Commentary
The Reasons for a Consumption Tax
and the Tax Treatment of Gifts and
Bequests

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I. Introduction

In a 1978 article advocating the income taxation of gifts and bequests to recipients (without deduction by the transferor), Joseph Dodge briefly argued that similar double taxation\(^1\) of gratuitous transfers would be appropriate under a cash flow (consumed income) type consumption tax.\(^2\) Under such a system, the transferred property would be taxed as consumption to the transferor,\(^3\) and taxed again when consumed by the transferee. In his current article, Professor Dodge considers the cash flow tax treatment of gratuitous transfers in more detail, and extends his analysis to other forms of consumption taxation, but arrives at the same result.\(^4\) He concludes that “the problem of taxing gratuitous transfers is essentially independent of the choice between an income tax and a consumption tax.”\(^5\) William Andrews, although disagreeing with Professor Dodge on the basic ques-

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\(^1\) The use of the “double tax” label has become a popular rhetorical device in attacks on both the income tax (as compared to a consumption tax) and on the unintegrated corporate tax system. In this Article, I use the double tax and single tax labels simply as a convenient shorthand description of the opposing positions on the taxation of gifts and bequests. The labels have no normative implications for me.


\(^3\) In the case of a gift of cash, this would be accomplished simply by not allowing the transferor a deduction (assuming the cash had not been treated previously as a deductible investment). In the case of a gift of investment assets, the gift would be treated as a realization event, resulting in inclusion of the fair market value of the assets in the transferor’s tax base.


\(^5\) Id. at 561.
tion—Professor Andrews favors the single taxation of gifts and bequests—agrees with Professor Dodge that the analysis is the same under either an income tax or a cash flow tax.

This agreement is not surprising. An individual's consumption is part of the tax base under either an income tax or a consumption tax, and the core of the debate about gifts and bequests is whether the transferor should be viewed as having consumed the transferred property. If he should be so viewed, a double tax is appropriate under either tax system; if he should not, either tax system requires only a single tax.

The Dodge double tax position is in conflict with Edward McCaffery's proposal for a progressive consumption tax without an estate tax. Professor McCaffery assumes without discussion that his proposed consumption tax would not itself double tax gifts and bequests, but he argues at great length that it should not be accompanied by a separate transfer tax. The only difference between double taxing gratuitous transfers under the consumption tax itself, and single taxation under the consumption tax plus a separate transfer tax, is the rates and exemptions that apply to the transfers. Thus, Professor McCaffery's opposition to an estate tax implies opposition to the Dodge proposal as well.

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6 Single taxation can be achieved either by a deduction for the donor and inclusion for the donee, or by the current income tax system's approach of no tax consequences to either party (which results in single taxation because the donor already has been taxed).


8 See Andrews, Personal Deductions, note 7, at 317. This follows from the fact that income equals consumption plus accumulation.

9 Henry Simons, the dean of the double tax school, remarked, "If it is not more pleasant to give than to receive, one may still hesitate to assert that giving is not a form of consumption to the giver." Henry C. Simons, Personal Income Taxation 57 (1938).

10 Michael Graetz, however, has suggested that the single tax approach "seems more clearly compelled [under a consumption tax than under an income tax] by the premise that an expenditure tax is intended to impose a progressive levy on consumption." Michael J. Graetz, Implementing a Progressive Consumption Tax, 92 Harv. L. Rev. 1575, 1624 (1979). It is hard to see the point of this, given that consumption is part of the tax base under either tax. Marjorie Kornhauser also has suggested that single tax treatment of gifts may make more sense under a consumption tax than under an income tax. See Marjorie Kornhauser, The Constitutional Meaning of Income and the Taxation of Gifts, 25 Conn. L. Rev. 1, 37 (1992). She may simply mean, however, that under a consumption tax, the second tax should be deferred until the donee has consumed the gift.


12 Although rates and exemptions are the only differences, when the transfer tax exemption is $600,000, see IRC §§ 2001, 2010, and the top rates under the two taxes differ by 15.4 percentage points, see IRC §§ 1, 2001, those differences are significant. The implications of those differences are discussed briefly in Section III.B.
My initial sympathies are with the double tax. The argument that the donor has not consumed the transferred property is, at bottom, an argument that the donor and donee should be viewed as a single taxable unit, with only one consumption between them.\textsuperscript{13} This is not an absurd position, but with respect to all transferees other than spouses and children under age 14,\textsuperscript{14} it is fundamentally inconsistent with how taxable units are defined for other purposes—most importantly, for determining rates and exemptions.\textsuperscript{15} Perhaps there is some reason why the taxable unit should have a broader definition for this purpose than for any other,\textsuperscript{16} but the inconsistency calls for putting the burden of persuasion on those who oppose the double tax. The next Section considers how that burden might be satisfied.

II. \textsc{The Reasons for a Consumption Tax and the Tax Treatment of Gifts and Bequests}

Despite my suggestion that how one feels about double taxation of gifts and bequests is likely to be the same under either an income tax or a consumption tax, Professor Dodge’s special focus on transfers under a consumption tax is appropriate. People advocate consumption taxes for a variety of reasons, and the reason why one wants a consumption tax may have implications for the tax treatment of gratuitous transfers under the tax. This is the central insight of Carolyn Jones’ 1985 article—the only sustained discussion of double taxation of gifts and bequests under a consumption tax, prior to the current Dodge article.\textsuperscript{17} Professor McCaffery takes a similar approach when he considers the implications for the estate tax of the various theoreti- 


\textsuperscript{14} See IRC § 1(a) (joint returns), § 1(g) ("kiddie tax").

\textsuperscript{15} The loss disallowance provisions of § 267 and the family attribution rules of § 318 could be viewed as minor exceptions.

\textsuperscript{16} Professor Andrews states this position, but offers no real justification for it. The single tax treatment of gifts under the income tax he argues:

implies that the household whose consumption is indirectly reflected on an individual’s income tax return is not defined rigidly in terms of prescribed relationships. Instead, it is more flexibly conceived as embracing all his friends and relations to whatever extent he may in fact choose to support or entertain them at his expense.

Andrews, Personal Deductions, note 7, at 350-51 (footnote omitted). I agree with Professor Kornhauser that it appears “simply inequitable and inconsistent to treat [donor and donee] as the same taxable unit for some purposes and not others.” Kornhauser, note 10, at 36.

cal justifications for a consumption tax.¹⁸ I first review Professor Jones' analysis under the two rationales she identifies for a cash flow tax, and then add my own analysis under two additional consumption tax rationales. Because the focus of this Colloquium is on Professor McCaffery's proposal for a cash flow consumption tax without a transfer tax, I limit my analysis to the cash flow form of consumption tax.

A. The Utility Rationale

Professor Jones labels one argument for a consumption tax "the utility-based view."¹⁹ This is based on the idea that the tax burdens of individuals should vary according to the amount of utility each possesses,²⁰ and that "consumption reflects a taxpayer's utility more accurately than income."²¹ She concludes, with respect to inter vivos gifts, that one reasonably can assume the gift has utility to the donor at least equal to the fair market value of the gift. It follows, under the utility rationale, that the gift should be taxed as consumption to the donor and taxed again when consumed by the donee.²²

Professor Jones is more troubled by transfers at death. Death transfers are involuntary—you may choose to whom to make the transfer, but you cannot choose to take it with you. "This lack of voluntariness wreaks havoc with the underlying notions of utility measurement."²³ The fact that one could have consumed everything during life does not necessarily make the transfer at death voluntary, because one may have died earlier than planned.²⁴ On the other hand, the effort devoted to estate planning suggests that many people experience utility from the prospect of making bequests.²⁵ That utility may be nothing more than a pathetic grasp at immortality in the absence of faith in an

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¹⁸ See McCaffery, note 11, at 335-45. His conclusion is that "the estate tax turns out to be in tension with many, and possibly all, of the underlying norms of consumption tax theory." Id. at 335. Presumably, he would reach the same conclusion for the Dodge proposal.

¹⁹ Jones, note 17, at 1171.

²⁰ This approach, however, would "leave nonmarket utility-evoking events out of account for tax purposes." Id. at 1168.

²¹ Id.

²² See id. at 1171-74. Professor McCaffery is not much interested in this sort of analysis: "[A] donor clearly receives some real, psychic benefit from making gifts, which we are free to call 'consumption' if we want. But all of the norms supporting the consumption tax can, and I believe should, be divorced from merely semantic labels." McCaffery, note 11, at 336.

²³ Jones, note 17, at 1180.

²⁴ See id. at 1183. The argument that the uncertain timing of death makes some bequests accidental, with no utility to the decedent, depends on the assumption that the decedent could not have annuitized her wealth.

²⁵ See id. at 1184.
afterlife—"I may die, but my money will live on"—but it is utility nevertheless. She delicately concludes that bequests typically have some utility for transferors, but less than their fair market value, and suggests that this might lead to partial double taxation of bequests. Under partial double taxation, some fraction of the value of a bequest would be taxed to the decedent; there would be a second tax on the consumption of the bequest by its recipient.

B. The Private Preclusive Use Rationale

The second consumption tax rationale Professor Jones identifies is that taxation should reach only "private preclusive use" of scarce resources. She identifies this position most closely with Professor Andrews, but traces it back to the Hobbesian idea of the common pool of savings that serves the public good, and so deserves to remain untaxed. Professor McCaffery also proclaims his allegiance to the pool school, when he claims, "[i]t is use that takes away from others . . . and diverts resources to private preferences. Use represents an imposition by the individual on the collective." Common pool and preclusive use arguments have been criticized forcefully by many commentators, but the point here is that if one accepts those arguments for a consumption tax, the proper treatment of gifts and bequests readily follows. Gratuitous transfers should not be taxed to the transferor, because they do not remove the transferred property from the common pool of savings and devote it to private preclusive use.

C. A Consumption Tax, Efficiency and Increased Savings

An argument not considered by Professor Jones, but central to the current public debate about income versus consumption taxation, is

26 Professor Jones bears no responsibility for this speculation; it is my own editorializing.
27 See Jones, note 17, at 1184.
28 See id. at 1185, 1199. Under current law, bequests are taxed more heavily than gifts, because the estate tax base is tax-inclusive, whereas the gift tax base is tax-exclusive. Under the Jones utility analysis, this distinction gets things exactly backwards.
29 See id. at 1174.
30 See id (citing Andrews, Cash Flow Tax, note 7).
32 McCaffery, note 11, at 341.
33 See Anne L. Alstott, The Uneasy Liberal Case Against Income and Wealth Transfer Taxation: A Response to Professor McCaffery, 51 Tax. L. Rev. 363 (1996); Jones, note 17, at 1174-76; Kornhauser, note 10, at 29-30. The basic problem with the common pool metaphor is that no one but the investor is allowed to swim in the pool of his savings.
34 See Jones, note 17, at 1174-79 (gifts), 1179 (bequests). Professor Jones notes that this treatment puts pressure on the distinction between true gratuitous transfers and disguised compensation for services. See id. at 1177.
that a consumption tax would eliminate the bias of the income tax in favor of current consumption and against savings. As Professor McCaffery notes, "The major efficiency claim is that the consumption tax is efficient because it does not distort the savings-consumption decision." A related argument is that aggregate savings will increase under a consumption tax. This is the stated purpose of the leading current cash flow tax proposal—the USA tax proposed by Senators Nunn and Domenici. As others have pointed out, the empirical foundation for the claim that a consumption tax would increase savings is not firmly established. The differential treatment of current consumption and savings for future consumption clearly exists in the income tax, but the resulting behavioral effects are uncertain.

Is Professor Dodge's double consumption tax subject to an efficiency-based critique, similar to that levelled against the income tax? Professor Dodge says no: "In the case of investment property, the choice is between converting the property to current consumption or making a gift or bequest of it. Converting the asset to consumption does not save taxes relative to making a gift or bequest."

An example illustrates both Professor Dodge's point and the weakness in his argument. Suppose Mother (M) owns a $100 investment asset, which she can either consume now or invest at a 10% rate of return for the next 10 years, at which time she will give or bequeath the asset to Child (C). There is a 20% flat rate consumption tax, which is imposed on gratuitous transfers as well as on ordinary consumption. M could convert the asset to $80 of current consumption, after-tax. The alternative is to allow the $100 to grow to $259 in 10 years, and then transfer $207.20 net of tax to C. Applying a 10% discount rate, the present value of $207.20 “consumption” in 10 years is $80. Thus, Professor Dodge would say, the tax does not bias the

35 McCaffery, note 11, at 336. As he later points out, the neutrality of a consumption tax between current and future consumption depends on application of the same tax rate to all consumption at all times, so his own proposal for a progressive consumption tax is objectionable to those for whom this neutrality is crucial. See id. at 350-53.

36 Professor McCaffery notes that this “is not technically an efficiency claim because it does not look to some function of individual preferences.” Id. at 337.

37 USA Tax Act of 1995, S. 722, 104th Cong. (1995). The proposed Act begins with a congressional finding that “to provide for the prosperity of future generations, the United States must achieve high levels of saving and investment, which will in turn increase productivity, economic growth, and living standards.” Id. § 101(a)(1).


39 Dodge, note 4, at 579 (footnote omitted). By contrast, under the current income estate tax system, converting an asset to consumption clearly does save taxes, relative to making a gift or bequest of the asset. The act of consumption is not subject to tax, but the gratuitous transfer is. This is a major theme of Professor McCaffery's critique of the current system. See McCaffery, note 11, at 325-35.
choice between current consumption and future gift or bequest—without tax, either choice would have a present value of $100, and with tax, either choice would have a present value of $80.

Professor Dodge is correct, if \( M \) is interested only in the dollar amount she can transfer to her child, and not in the amount of consumption by \( C \) that dollar amount will support. But that is an unlikely frame of mind. Suppose instead, that \( M \) assumes \( C \) will consume the gift or bequest immediately upon receipt, and that \( M \) cares about the second tax that will be imposed on \( C \).

After the second tax, \( C \) would be able to consume only $165.76. Again discounting at 10%, \( M \) would value \( C \)'s consumption of $165.76 at only $63.82—which is, of course, substantially less than the $80 of current consumption that \( M \) may choose instead.

Taking the second tax into account, Professor Dodge's double tax creates a bias against bequest savings in much the same way as does an income tax.

Anyone whose support for a consumption tax is based on the premise that the income tax discourages savings is not going to be happy about a so-called consumption tax that could have the same effect.

D. A Lifetime Endowment Tax

Treasury's classic Blueprints for Basic Tax Reform (authored principally by David Bradford) argues for the superiority of a cash flow

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40 Under Professor Dodge's suggested exemption for inter vivos gifts for consumption, \( M \) might avoid the double tax if she makes the transfer by gift. See Dodge, note 4, at 586-88. She definitely will not avoid the double tax on a bequest. Professor Dodge suggests that the likelihood the transferor cares about the second tax (on the transferee) decreases as the time between the two taxes increases. See id. at 570. He may be right. He stacks the deck a bit, however, by using bequest hypotheticals involving extremely long periods of time between the first and second taxes. See id. at 570-71 (Examples 2 and 3).

41 The result does not depend on \( M \)'s expecting \( C \) to consume the wealth immediately. Even if \( C \) consumed neither the transferred property nor the subsequent income from it, at \( C \)'s death there would be another tax on the increased wealth. In present value terms, the burden of the tax at \( C \)'s death would be the same as the burden of the tax on \( C \)'s immediate consumption of the wealth.

42 That does not mean the burden of an income tax (without a wealth transfer tax) and the burden of Professor Dodge's double consumption tax would be identical. Suppose \( M \) has just earned $100, and wants to invest it at 10% for the rest of her life, and then bequeath the resulting wealth to \( C \), who will immediately consume it. Will \( M \) be able to support more consumption by \( C \) under a 20% income tax (investment of an after-tax amount of $80 at an after-tax return of 8%) or under the Dodge double tax (investment of $100 at a return of 10%, until consecutive 20% taxes are imposed at \( M \)'s death—that is, a tax on the bequest as consumption by \( M \), and a second tax on the actual consumption by \( C \)?) As it turns out, the answer depends on how long \( M \) lives. If \( M \) survives for 12 years or less, \( C \) will be able to consume more under the income tax; if \( M \) survives for 13 years or more, \( C \) fares better under the double consumption tax.

43 The comparison is with an income tax that does not double tax gratuitous transfers.

44 See David F. Bradford & the U.S. Treasury Tax Policy Staff, Blueprints for Basic Tax Reform (2d ed. 1984) [hereinafter Blueprints].
tax to an income tax on equity grounds. The controlling principle of equity for Blueprints is that those with the same endowments—the same lifetime capacity for consumption, in present value terms—should pay equal lifetime taxes. A cash flow consumption tax can achieve this objective because it is neutral between current consumption and savings for future consumption; an income tax fails to achieve the goal because it is biased in favor of grasshoppers and against ants.

According to Blueprints, this reason for choosing a cash flow tax has no implications for the tax treatment of gifts and bequests. It describes the choice between single and double taxation of gifts as a choice between standard of living and ability to pay as a basis for taxation. A standard of living tax system would impose only a single tax on gifts (ideally on the consuming donee), because the gifted property improves the standard of living of only the taxpayer who spends it; an ability to pay tax system would double tax gifts because the successive control over the same resources, by donor and donee, gives each ability to pay tax. The fact that one favors cash flow taxation in order to achieve equal taxation of those with equal lifetime endowments regardless of their lifetime consumption patterns, is said to imply nothing about one’s position on the issue of standard of living versus ability to pay taxation of gifts. Blueprints proposes a single tax (standard of living) approach to gifts and bequests, with the tax placed on the transferee. It considers, however, that a double tax on gifts and bequests (based on ability to pay) also would be consistent with the goal of equal tax on those with equal lifetime endowments.

Blueprints’ analysis of gratuitous transfers is curious. It recognizes that it is necessary to tax gifts and bequests to the transferee “to assure that the tax base is related to the lifetime consumption of every

45 See id. at 36-38. This does not strike some people—including Professor Dodge and me—as a compelling moral principle. See Dodge, note 4, at 553-54. My concern at the moment, however, is what follows for tax system design, assuming the principle is to be implemented. Professor McCaffery does not cite Blueprints in this regard, and does not use the term “endowment tax,” but his hypothetical of Ms. Thrifty and Mr. Spendthrift, who “face, ex ante, the same opportunity set,” but who make different consumption and savings decisions, is intended to make the same point. See McCaffery, note 11, at 343. He believes that Ms. Thrifty and Mr. Spendthrift “are equal in some morally compelling sense.” Id.

46 See Blueprints, note 44, at 37-38.

47 See id. at 38-39.

48 See id. at 33-35.

49 See id.

50 See id. at 38-39.

51 See id. at 123-25. This differs, of course, from the current income tax, which places its single tax on gifts and bequests on the transferor.

52 See id. at 38-39, 125.
individual." This is fine as far as the front end—the receipt of transfers—is concerned. But not taxing the transferor defeats, at the back end, the goal of equal taxation of those with equal endowments.

Under the Blueprints' proposal, if two taxpayers have equal endowments, and one consumes his entire endowment during his lifetime, while the other passes on much of his endowment to the next generation, the latter will have a lighter lifetime tax burden despite their equal endowments. A simple example makes the point. Two taxpayers, Mr. Spender and Ms. Saver, have identical endowments and identical consumption paths until the last year of their equally long lives. In that final year, Mr. Spender goes on a spending spree, and succeeds in spending his last penny the moment before he dies. Ms. Saver goes on no such binge, and leaves a substantial estate. Their endowments were equal, but if Ms. Saver gets a final year deduction for the amount of the bequest she makes (as Blueprints would permit), and Mr. Spender gets no corresponding deduction for his binge, their lifetime tax burdens are not equal.

Blueprints notwithstanding, an endowment tax requires double taxation of gratuitous transfers—at least apart from the argument that anything you end up giving away was not really part of your endowment, after all. That argument strikes me as totally unconvincing, but, in fact, Professor Bradford makes essentially that argument in Untangling the Income Tax, which he wrote after Blueprints. He describes the Blueprints' proposal as "a lifetime tax based . . . on the individual's 'lifetime wealth,' defined as the amount of money an individual would need to fund his consumption for the rest of his life." Because this definition assumes that gifts and bequests are not consumption of the transferor, it amounts to a statement that whatever one gratuitously transfers was never part of one's "lifetime wealth." While such a definition is, of course, possible, I do not understand its attraction.

Professor Dodge criticizes the same aspect of Blueprints from a different perspective; he describes it as "posing the issue as one of fairness among lineages and dynasties"—an approach Professor Dodge finds "far less appealing than posing the issue as fairness among individuals." Professor Bradford asks a rhetorical question in Untangling that indicates his agreement with Professor Dodge, as a descriptive matter:

Consider two dynasties, identically endowed in the form of earning power of their successive generations. In one dy-

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53 Id. at 123.
55 Id. at 90.
56 Dodge, note 4, at 571 n. 180.
nasty each generation consumes what it earns . . . . Suppose a
generation of one dynasty chooses to pass some of its earn-
ings forward to future members. Is there a basis for assess-
ing it with a heavier tax? 57

Where Professors Bradford and Dodge differ is on the normative
question. Professor Bradford's implicit answer to his own question is
that there is no basis for a heavier tax on the more frugal dynasty,
whereas Professor Dodge believes equity is a matter of taxation of
individuals, not dynasties. I lean towards the Dodge position; I have
difficulty thinking of Professor Bradford's dynastic "it" as something
that can be treated either fairly or unfairly.

A 1984 proposal by Henry J. Aaron and Harvey Galper would re-
place the income tax and the estate and gift tax with a progressive
cash flow tax, including a double tax on gifts and bequests. 58 Unlike
Blueprints, Aaron and Galper recognize that taxing the transferor (in
addition to the transferee) is necessary to "ensure that people with the
same lifetime capacity to consume, discounted to present value, pay
equal lifetime taxes." 59 They explain:

[T]his principle of fairness in taxation, which we find compel-
ing, can be achieved under a cash flow tax that taxes all uses
of lifetime income—consumption, bequests, and gifts to
others. Under a cash flow tax, whether one consumes early
in life, saves for later consumption, or bequeaths an estate to
one's heirs, the present value of all tax liabilities incurred
over one's lifetime is unaffected. 60

In a footnote, they remark that their proposal, which can properly
be described as an endowment tax, is not the same as a consumption
tax, "which falls only on consumption but excludes changes in net
worth by exempting gifts and bequests from the tax base." 61 In other
words, the tax proposed by Blueprints does not achieve its stated goal
of being an endowment tax, precisely because it does not double tax
gifts and bequests.

57 Bradford, note 54, at 159.
58 See Henry J. Aaron & Harvey Galper, Reforming the Tax System, in Economic
Choices 1984, at 87 (Alice M. Rivlin ed., 1984). The proposal exempts from the double tax
the first $100,000 of each transferor's lifetime transfers. See id. at 94-95. The exemption
makes the proposal's treatment of gratuitous transfers a hybrid between double taxation
under a cash flow tax and single taxation under a cash flow tax accompanied by a separate
transfer tax system.
59 Id. at 101.
60 Id. at 101-02 (emphasis added).
61 Id. at 102 n.13.
III. Two Asides

A. Human Capital

For the vast majority of people, including the affluent, gifts and bequests of traditional forms of capital are almost trivial, compared with the human capital children acquire from and with the help of their parents. How should a cash flow consumption tax be designed, in order to implement either single or double taxation of parental gifts of human capital?

Broadly speaking, a person's human capital—the present value of her expected lifetime earnings—can be traced to two sources: her innate ability and educational investments necessary to take advantage of that ability. For example, if a person will have $1 million of human capital after spending $100,000 on a college education, $900,000 of that human capital is attributable to her innate ability and $100,000 to the educational investment.

Consider first the tax treatment of the $100,000. If the investment is made with the child's own money—that is, if there is no gratuitous transfer involved—the correct treatment under a cash flow tax is clear. Investment in human capital should be expensed, like investment in other forms of capital. A single tax would be imposed on the child when she realized and consumed the return on the investment.

If the $100,000 comes instead from her parents—the more likely situation—it is simple to implement either a single tax or a double tax system with respect to this gift of human capital. If the parents are allowed a deduction for the $100,000, the result is a single tax (on the child, when the resulting income is realized and consumed); if the parents are denied a deduction, the result is a double tax.

What about taxation of the $900,000 of innate human capital—the amount by which the value of the child's human capital exceeds the parental investment? It is inconceivable that any real world cash flow

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62 For example, Professor Bradford presents data indicating that "if a male with the 90th-percentile position in the discounted income [human capital valuation] ranking received at age 40 the 90th-percentile inheritance, the effect would be to increase his lifetime wealth by about 4.2%; at the 95th-percentile position (by interpolation), 3.6%." Bradford, note 54, at 173.

63 Before entering college, she has the opportunity to create a million dollar asset by investing only $100,000. Even before it has been exploited, that opportunity has a value of $900,000.

Obviously, it is highly stylized to treat college costs as the only parental investment in a child's human capital. Even with a more expansive concept of investment, however, many children will have human capital far in excess of parental investment.

tax would impose a double tax on innate human capital. The only tax would be on the child’s consumed earnings; the parents would never be taxed on a gratuitous transfer of innate human capital. Does the impossibility of imposing a double tax on innate human capital—perhaps the most important category of wealth—make it unfair to impose a double tax on gifts and bequests of other forms of wealth? I believe it does not. A system that double taxes gifts and bequests, except for parental “gifts” of innate human capital, can be justified. The crucial point is that the child’s innate human capital never belonged to the parents. The fundamental difference between innate human capital and other forms of endowment is that the parents never owned the child’s human capital, but the parents did own other wealth they bestowed on the child. This difference justifies double taxation of traditional gifts and bequests, and of parental expenditures for children’s education, without at the same time double taxing innate human capital.

**B. “Only” Exemptions and Rates?**

As I noted earlier, the difference between the Dodge proposals for double taxation of gifts and bequests under an income or consumption tax, and single taxation under an income or consumption tax plus a separate transfer tax, is only the exemptions and rates. That is an awfully big “only,” however, given the exemptions and rates of the current income and estate taxes.

Under the estate and gift taxes, the first $600,000 of a transferor’s lifetime transfers is exempt from tax; under the Dodge system, every dollar of transfer would be taxed, except for transfers eligible for the proposed exemption for inter vivos consumption gifts. Thus, for the vast majority of families, the Dodge system would impose a heavier burden on gratuitous transfers. On the other hand, the Dodge system would lessen the burden on the most affluent families, because the top rate under the income tax is 15.4 percentage points lower than the top rate under the estate and gift taxes.

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65 Parents have tremendous (but not unlimited) control over the development of their children’s human capital, but it never belongs to the parents. Business opportunities that parents could have exploited themselves, but that they instead transfer to their children, are a different matter. If there is a practical way to do it, transferred business opportunities should be double-taxed under the Dodge system.

66 See IRC §§ 2010, 2505.

67 See Dodge, note 4, at 586-88. A transfer might also escape tax by reason of the general exemption allowance of the income or consumption tax (such as the standard deduction and personal exemptions of the current income tax), but there would be no special exemption for gratuitous transfers. See id.
rate under the estate tax. Compared to the exemptions and rates of the current system of separate taxes, the Dodge unified double tax on gratuitous transfers would increase the tax burden on the middle class and decrease the burden on the wealthy.

Suppose one wanted a double tax on gratuitous transfers, and has narrowed the choices to the Dodge unified double tax or a separate estate tax. How should one decide between them? One could—and probably should—do an analysis of which approach makes more theoretical sense. But in the end, one might be more persuaded by feelings about the very different distributional and revenue effects of the two systems.

IV. Conclusion

Where you end up depends on where you start. If you grant Professor McCaffery his ethical premise (that savings is good and much consumption is bad), and his factual premise (that double taxation of gifts and bequests discourages savings), you will end up where he does—with no double taxation of gifts and bequests, either within the cash flow tax itself, or through a separate transfer tax. But if savings does not feature so prominently in your personal book of virtues, or if you doubt the responsiveness of savings rates to taxation, you will find the Dodge position more appealing.

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68 The top stated income tax rate is 39.6%; the top stated estate tax rate is 55%. See IRC §§ 1, 2001(c). Both taxes have “bubbles”—true marginal rates higher than the official top rates, during phaseout ranges. See IRC § 151(d)(3), § 2001(c)(2) (income tax phaseout of personal exemptions), (estate tax phaseout of graduated rates and unified credit).