Many developing countries simultaneously tax commodities and subsidize them up to a quota level through ration shops. This particular combination of taxes and subsidies plays an important role in the public budgets of developing countries; 11% of the world’s population uses India’s ration shop system. This paper first studies under what conditions a ration shop system (piece-wise linear commodity taxes) is welfare improving compared to standard linear taxes once we take into account the relevant characteristics of developing countries. These are i) limited government capacity to observe household incomes and ii) market fragmentation. I find that an inequality-averse government would set convex taxes on a wide range of goods to redistribute and to partially insure households against price risk. Welfare gains to introducing convex taxes are highest for necessities: normal goods that most poor households consume. I then take the model to Indian data and find that combining ration shops and commodity taxes is welfare improving for three out of the four goods that are currently in India’s ration shop system.