Wealth is Just Capital!

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Wealth, like virtue, is its own reward. This notion underlies our transfer tax system. Notwithstanding, discussions of income tax policy frequently view wealth as just deferred future consumption rather than as an end of itself. Professor Louis Kaplow, in _Utility from Accumulation_, reminds us that the benefits from having wealth in addition to providing financing for future consumption should be taken into account in all tax analyses and that, if so, very different conclusions on a number of issues can be reached.

The importance of Professor Kaplow’s point cannot be overemphasized. If wealth is just deferred future consumption, taxing the income from wealth — from savings, from capital — distorts the decision of whether to consume now or in the future. The resulting incentive to consume sooner rather than later reduces economic efficiency. An example of tax rules that are consistent with this view is that we now have a very low tax on the return to savings (as a consequence of the low and expansive special rate on capital gains), rather than, as Pre-Reagan, having a lower tax on services (“earned”) income than on the return to wealth.

But, as Professor Kaplow explains, there **are** benefits from wealth in addition to being able to spend it at some time in the future:

It is familiar that individuals might derive utility from accumulation, that is, from the possession (in contrast to the expenditure) of wealth... The benefits may be internal (peace of mind, a sense of success) or external (status, power). Another possibility is that individuals merely behave as if there is utility from accumulation, due perhaps to evolutionary imperatives or habits developed during working years that persist through retirement. [Footnote omitted.] Utility from accumulation may help to explain the existence of misers, of high-ability individuals who continue working longer and harder than seems to be justified by needs for future consumption or bequest motives, and, relatedly, of people who view their wealth more as a measure of success (a way of keeping score) than as a means to more tangible ends.
Professor Kaplow discusses how the utility from accumulation explains a variety of empirical phenomena. For example, retirees do not spend as much in retirement as otherwise would be expected. Another interesting example noted is that people give to charities at death (with no income tax benefit) rather than while still alive when they would benefit from generating an income tax deduction and they would be able to enjoy the intangible benefits of the donation.

The heart of the article is a mathematical model of lifetime utility that reflects utility from consumption, gifts, bequests, and saving. The model demonstrates that, if people value wealth for its own sake, lifetime consumption and inter vivos giving must decline. Since people save more, more wealth remains at death to bequeath.

Professor Kaplow does not attempt to measure the utility of accumulation. He observes that it likely varies considerably from individual to individual. The utility nevertheless can have real economic significance, because those who do value wealth save a great deal.

The article notes that its conclusions have a role to play in the analysis of a variety of tax topics. Obviously, the article helps one understand estate and gift tax policy. More importantly in the current climate, however, the article says something very important about income taxation: There is no a priori economic-efficiency reason that income from capital should be taxed at a low, or even zero, rate. As we debate how the federal government should find more revenue, this fact must be kept in mind throughout. Professor Kaplow’s article provides the needed, rigorous reference.