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THE INCOME TAX VERSUS THE CONSUMPTION TAX AND THE TAX TREATMENT OF HUMAN CAPITAL

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Abstract

In two recent articles, I explore the conceptual question of how human capital would be treated under a pure, comprehensive, accrual income tax, pursuing the analogy to accrual treatment of physical and financial capital, which has received much academic attention. My central conclusion is that conventional income tax treatment of human capital -- taxing wages when earned -- is close to the treatment required by a pure consumption tax, whereas accrual income tax treatment would be quite different from that in existing income tax systems.

Professor Zelenak's article largely agrees with my central claims. Much of his article is concerned with criticizing me for advocating a consumption tax, which I do not in fact do. Indeed, I castigate the very type of argument he attempts to attribute to me and relies upon in defending his own views. It is also the case that Zelenak's affirmative arguments for the existing hybrid income/consumption tax and his various objections to particular elements of my analysis are largely without foundation.

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In two recent articles, I explore how human capital would be treated under a comprehensive, accrual ("ideal") income tax.[1] My central conclusion is that traditional income tax treatment of human capital -- taxing wages as earned -- is close to the treatment prescribed under a consumption tax: rather than taxing human capital upon creation and as it changes in value, only realizations are taxed, with no allowance for basis. These articles are conceptual: their purpose is to illuminate the comprehensive income concept and to explore a number of issues concerning the tax treatment of human capital, not to advocate either a particular regime for human capital or a specific tax system (such as a comprehensive income tax or a consumption tax). Indeed, both articles criticized the approach of making normative judgments based upon the resolution of semantic disputes (such as what "capital" or "income" truly mean) or upon ad hoc appeals to unelaborated norms such as "ability to pay."[2]

Lawrence Zelenak's article criticizes my writing on this subject.[3] But it is an odd sort of critique. It begins by attributing to me a position -- advocacy of a consumption tax -- that I explicitly disclaim, as if I were advocating policy using precisely the form of argument that I castigated. Then, he offers his own defense of the existing income tax (one that embraces its substantial consumption-tax-like features) by relying upon precisely the sort of approach that I had criticized, but without offering any response. In addition, much of his defense of the current

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[1]Louis Kaplow, Human Capital Under an Ideal Income Tax, 80 Virginia Law Review 1477 (1994) [hereinafter Human Capital I]; Louis Kaplow, On the Divergence Between "Ideal" and Conventional Income-Tax Treatment of Human Capital, 86 American Economic Association Papers and Proceedings 347 (1996) [hereinafter Human Capital II].

[2]Human Capital I, at 1513 & n.87, Human Capital II, at 351.

[3]Lawrence Zelenak, The Reification of Metaphor: Income Taxes, Consumption Taxes, and Human Capital, __ Tax Law Review ___ (199_).

tax system invokes arguments that are largely irrelevant to the choice between an income tax and a consumption tax or that are invalid.

I. Understanding the Relationship Between Human Capital and an "Ideal" Income Tax

A. My Claims about Human Capital and My Views on Normative Tax Policy Analysis

My writing on the taxation of human capital emphasizes the following points:[4]

1. Under a pure, comprehensive, accrual income tax -- that is, a tax reaching all value as it accrues, regardless of whether there is a "realization" event and regardless of whether an asset is traded on the market -- human capital would be taxed as follows: (a) the present value of future labor income would be taxed at birth (because this is when an individual first comes into possession of human capital); (b) as time passes, the value of human capital would change on account of the time value of money and depreciation, and this net change in value would constitute (possibly negative) income; (c) as uncertainty is resolved, gains and losses would constitute (possibly negative) income. (Further discussion in my articles applies these principles to determine pure income tax treatment of investments in human capital.)
2. Conventional income tax treatment incorporates none of the foregoing three principles and instead taxes wages when earned. This conventional treatment, which is realization-based, is tantamount to a consumption tax approach. (This point can be illustrated by comparing analogous circumstances involving physical and financial capital.)
3. Conventional income tax treatment cannot be rationalized within a comprehensive, accrual income tax by appeal to the treatment of gifts and bequests.

[4]These five points are those emphasized, respectively, in Parts I-V of Human Capital I; most of them are stated, much more briefly, in Human Capital II.

4. Points 1-3 cast familiar comparisons of an ideal income tax and a consumption tax in a different light. The very fact that comparisons, in describing an income tax, have mixed ideal income tax treatment of physical and financial capital with consumption tax treatment of human capital suggests the need for reevaluation. In particular, I note that one of the most common arguments suggesting that a consumption tax is more fair than an income tax is incorrect in the sense that the argument is valid only because the income tax being examined is not a pure income tax.

5. One can imagine using a proxy scheme for taxing human capital that would avoid many familiar objections to the direct taxation of human capital. Thus, the possibility of accrual taxation of human capital should not be ignored out of hand.

After making these points and some others (notably, concerning the subtle efficiency effects of conventional versus ideal income tax treatment of human capital[5]), I offered extremely limited remarks on the policy implications of my analysis. One remark -- which I understood as merely stating the obvious -- is that my analysis raises questions about previous arguments concerning the relative merits of income taxes and consumption taxes. In particular, adherents to pure, accrual income taxation should ask themselves whether they favor (a) extending pure, accrual income tax treatment to human capital as well as to physical and financial capital or (b) retaining conventional tax treatment of human capital -- consumption tax treatment -- in which case they would need to explain why the different sorts of capital should be treated so differently.

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[5]See, e.g., Human Capital II, at 349-51.

Zelenak's interpretation notwithstanding,[6] raising this question is not tantamount to advocating a consumption tax.[7] Indeed, my longer article -- the one upon which he focuses -- contains such statements as "the discussion is not normative and does not make policy recommendations" (introduction), "neither the ideal income concept nor the base of a consumption tax directly follow from fundamental moral principles or views of distributive justice" (conclusion), and "[t]his Article does not address the merits of arguments about the relative desirability of a consumption tax and an income tax" (in passing).[8]

More important than any ambiguity that the reader may or may not find in such passages, Zelenak does not appear to understand the views I express on the nature of normative tax policy analysis. In interpreting my article as consumption tax advocacy, Zelenak must believe that I find convincing policy arguments that are based upon stipulated definitions (notably, of "income") and ad hoc concepts (in particular, "ability to pay"), since there is little else he could have in mind. In

[6]See especially Zelenak's introduction, which includes the following: "Kaplow[] ... uses his analysis of the taxation of human capital, and his suggested proxy tax, to argue for applying a pure consumption tax model to physical and financial capital." Zelenak at 7. "[T]he political point of the entire article [is to offer] a new and important argument for replacing the income tax with a consumption tax." Id. at 8.

[7]Indeed, this question is directed at income tax purists, those who favor a comprehensive, accrual income tax. Neither I nor Zelenak is in this camp. (I am not because I reject argument from definition and ad hoc norms, see below, and Zelenak obviously is not because he defends the current hybrid income/consumption tax system. In this regard, I would have thought that Zelenak might interpret my articles as supporting his position to the extent that these articles pose a challenge to the income tax purists with whom Zelenak disagrees.)

[8]Human Capital I, at 1481, 1513, and 1504 n.61 (respectively). With regard to my second article, the quotation in the text below should suffice to make my position clear. Perhaps Zelenak's interpretation of my writing is based upon the assumption that I must be advocating a consumption tax, for why else would I offer analysis that some income tax advocates would find disturbing. Following this logic, however, one could just as easily tag me as an income tax advocate, on the ground that I have criticized Jeff Strnad's article, Taxation of Income from Capital: A Theoretical Reappraisal, 37 Stanford Law Review 1023 (1985), for an argument it presented that was favorable to a consumption tax. See Louis Kaplow and Alvin C. Warren, Jr., An Income Tax by Any Other Name -- A Reply to Professor Strnad, 38 Stanford Law Review 399 (1986); Louis Kaplow and Alvin C. Warren, Jr., Professor Strnad's Rejoinder: Simply Semantics, 39 Stanford Law Review 419 (1987). (One might draw further evidence of my pro-income-tax intentions from the fact that these critiques were co-authored with Alvin Warren, the author of the leading articles articulating fairness arguments for an income tax, articles that Zelenak cites with approval, see Zelenak at 11-12 n.34, 56 n.125.) See also Human Capital I, at 1501-03 (criticizing one of the fairness arguments most commonly offered in support of a consumption tax). In the end, however, I believe it better to pursue the relevant substantive analysis directly than to devote so much effort to attributing motives or arguments to an author, particularly ones that the author explicitly disclaims.

fact, however, I eschew making policy in reliance on this entire class of arguments, proposing instead that tax policy be based on analysis of economic welfare. Thus, in the conclusion to my first article, I state: "Whatever the magnitude of the net effect of these changes, however, it seems arbitrary to determine the shares of revenue from labor and capital by reference to a stipulated definition of income that does not consider efficiency and the resulting distribution of wealth."[9] I conclude my second paper on the subject as follows:

> I do not, however, find these sorts of arguments for tax reform persuasive. Whether human capital should truly be viewed as "capital" for purposes of defining "income" involves a semantic dispute.[10] Much debate about the relative merits of income and consumption taxation and about defining the base for either tax is grounded in ad hoc, intuitive appeals (e.g., to definitions of income and unelaborated intermediate norms like "ability to pay"). Like others ..., I believe that normative analysis of tax policy must be based directly upon first principles, namely, a theory of distributive justice embodied in an explicit social welfare function....[11]

These passages make clear my positions on these issues, positions that I and a number of others have articulated for many years.[12]

B. Fundamental Defects in Zelenak's Defense of a Hybrid Income/Consumption Tax

The foregoing conclusions about the appropriate character of normative tax policy analysis -- which Zelenak does not challenge -- undermine his attempt at constructive argument. He offers two reasons for embracing his preferred hybrid income/consumption tax. The first

[9]Human Capital I, at 1514.

[10]I simply do not understand how this view can be characterized as "The Reification of a Metaphor," as Zelenak states in his title and in the body of his article.

[11]Human Capital II, at 351. See also Human Capital I, at 1513.

[12]See, e.g., the sources cited in Human Capital I, at 1513 n.87.

reason is grounded in "ability to pay."[13] Yet, despite my emphatic criticism of such normative analysis, he makes no attempt to define this concept (except operationally, in a manner that includes all that he thinks should be taxed and excludes everything else), and he offers no argument to justify this sort of approach.[14] Zelenak's primary application of the ability-to-pay concept is in arguing that human capital should not be taxed because it is not liquid.[15] Perhaps this is a relevant concern, but the connection to his unstated normative theory of taxation is not given. He does not even ask such questions as why two taxpayers, with the same earnings and consumption streams -- *neither of whom are liquidity constrained* given their desired consumption plans -- should pay very different taxes because one taxpayer could not liquidate (or borrow against) all of his capital.[16] (Also, Zelenak concedes my observation that there is in fact

[13]Zelenak, at 11-16.

[14]Consider such questions as what ability means, why some types of ability matter and other do not, and, whatever one's ability to pay is deemed to be, how much of what one is *able* to pay one *should* pay (given that taxes are generally far below one hundred percent of "ability to pay").

[15]In addition to mischaracterizing the normative status of my arguments, Zelenak repeatedly mischaracterizes my discussion of the particulars. For example, in his introduction, he states that I "disregard the possibility of ... differences" between human capital and other assets. Zelenak, at 9. In point of fact, both of may papers specifically mentioned the argument about liquidity that Zelenak emphasizes. See Human Capital I, at 1505; Human Capital II, at 351 n.8. Indeed, my longer article posed the question whether there might be differences between the two sorts of capital and proceeded to examine them, in many instances making points that Zelenak concedes or ignores. (See, e.g., the discussion below of intangible returns to wealth.)

In his section on liquidity, he also takes me to task for suggesting accrual taxation of human capital when such treatment has never been imposed on physical capital, and states that this point constitutes a sufficient refutation of my claim about any inconsistency in the treatment of the two sorts of capital. Zelenak at 15-16. See also id. at 20 ("His analysis disregards the considerable extent to which the real income tax applies a consumption tax model to traditional capital.") As a matter of fact, my conclusion, in the paragraph preceding the one Zelenak discusses, explicitly refers to the hypothetical possibility of moving to accrual taxation of human capital and "*simultaneously* mov[ing] more closely to accrual taxation of capital income." Human Capital I, at 1514 (emphasis added); see also id. at 1477 n.1 (referring to the issue and providing extensive citations to those who have proposed schemes that would move toward accrual taxation of physical and financial capital); Human Capital II, at 351.

[16]I explicitly raised the point that many individuals may not be constrained with respect to borrowing, suggesting that the liquidity argument may thus be irrelevant. Human Capital I, at 1505 & n.66. (In addition, one should keep in mind that proxy taxation of human capital is possible without raising liquidity problems.)

some significant borrowing against human capital,[17] but does not accordingly advocate a substantial reform to tax such borrowing;[18] similarly, he does not address my observation[19] that the current system, which he is defending, does tax physical and financial capital even when it is illiquid.)

Zelenak's second major argument in favor of the current hybrid income/consumption tax system is that we should not tax lifecycle savings but only bequest savings.[20] I do not find his limited argumentation (for either half of his position) convincing.[21] For present purposes, however, I confine myself to some immediately apparent points: his view is not linked to any

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[17]He characterizes the magnitude of this point with the phrase "except for two special situations," Zelenak, at 14, but those situations are educational loans and home mortgages, hardly insignificant sorts of personal borrowing.

[18]Zelenak, at 15, states that one may not be able to obtain a mortgage substantially in excess of the full value of a home, using the excess to pay taxes. But one who uses an entire paycheck for consumption cannot expect his employer to make a loan to cover the income taxes owed, and this is not viewed as an argument that makes high livers exempt from tax. Independently of whether human capital is necessary to obtain a mortgage, when the amount borrowed exceeds basis (as is undoubtedly frequent in the case of home equity loans), there is no liquidity (or difficulty-of-valuation) rationale for deferring taxation of unrealized gains until realization (or indefinitely, as when I.R.C. §121 or I.R.C. §1014 applies). Clearly, the absence of any liquidity constraint is not viewed as sufficient to trigger income taxation in the current system that Zelenak defends. (And, as indicated in the text that follows, liquidity is also not a necessary condition.)

[19]Human Capital I, at 1482 n.11, 1505 n.67.

[20]Zelenak, at 16-31. I find his position here difficult to understand. His argument for consumption taxation of lifetime savings is essentially one of the arguments most commonly given in favor of a comprehensive consumption tax. As explained in the text, his distinction of bequest savings has no logical nexus to the aspects of income taxation he defends. Moreover, other arguments he offers for income taxation later in the article (reaching the returns to intangible wealth) are applicable to all assets as they are being held, without regard to whether they are subsequently bequeathed.

[21]His discussion of the motivation for redistributive taxation and its relationship to human capital, Zelenak at 26-31, seems confused. He suggests that we do not redistribute human capital, only other capital. But most income tax revenue is directly from wages -- that is, *income realized from human capital*. (Surely Zelenak does not think that an income tax's levy on capital gains is not a levy on capital because it awaits realization.) Indeed, Zelenak seems to accept such a view toward the end of his discussion. See id. at 30.

More generally, in this section Zelenak moves from the observation that a person's human capital might be viewed as a gift from one's parents to in inquiry about whether parents should in some way be taxed on this gift, see, e.g., id. at 24. But I do not understand how his (inclusive) discussion of the latter question serves to resolve the former concern with proper taxation of the human capital to the human who possesses the capital, and he does not integrate these inquiries. In addition, he disregards my explicit discussion that explains how viewing human capital as a sort of gift from one's parents cannot rationalize ignoring human capital under a pure, accrual income tax. See Human Capital I, at 1498-1500.

normative view of taxation, it is inconsistent with both his first argument about liquidity[22] and the one he offers later (discussed below) that favors the taxation of wealth holdings directly, it does not justify pure consumption taxation of human capital (because there is no strong, inherent tendency for human capital to fund lifecycle savings whereas other capital funds bequests[23]), and it suggests that Zelenak should favor a pure consumption tax plus an estate (and gift) tax instead of an income tax (indeed, with respect to the latter, he does not even express objection to I.R.C. § 1014's exclusion of capital gains at death[24]).

In sum, Zelenak's affirmative arguments for an income tax -- actually, for a consumption tax on human capital and most of physical and financial capital, with realization income tax treatment of the residual -- are empty. In saying this, however, I am not adopting the opposite view on any of these arguments. Rather, as I had hoped to make clear in both of my initial articles, I find such arguments -- appeals to definitions, ad hoc invocations of ungrounded concepts -- fruitless. Instead, one must attend directly to the manner in which different tax systems promote well-specified and adequately justified notions of social welfare. My articles on

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[22]To put the point simply, it is hardly the case that liquid capital is most likely to be used for bequests and illiquid capital for lifetime consumption.

[23]For example, term life insurance funds only bequests, but it is often funded by employer withholding from wage income.

Zelenak, at 23 n.57, acknowledges that human capital can be bequeathed after it is converted to cash, but he emphasizes that "at that point it is no longer human capital." This suggestion, however, is beside the point: my argument was simply that income from human capital is deferred *until realization*, and Zelenak is not disagreeing; by contrast, his argument at this point is concerned with defending such deferral on the ground that the benefit accrues to savings for consumption during one's life, ***not for bequests***.

[24]That the current income tax does reach capital gains realized during life (and interest and dividends received) but exempts those on assets passed on at death indicates that the income tax Zelenak defends does precisely the *opposite* with physical and financial capital of what he suggests would justify an income tax in the first place. The exclusion of gifts and bequests from donees' income, I.R.C. §102, and the carryover of basis (instead of realization) on gifts, I.R.C. §1015, are additional embarrassments to his position that Zelenak ignores.

human capital attempt to clarify concepts rather than pursue this normative program.[25] (To be sure, in other writing, on other subjects, I have often engaged more directly in normative analysis of tax policy.)

II. Notes on Some Particular Criticisms

Much of Zelenak's article is concerned with criticizing my writing for failing adequately to attend to various problems with my supposed argument for consumption taxation. As such, many of his points are simply irrelevant to my articles. In fact, most of my five main points, summarized above, are ones that he accepts.[26] Nevertheless, I believe that some brief comments may clarify issues that are central to Zelenak's position and may be relevant to subsequent work.

Imprecision of a "proxy tax" on human capital. Zelenak objects that the proxy I develop for taxing human capital,[27] should one wish to do so, is imprecise in various respects.[28] Of course, I label it a "proxy" for precisely this reason, and I note many more respects in which it would be imprecise than those Zelenak discusses.[29] The objection he emphasizes (involving uncertainty as

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[25]I take issue with Zelenak's repeated criticism of my articles for committing the sin of failing to be comprehensive in the course of policy advocacy -- simply because that is not what these articles are about. His criticism is misdirected, for *he* is the one seeking to provide a defense of a particular tax system, and in doing so he is, in many respects, less comprehensive than I was. (For example, he ignores the few efficiency arguments I do mention, Human Capital II, at 350-51, and does not address my one comment on previous analysis that seeks to examine optimal tax policy -- taking into account distribution as well -- with regard to the choice between an income and a consumption tax. Human Capital I, at 1513 n.86.)

[26]The bulk of his critique is leveled against my fifth point about the proxy tax, the discussion of which occupied five pages of my longer article, Human Capital I, at 1507-12, and one (admittedly long) paragraph of my shorter article, Human Capital II, at 349.

[27]Human Capital I, at 1507-12. The proxy system involves taxing labor income at a higher rate when the income is earned later in life to account for the implicit deferral offered by ignoring human capital. (By analogy, if one allowed deductions for contributions and exclusions for capital income on a form of savings account but wished to tax withdrawals in a manner that simulated accrual income taxation, one would apply a higher tax on savings held longer, absent any specific information on when income actually accrued.)

[28]Zelenak, at 32-37.

[29]See Human Capital I at 1508-09 n.76 (discussing five respects in which the proxy "does not simulate implementation of an ideal income tax base").

to when value first accrues) is one that I did explain[30] and also is one that plagues most attempts to move to accrual taxation of physical and financial capital.[31] (Indeed, as I noted, the retrospective -- realization-based -- proxy I describe is analogous to proxies that have been proposed in these other spheres.[32]) If one were to make a policy decision (which I did not attempt to do), one would have to ask whether and why one wants accrual taxation in the first place and, if one does, whether a proxy is better than nothing.

Imputed income. Zelenak finds it "[s]trange[]" that I "ignore[]" imputed income when designing a proxy tax.[33] But "ignore" is inaccurate, as I twice (in the relevant five pages) refer to it.[34] I made a conscious decision not to include imputed income in the proxy, for familiar reasons: "Imputed income continues to be omitted, as in most discussions of income and consumption taxation. Imputed income does not bear directly on the choice between an income tax and a consumption tax. . . . But a true believer in taxing ideal income -- or consumption -- would include [imputed income]."[35] Zelenak does not explain why excluding imputed income is fatal to

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[30]See id. ("This statement is correct on average before uncertainty is resolved, but not after. For example, individuals experiencing more favorable than average resolutions will be overtaxed, in that the multiplier is based on the assumption that the higher wages were anticipated beginning in period 0. Individuals experiencing unfavorable resolutions will be undertaxed.").

[31]He also is bothered by the fact that the degree of imperfection of the proxy might be reduced if the proxy were made to depend, say, on race, which would be objectionable. This is a familiar red herring: almost any measure would be improved by adding factors, and much in our society depends in part on race (at least when one cannot control for literally all other factors). For example, the extent to which giving consumption tax treatment to lifecycle savings, human capital, or changes in the value of small businesses is justified by his bequest theory or views about intangible returns to human capital is almost undoubtedly a function of race as well; thus, according to this objection, we could not employ income taxation at all.

[32]Human Capital I, at 1508 n.74.

[33]Zelenak at 38 n.90; see id. at 37-41.

[34]Human Capital I, at 1507 n.73, 1509 n.76. (Zelenak does refer to these notes elsewhere, see 32 n.78, but he seems to have forgotten about them when reaching the subject, where he makes the strong claim previously noted.)

[35]Id. at 1507 n.73.

the proxy but not fatal to his own or others' positions, which exclude imputed income in precisely the same manner, or how imputed income is even relevant to the income versus consumption tax debate in which Zelenak seeks to defend a particular, intermediate position.

Intangible return to wealth. As noted in one of my articles, taxing the intangible return to wealth is a rationale frequently offered for income (versus consumption) taxation.[36] Zelenak concedes my point that this rationale applies to human capital as well as to physical and financial capital. His criticism is that the proxy tax I describe would do a mediocre job taxing intangible returns to human capital.[37] I agree. But he does not even *attempt* to argue that it would do a worse job at reaching these returns than an accrual or conventional (realization) income tax does at reaching intangible returns to physical and financial capital. (Is a reliable indication of the power and prestige that accrues to capitalists given by the current level of the interest rate, the fact that a stock pays dividends rather than retaining earnings, or the change in the market value of an investment portfolio or of a small business? Is this intangible return the same for one who holds large passive investments and does not reveal her holdings publicly as it is for those who buy conspicuous consumer durables?[38]) In addition, I criticized as incoherent the view that

[36]Id. at 1504-05.

[37]Zelenak, at 41-47. To be more precise, at one point he describes the proxy as "hopelessly bad." Id. at 45. In substance, however, he concedes that the proxy would tend to be correct on average, id. at 45-46, and cites some instances (which are nontrivial, but hardly typical) in which the proxy would be poor, id. at 45. (In those very same instances, it turns out, taxing income from physical and financial capital would be very poor proxies as well.) But he falls back to the more modest statement that "normally we do not settle for tax rules that treat groups fairly; we insist on rules that are fair among individuals." Id. at 46. Zelenak must have a different copy of the tax code than mine. See, e.g., I.R.C. §1 (grouping family units into 4 types),.... (The only exception involving group treatment that Zelenak seems to have located involves the treatment of term life insurance. Zelenak, at 46 n.101.) Also, in light of my point that taxing income from physical and financial capital is a poor proxy for intangible returns, it presumably follows that Zelenak favors a consumption tax. But since consumption is a crude proxy for well-being, perhaps he should oppose any tax.

[38]In fact, due to the exclusion of imputed income on consumer durables, the latter is actually taxed more lightly than other capital under the income tax that Zelenak defends.

intangible returns to wealth justify income taxation,[39] a difficulty Zelenak chooses to ignore entirely.

Costs of maintaining and producing human capital. Zelenak objects to my analysis of human capital for being incomplete: if human capital is to be treated as capital, he asks, should not provision be made for deducting human capital expenses, such as the personal subsistence that is required to be able to work?[40] Again, I fail to see the relevance of his argument. First, many of these expenses are traditionally viewed as jointly involving consumption and thus nondeductible (under both income and consumption taxes) regardless of whether they are also necessary for work.[41] Second, if one takes the view that allowances should be made (as is clear, in principle, for incremental expenses incurred for work), the implications are largely the same for a pure, accrual income tax, Zelenak's hybrid income/consumption tax, the proxy I describe, and a consumption tax: in *all* cases, an allowance should be made, and the only difference among the systems concerns the *timing* of the deductions. Hence, if one favors consumption tax treatment of human capital, as Zelenak does, one should favor an *immediate deduction* (rather than depreciation or amortization, as under an accrual income tax). Thus, I cannot see how *my* not giving detailed attention to this issue is somehow an argument for Zelenak's scheme or some other one.[42]

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[39]Human Capital I, at 1504 n.61.

[40]Zelenak, at 47-56. For example, he quotes Thurow, who refers to the need to eat and sleep. Id. at 48 n.105.

[41]At one point in his discussion, Zelenak discusses the possibility of viewing parental transfers that enhance children's human capital as "gifts," Zelenak at 54, but he ignores my section that discusses this. See Human Capital I, at 1498-1500.

[42]I also am unpersuaded by Zelenak's assertions about the magnitudes involved. First, variations in human capital maintenance needs (e.g., extra caloric requirements for physical labor) seem modest relative to the trillions of dollars of value of human capital. Second, I do not understand his claim that the existing rate structure (e.g., personal exemptions and standard deduction) does not take into account average needs. I would assume that analysts and policy makers have in mind individuals' typical needs when setting these amounts. Zelenak imagines that they do not and assumes that including them would be a massive reform that would reduce the taxation of labor income substantially. (Why is it that one would have to raise exempt income by something like $10,000 per family of four to account for such

Sum. Although these few pages do not capture each nuance of Zelenak's arguments, I believe they suffice to show that his points are largely irrelevant both to the main points in my article (which concern how one might think about pure, accrual taxation of human capital) and to the policy advocacy in which Zelenak is engaged.

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costs? Perhaps at above-average incomes such a large figure would be reasonable, but to the extent the exempt amount rises with income, it is equivalent to adjust rates instead of raising the exemption. Indeed, Zelenak, at 52, suggests that the result would be more redistributive tax rates, but again does not suggest why existing thought about the rate structure does not already reflect the net increment to well-being that is thought to be associated with a given level of income.) In any event, I explicitly disclaimed a view on the relative magnitudes of the changes in taxation of capital and labor income in moving to accrual taxation. Human Capital I, at 1514 ("[w]hatever the magnitude of the net effect of these changes").