector comes from large amounts of unaccounted money which may cancel out the adverse effect of increased entertainment tax on employment.

Regarding the question of effect of entertainment tax on savings of the parties concerned, we can make following statements.

In the case of low income group people whose savings are basically very limited, savings will be adversely affected if entertainment taxes increase excessively. Because in such a situation, further reduction in the consumption of essential goods and services may become very difficult and as a result, rate of savings will be definitely smaller. In the case of people belonging to higher income groups, entertainment

taxation may not have any adverse effect on their savings. However, if at all, they reduce their frequency of visits to cinemas, the amount thus not spent on cinema may be used either for savings or for some other type of entertainment. In case of cinema owners, entertainment taxation may reduce savings in case of a larger frequency of less than full capacity utilization because in that case their average net earnings per show decrease, as their operation costs are not related to the capacity utilization.

## 2.8 Equity in Entertainment Tax :

We have already stated that entertainment tax is an indirect tax imposed on the sale of different types of commercial entertainments where the price of the entertainment is the base of the tax. It is generally said that to introduce equity considerations in most of the indirect taxation is very difficult, if not impossible. In this sense, entertainment tax is more or less regressive in character. Usually the amount of entertainment tax is expressed as a percent of the price of the ticket of admission. If this percentage increases with the higher levels of classes (to the extent the assumption that people belonging to low income group purchase low class tickets and people belonging to high income group purchase high class tickets is correct), the tax can be considered progressive and vertically equitable. Regarding horizontal equity, the only thing that we can say is that when A and B

purchase the same class of ticket, it means they have the same ability to pay at least at that particular moment and so the needs of horizontal equity are served. But in a more broad manner, we can say that entertainment tax falls heavily on the lower income group people and lightly on the high income group people. Even with the progressive rate structure, it is very difficult to maintain equity in entertainment tax. For this purpose a proper study of income classwise expenditure on entertainment will be needed particularly in the light of different rate structures. 'A Priori' it can be suggested that to make entertainment tax more equitable, the lowest class of admission tickets will have to be fully exempted from this tax and the higher class ticket will have to be taxed at much higher rates.

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