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Limor Riza
limor.riza@gmail.com

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Cover Page Footnote

Senior Lecturer, School of Law, Ono Academic College.

TAXATION OF LONG-TERM UNEMPLOYMENT: FACING THE TWENTY-FIRST CENTURY CHALLENGES

Limor Riza[+]

It's a recession when your neighbor loses his job;
It's a depression when you lose yours[1]

This Article examines the policy of taxing long-term unemployment in jurisdictions where unemployed individuals are entitled to unemployment benefits. It claims that tax systems should *not* tax the unemployed *regardless* of whether they reenter the labor market. In the U.S. and many other developed countries, it is common to grant unemployment benefits and tax them. In those jurisdictions, tax laws in general do not distinguish between short- and long-term unemployed taxpayers. Given that the future of the professional and occupational security of the unemployed is uncertain mainly due to the twenty-first century's new challenges, taxation should take into consideration, ex post, the future "dimension" of equity. Equity cannot be measured over a single year, but over a longer period, during which we should examine whether the unemployed population has become chronically unemployed—which would include those who cannot find a job even after exhausting their rights to unemployment insurance. Note that until now, tax laws have treated the unemployed uniformly, without distinguishing between regular and chronic unemployment.

Unemployment is a major global socioeconomic problem, and many individuals are unemployed in developed countries as well. The fear of expanding unemployment grows during recessions, when the chances of finding

[+] Senior Lecturer, School of Law, Ono Academic College.

1. Oxford Reference, https://www.oxfordreference.com/view/10.1093/acref/9780191843730.001.0001/q-oro-ed5-00011019 (last visited June 5, 2021).

a job are lower; but it also results from technological progress. The twenty-first century began just two decades ago, but has already seen multiple local and global economic crises: the 2008 crisis, and, above all, the coronavirus pandemic, which has been affecting employment worldwide. Economists predict that the post-coronavirus unemployment crisis could continue for many years[2] and compare it to the unemployment of the Great Recession.[3] However, note that growing unemployment is also a byproduct of the digital economy, which started before the pandemic. As early as the 1930s, John M. Keynes expressed his fear of the economic challenges his grandchildren's generation would face, coining the term "technological unemployment."[4] Several contemporary economists substantiate this fear by showing that some occupations and professions are bound to disappear.[5] Even in more optimistic scenarios, where the digital economy would not just eliminate jobs but create new types of jobs, individuals may still face unemployment in the transition period—before they are able to acquire new skills.[6] Thus, due to the economic crises and the digital economy, but mainly because of the latest coronavirus pandemic, which forced millions of people around the globe to stay at home and lose their jobs, unemployment is now more relevant than ever.

Unemployment is becoming chronic, with many remaining involuntarily jobless for a long period, including those who are available for work and who are "seeking work"[7] to the point of exhausting their unemployment insurance rights. Economists usually treat a period of over six months as severe unemployment, though the definition of chronic unemployment may vary across

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2. *See, e.g.*, Vince Golle & Sarina Yoo, *The Post-Coronavirus Unemployment Crisis Could Last for Years, Economists Say*, TIME (Apr. 10, 2020), https://time.com/5819080/unemployment-coronavirus/.

3. *See, e.g.*, Simon Kennedy, *Risk to Jobs Now "Unprecedented Since the Great Depression,"* BLOOMBERG (Apr. 4, 2020), https://www.bloomberg.com/news/articles/2020-04-03/jobs-destroyed-worldwide-as-coronavirus-sparks-recession.

4. John Maynard Keynes, *Economic Possibilities for Our Grandchildren*, *in* ESSAYS IN PERSUASION 364 (1933).

5. *See* Carl Benedikt Frey & Michael A. Osborne, *The Future of Employment: How Susceptible Are Jobs to Computerisation?* 48 (Oxford Martin Programme on Tech. & Emp., Working Paper, 2013), https://www.oxfordmartin.ox.ac.uk/downloads/academic/future-of-employment.pdf (examining the influence of the technological development of U.S. labor market and finding that 47% of U.S. workers are at risk and that "wages and educational attainment exhibit a strong negative relationship with [an occupation's] probability of computerization. . . . [C]omputerisation being principally confined to low-skill and low-wage occupations").

6. *See* Markus Lorenz et al., *Man and Machine in Industry 4.0.*, THE BOS. CONSULTING GRP. 8 (Sept. 2015), http://englishbulletin.adapt.it/wp-content/uploads/2015/10/BCG_Man_and_Machine_in_Industry_4_0_Sep_2015_tcm80-197250.pdf.

7. *See* Int'l Labour Org. [ILO], *Resolution Concerning Statistics of the Economically Active Population, Employment, Unemployment and Underemployment* ¶ 10(1)(c) (Oct. 1982), https://www.ilo.org/wcmsp5/groups/public/—-dgreports/—stat/documents/normativeinstrument/wcms_087481.pdf.

countries.[8] Organization for Economic Co-operation and Development (OECD), data, for example, show that the number of those unemployed for over twelve months is still significant.[9] In the United States, unemployment is considered long-term when it continues for over twenty-seven weeks.[10]

The reasons for being chronically unemployed vary. For example, the professional skills of the unemployed may not be required by the market, and employers may stigmatize them for having inferior skills. In addition, low-skill workers face difficulties finding a job in the digital robot economy, keeping them unemployed for a long period. This long period of unemployment weakens the willingness of the unemployed to seriously look for a job. As does, naturally, the global economic crisis due to COVID-19 that shut down large sectors of the economy for a long period.

This Article does not claim that tax law is the best scheme to address unemployment. Instead, it argues that given the significant power of tax law to direct human behavior, countries that have adopted unemployment benefits should address growing chronic unemployment needs from a tax perspective as well. The Article supports general taxation of unemployment benefits, but asserts that equity is compromised when tax law does not differentiate between unemployment benefits received by regularly and chronically unemployed—and, accordingly, does not promote social values.

The remainder of this Article is organized as follows. Part I briefly introduces the social and individual problems of unemployment. Parts II and III, respectively, comparatively review unemployment benefits and their taxation, and discuss American law. The main part—Part IV—begins with the mainstream arguments for and against taxing unemployment benefits. It then analyzes the question of long-term unemployment through both the lifecycle theory and the principle of reciprocity, and concludes by recommending that the unemployment benefit tax be reimbursed in the case of the chronically unemployed in order to achieve equity.

I. THE PROBLEM OF UNEMPLOYMENT

This Article proceeds on the following assumptions. First, that unemployment—regular or chronic—is undesirable for both the individual and society as a whole; and second, that unemployment benefits are necessary to preserve a just and well-ordered society (and the Article does not discuss the

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8. *See, e.g.*, Gary Burtless, *Long-Term Unemployment: Anatomy of the Scourge*, BROOKINGS (July 27, 2012), www.brookings.edu/articles/long-term-unemployment-anatomy-of-the-scourge/.

9. *See OECD Employment Outlook 2016*, ORG. FOR ECON. CO-OPERATION AND DEV. 28–29 (2016), https://www.oecd-ilibrary.org/employment/oecd-employment-outlook-2016_empl_outlook-2016-en (stating that although long-term unemployment increased by 55% between 2007 and 2015, it has recently been slightly declining).

10. *Employment Situation Summary*, U.S. BUREAU OF LAB. STAT. (Oct. 5, 2020), https://www.bls.gov/news.release/empsit.t12.htm.

social alternatives of unemployment benefits).[11] The negative implications of unemployment for an individual and his family are obvious. It carries direct economic implications, as well as less direct social and emotional effects, as Truman's opening quote illustrates.

Moreover, unemployment is not just an individual but also a national problem. The OECD regularly publishes statistics on unemployment in member states, including during the pandemic, and reports are also available from the International Labor Organization (ILO). The data from both organizations are cause for concern, especially with respect to recent publications on the sudden rise of individuals unemployed due to the coronavirus pandemic. For example, approximately twenty million people became jobless in the United States in just four weeks due to the coronavirus restrictions,[12] and that number almost doubled in a month.[13]

Regardless of the COVID-19 pandemic, in 2000, about one-third of the world's population was unemployed or underemployed.[14] Following the global economic crisis of 2008 and various technological developments that eliminated jobs, the number of unemployed individuals increased significantly in OECD member states.[15] The number of long-term unemployed individuals also grew, and, as of 2016, "one in three unemployed persons" were long-term unemployed.[16] In the last few years, there has been some improvement,[17] although the improvement among chronically unemployed was lower than

11. *See* Cheung Wai-lam, *Unemployment-Related Benefits Systems in Singapore*, RSCH. & LIBR. SERVS. DIV. LEGIS. COUNCIL SECRETARIAT 4, 6, 8 (June 2000), https://www.legco.gov.hk/yr99-00/english/sec/library/e17.pdf (discussing that most countries adopt unemployment benefits, while other countries, such as Singapore, support a different assistance program). In Singapore, the main program is to help the unemployed seek a new job, but there is also some financial assistance for the short term. *Id.* at 8.

12. *See* Nelson D. Schwartz, *"Nowhere to Hide" as Unemployment Permeates the Economy*, N.Y. TIMES (May 28, 2020), https://www.nytimes.com/2020/04/16/business/economy/unemployment-numbers-coronavirus.html.

13. *See* Lauren Aratani, *Jobless America: The Coronavirus Unemployment Crisis in Figures*, THE GUARDIAN (May 28, 2020), https://www.theguardian.com/business/2020/may/28/jobless-america-unemployment-coronavirus-in-figures.

14. *World Labour Report 2000: Income Security and Social Protection in a Changing World*, INT'L LAB. OFF. 4 (Nov. 2000) [hereinafter ILO Report], https://www.ilo.org/public/english/standards/relm/gb/docs/gb279/pdf/esp-7.pdf.

15. The increase in the unemployment rate among OECD state members can be observed in the graph available at OECD, *Unemployment Rate*, https://data.oecd.org/unemp/unemployment-rate.htm.

16. *See OECD Employment Outlook 2017*, ORG. FOR ECON. CO-OPERATION AND DEV. 23 (2017) [hereinafter *OECD 2017*], https://data.oecd.org/unemp/unemployment-rate.htm (last visited June 5, 2021).

17. *See OECD Employment Outlook 2018*, ORG. FOR ECON. CO-OPERATION AND DEV. 22 (2018) [hereinafter *OECD 2018*], https://www.oecd-ilibrary.org/employment/oecd-employment-outlook-2018_empl_outlook-2018-en.

among "regularly" unemployed.[18] Nevertheless, this data was before the outbreak of the pandemic and, as of today, the OECD identifies a sharp growth of unemployment.[19] The OECD is not only concerned with the number of unemployed, but also with the externalities of that phenomenon—primarily skill depreciation. Unemployment may cause individuals to compromise, and force them to take either part-time jobs or jobs for which they are overqualified.[20]

As previously stated, this Article's two premises are that unemployment is undesirable and unemployment benefits are necessary. There may be various mechanisms to address the long-term unemployment problem, but this Article addresses it through the prism of taxation by showing that the current system applied in many countries has an impaired tax rationale. Before discussing the proper way to tax long-term unemployment in the twenty-first century, this Article briefly presents the global social security law and its taxation aspects.

II. Comparative Analysis of Unemployment Benefits and Taxation

International law recognizes the social necessity of securing the unemployed, with social security seen as a universal social right in the 1948 Universal Declaration of Human Rights.[21] Article 23(1) of the Declaration states that "[e]veryone has the right to work, to free choice of employment, to just and favorable conditions of work and to protection against unemployment."[22] Articles 19–24 of the 1952 Social Security (Minimum Standards) Convention oblige member states to secure the unemployed with employment benefits[23]—a duty reinforced by Article 9 of the 1966 International Covenant on Economic, Social and Cultural Rights.[24]

Despite the international treaties, most of the global population does not enjoy any unemployment protection.[25] Nevertheless, in developed countries, there are

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18. *OECD 2017*, *supra* note 16, at 23.

19. *See Unemployment Rates, OECD*, Org. for Econ. Co-Operation and Dev., https://www.oecd.org/sdd/labour-stats/unemployment-rates-oecd-update-may-2020.htm (last updated May 2020).

20. *See, e.g.*, *OECD 2018*, *supra* note 17, at 12; *OECD 2017*, *supra* note 16, at 27.

21. G.A. Res. 217 A (III), Universal Declaration of Human Rights, art. 22 (Dec. 10, 1948) ("Everyone, as a member of society, has the right to social security and is entitled to realization, through national effort and international co-operation and in accordance with the organization and resources of each State, of the economic, social and cultural rights indispensable for his dignity and the free development of his personality.").

22. *Id.* art. 23(1).

23. *See* Int'l Lab. Org. [ILO], *Social Security (Minimum Standards) Convention*, June 28, 1952, No. 102, www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CODE:C102.

24. G.A. Res. 2200A (XXI), International Covenant on Economic, Social and Cultural Rights, at 7 (Dec. 16, 1966), https://www.refworld.org/docid/3ae6b36c0.html ("The States Parties to the present Covenant recognize the right of everyone to social security, including social insurance.").

25. ILO Report, *supra* note 14, at 6.

three main mechanisms to assist the unemployed: unemployment insurance (UI), which is the focus of this Article, unemployment assistance (UA), and social assistance (SA).[26] UI is part of social law, aimed at granting financial security during unemployment by redistribution. In general, unemployment benefits are payments given to unemployed individuals by authorized institutions. It is compulsory insurance (also named unemployment insurance) that is financed by taxes levied on employees' salaries. Under certain conditions, the unemployed are entitled to compensation. Unemployment benefits are a common social mechanism, for example, in EU countries and in most OECD member states (excluding, for example, Singapore, which has adopted a different form of social assistance).[27] Unemployment benefits are usually derived from past salaries, but their scope and range vary between states. Due to the COVID-19 pandemic, many countries have adjusted the unemployment compensation terms either by amount or duration; or, alternatively, by extending the recipient's identity. For example, in the United States, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed on March 27, 2020, authorizes states to extend unemployment compensation even to individuals who are usually not entitled to unemployment compensation, such as independent contractors.[28]

In addition, because unemployment compensation is derived from past salaries, it is usually treated as ordinary income and taxed accordingly with regard to income taxation.[29] In several countries, it is exempted from tax.[30] For example, in Germany, unemployment benefits are not taxed;[31] rather, they are added to other income for determining the tax rate, thus subjecting the other income (if any) to a higher tax rate.[32]

26. *See* Jackie WU, *Unemployment-Related Benefits Systems in the Organization for Economic Co-operation and Development (OECD) Countries*, RSCH. & LIBR. SERVS. DIV. LEGIS. COUNCIL SECRETARIAT 3–6, 9–10, 16 (June 2000), https://www.legco.gov.hk/yr99-00/english/sec/library/e13.pdf (stating that in some countries, unemployment assistance and social assistance are usually granted when the unemployed have exhausted their rights with respect to unemployment benefits).

27. *See id.* at 6–8; Ingrid Esser et. al., *Unemployment Benefits in EU Member States*, EUROPEAN COMM'N 5 (2013), https://ec.europa.eu/social/BlobServlet?docId=10852&langId=en; *see also supra* note 11 and accompanying text.

28. CARES Act of 2020, Pub. L. No.116–136, 134 Stat. 281, § 1002(a)(1)(D)(ii) (codified as amended in scattered sections of 15 U.S.C.).

29. *Id.*

30. *See* WU, *supra* note 26, at 5 (excluding from Table 1, for example, Germany, Japan, and South Korea).

31. *See* Sozialgesetzbuch III Drittes Buch [SGB] [Social Code Third Book—Employment Promotion], § 434j, para. 5a, https://www.gesetze-im-internet.de/sgb_3/BJNR059500997.html (Ger.); *see also* OECD *Economic Surveys: Germany*, ORG. FOR ECON. CO-OPERATION AND DEV. 97 (2006), https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-germany-2006_eco_surveys-deu-2006-en. For the tax exemption, see Einkommensteuergesetz [EStG] [Income Tax Act], § 3, http://www.gesetze-im-internet.de/estg/ (Ger.) (stating tax exemption).

32. *See* EStG, § 32b(1)(a), http://www.gesetze-im-internet.de/estg/ (Ger.) (stating progressive rate).

III. UNEMPLOYMENT BENEFITS AND TAXATION IN THE U.S.

In 1935, the United States adopted an unemployment benefits program.[33] This program is mainly executed through the Federal Unemployment Tax Act (FUTA),[34] but not solely. Unemployment benefits are administered in a combined program, run by the federal and state governments,[35] and in ordinary times (excluding the COVID-19 crisis) most employees—except self-employed individuals—are entitled to unemployment benefits.[36] Each employee is taxed on his income so long as he works, and this tax then finances unemployment benefits for involuntary unemployment.[37]

Unemployment benefits assist the unemployed in some but not all unemployment circumstances. Those who become unemployed voluntarily without good cause, or unemployed persons who have lost their jobs due to misconduct, are disqualified, despite having financed the program while employed.[38] The taxes levied by each state are deposited in the Unemployment Trust Fund, but the conditions and tax rates vary across states.[39] Nevertheless, there is one tendency shared by all states: since the 2008 financial crisis, most states have decreased the maximum duration of entitled unemployment benefits and their payment extent,[40] though this duration was partly released during the COVID-19 economic crisis.[41] For example, in the U.S. the Families First Coronavirus Response Act (FFCRA) was enacted to alleviate the economic effects of the pandemic. It aimed, inter alia, at easing the "eligibility

33. *See* Steward Mach. Co. v. Davis, 301 U.S. 548, 574, 585, 598 (1937) (holding that the Social Security Act of 1935, which imposed a tax on employers to fund unemployment benefits, was constitutional and within Congress' power).

34. I.R.C. §§ 3301–3311.

35. 42 U.S.C. §§ 501–04, 1101–09, 1321–24; Jonathan Barry Forman, *The Income Tax Treatment of Social Welfare Benefits*, 26 U. MICH. J.L. REFORM 785, 792 (1993); Wayne Vorman et al., *A Comparative Analysis of Unemployment Insurance Financing Methods*, URBAN INST. 1, 216 (Dec. 2017), https://www.dol.gov/sites/dolgov/files/OASP/legacy/files/A-Comparative-Analysis-of-Unemployment-Insurance-Financing-Methods-Final-Report.pdf.

36. Edward W. Harris, *Payroll Tax, Federal*, *in* THE ENCYCLOPEDIA OF TAXATION & TAX POLICY 293, 294 (Joseph J. Cordes et al. eds., 2005). *But see supra* note 28 (extending the entitlement to unemployment compensation through COVID-19 crisis).

37. *Id*. at 294.

38. SAUL J. BLAUSTEIN ET AL., UNEMPLOYMENT INSURANCE IN THE UNITED STATES: THE FIRST HALF CENTURY 88 (1993).

39. *See* 42 U.S.C. § 1104(a).

40. KATELIN P. ISAACS, CONG. RSCH. SERV., R41859, UNEMPLOYMENT INSURANCE: CONSEQUENCES OF CHANGES IN STATE UNEMPLOYMENT COMPENSATION LAWS 7 (2019), https://fas.org/sgp/crs/misc/R41859.pdf.

41. *See Unemployment Insurance Extended Benefits*, U.S. DEP'T OF LAB. (Nov. 1, 2019) https://oui.doleta.gov/unemploy/extenben.asp (explaining that unemployment insurance extends benefits that are granted "during periods of high unemployment"); *see also Unemployment Rates, OECD—Updated: May 2020*, ORG. FOR ECON. CO-OPERATION AND DEV., https://www.oecd.org/sdd/labour-stats/unemployment-rates-oecd-update-may-2020.htm (last visited Oct. 24, 2020).

requirements and access to unemployment compensation for claimants, including waiving work search requirements and the waiting week".[42] Today, unemployment benefits are taxed in the United States as ordinary income, similar to most OECD member states.[43] Nevertheless, until the 1980s, unemployment benefits were not necessarily taxed.[44] In the next Part, I will discuss the main rationales for and against taxing unemployment benefits.

IV. ANALYSIS

A. Taxation of Unemployment Benefits—Pros and Cons

Before diving into our research question, I will briefly discuss the pros and cons of taxing unemployment benefits. It seems that the main argument for taxing unemployment benefits is to induce people to work.[45] Unemployment benefits may deter the unemployed from looking for a job, because they are compensated for their lost salary income. Some empirical studies support this claim, showing that unemployment benefits prolong the unemployment period.[46] This is a moral hazard problem, causing the unemployed to change their behavior to avoid returning to the workforce because of the benefits.[47]

This argument was officially raised in the U.S. when a proposal to reform tax unemployment benefits was introduced. In 1977, the Blueprints for the Basic Tax Reform stated that "by taxing earnings and unemployment benefits alike, this treatment would reduce the disincentive to seek alternative or interim employment during the period of eligibility for unemployment benefits."[48] Therefore, taxing unemployment benefits similarly to salaries (especially when unemployment benefits are usually lower[49]) would induce the unemployed to rejoin the workforce. Note that even if this argument is true, it is doubtful

42. The Families First Coronavirus Response Act (FFCRA), Pub. L. No. 116-127, 134 Stat. 193 (2020).

43. I.R.C. § 85. For the taxation of unemployment benefits in OECD state members, see*, e.g.*, ROBERT J. FLANGAN, UNEMPLOYMENT AS A HIRING PROBLEM, 124, 127 (1989), *available at* https://www.oecd.org/economy/growth/35260989.pdf.

44. *See, e.g.*, David Weiner, *Social Security Benefits, Federal Taxation of*, *in* THE ENCYCLOPEDIA OF TAXATION & TAX POLICY 362, 362 (Joseph J. Cordes et al. eds., 2005).

45. *See* Wai-lam, *supra* note 11, at 4 (stating that "the best way to assist individuals who are retrenched or unemployed is to help them seek reemployment instead of handing out financial support such as unemployment benefits" and, additionally, that this rationale also supports not adopting an unemployment benefit program).

46. *See* Gary Solon, *Work Incentive Effects of Taxing Unemployment Benefits*, 53 ECONOMETRICA 295, 305 (1985) (examining the tax treatment of unemployment benefits on taxpayers with high income); Martin Feldstein, *Unemployment Compensation: Adverse Incentives and Distributional Anomalies*, 27 NAT'L TAX J. 231, 243 (1974).

47. *See, e.g.*, A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 56–57 (2d ed. 1989) (discussing the problem of moral hazard).

48. *Blueprints for Basic Tax Reform*, U.S. DEP'T OF TREAS. 61 (Jan. 17, 1977), https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Blueprints-1977.pdf.

49. *See* Isaacs, *supra* note 40, at 4, 7–12.

whether reimbursing the tax payments, would induce the chronically unemployed (as opposed to "regularly" unemployed) to stay jobless, given that those payments are usually negligible since they derived from the former salary and the tax is applied on a much lower amount.

The second argument in favor of taxing unemployment benefits, also raised in the blueprint, relates to equity. Some argue that taxation "conforms with the basic equity principle of subjecting all income to the same tax. Employed individuals would not be subject to a differentially higher tax than those of equal income who derive their income from unemployment benefits."[50] If we tax an employed person and do not tax an unemployed individual who receives unemployment benefits, where both individuals have the same ability to pay, we undermine the equity principle.[51] Thus, in order to comply with the equity principle, which is a key taxation principle, the law should tax all kinds of income similarly, no matter its source—whether salaries or unemployment compensation.

One argument against taxing unemployment benefits is social. Taxation is aimed not just at collecting tax, but also at promoting distributive justice.[52] In a well-organized society, it is the state's duty to assist the unemployed primarily when the unemployment is involuntary, and one can say that the state fails to integrate the unemployed in the labor market. This assistance should be reinforced in global economic crises with high unemployment. Indeed, during the 1930s and 40s, unemployment and many other social benefits were not taxed in the United States. This practice was not specified in law, but in IRS administrative rulings, which stated that those payments were similar to a state gift and therefore tax exempt.[53]

Although exempting unemployment benefits may be seen as inequitable tax treatment (as discussed above), if we adopt John Rawls' difference principle, there are some instances where we may overrule equity to assist the least advantaged.[54] Behind Rawls' veil of ignorance, each individual cannot be sure if he will be employed or unemployed.[55] Because exempting unemployment benefits is open to each involuntary unemployed, and as current workers have no guarantee that they would always be employed, treating unemployment

50. *Blueprints for Basic Tax Reform*, *supra* note 48, at 61.

51. *See, e.g.*, Emil M. Sunley, Jr., *Employee Benefits and Transfer Payments*, *in* COMPREHENSIVE INCOME TAXATION 75 (Joseph A. Pechman ed., 1977).

52. Richard A. Musgrave, *Perspectives on and Limits to Public Finance for the Financing of Social Policy in Market Economies*, *in* PUB. FIN. AND SOC. POL'Y 261, 261–62, (Guy Terny & A. J. Culyer eds., 1985).

53. Frank J. Sammartino & Richard A. Kasten, *The Distributional Consequences of Taxing Social Security Benefits: Current Law and Alternative Schemes*, 8 J. POST KEYNESIAN ECON. 28, 29–30 (1985), https://www.jstor.org/stable/4537928?seq=1#metadata_info_tab_contents.

54. JOHN RAWLS, JUSTICE AS FAIRNESS: A RESTATEMENT § 22.2 (Erin Kelly ed., 2001).

55. *Id.* §6.

benefits differently is not improper. Thus, tax law as a distributive mechanism can help the (regular and chronic) unemployed.

Given that most developed countries implement unemployment benefits and tax them, this Article adopts the current law and the "mainstream" argument that unemployment benefits should be taxed, even during economic crises such as the COVID-19 pandemic. It further adds a distinction that has not been made by the law, between regularly and chronically unemployed.

B. The Lifecycle Argument

Equity is one of the four tax canons formulated by Adam Smith.[56] He stated that "[t]he subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."[57] Nevertheless, even if scholars agree that taxes should fulfill the equity principle, many questions arise. For example, what is a better measurement for equity—income or consumption?[58] And when should we impose taxes? This Article focuses on the second question.

Suppose we adopt the ability-to-pay principle as a good measurement of equity. In that case, one can claim that a short period is not enough to evaluate taxpayers' ability to pay when they become chronically unemployed, as in the current global crisis. Following this argument, only a longer period—such as individuals' lifecycle—can serve for a proper estimation.

Lifecycle theory examines taxpayers' ability to pay over their lifetime, as opposed to an arbitrary (albeit straightforward) assessment of income over a one-year period. Lifecycle theory was developed by economists in the early twentieth century.[59] In general, it considers the use of income and consumption over the course of individuals' lives. It can be roughly divided into two hypotheses: the permanent income hypothesis and the lifecycle model.[60] Developed by Milton Friedman, the former examines rational individuals who consume products and services in consideration of their expected rather than current income.[61] The lifecycle model was conceived by Modigliani and

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56. 5 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATION 639 (S. M. Soares ed., 2007) (e-book), http://www.ibiblio.org/ml/libri/s/SmithA_WealthNations_p.pdf.

57. *Id.*

58. *Compare* William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113, 1113 (1974) (supporting tax consumption), *with* Alvin C. Warren, Jr., Comment, *Fairness and a Consumption-Type or Cash Flow Personal Income Tax*, 88 HARV. L. REV. 931, 931 (1975) (supporting income tax).

59. *See* Lee Anne Fennell & Kirk J. Stark, *Taxation Over Time*, 59 TAX L. REV. 1, 6 (2005).

60. *See id.* at 6–7.

61. *See* MILTON FRIEDMAN, A THEORY OF THE CONSUMPTION FUNCTION 20–37 (1957).

Brumberg[62] and later developed by Ando and Modigliani.[63] This model focuses on individuals' expected decisions of spending and saving over a lifetime. These two hypotheses share the fact that they take into consideration the lifetime sequence for economic decisions.

Naturally, those hypotheses are highly abstract and face theoretical and empirical criticisms, as well as counter-theories.[64] For example, *real* individuals are not aware of their "permanent income;"[65] *real* individuals also suffer from cognitive biases,[66] and face difficulties moving money within periods.[67] Due to the underlying difficulties of the lifecycle theory, scholars from various disciplines, including both economists and lawyers, have been referring to the lifecycle model mainly as an applicable yardstick.[68]

Because lifecycle theory cannot be easily implemented, tax laws adopt the taxable year as the relevant period for measuring taxpayers' ability to pay. Income tax liability is calculated in the United States, Canada, and many other jurisdictions on the basis of a "taxable year,"[69] usually twelve months.[70] Tax returns are also filed annually.[71] In some rare circumstances, a taxable year may be shorter than twelve months, such as when a business is closed during part of

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62. *See generally, e.g.*, Franco Modigliani & Richard Brumberg, *Utility Analysis and the Consumption Function: An Interpretation of Cross-Section Data*, *in* 6 THE COLLECTED PAPERS OF FRANCO MODIGLIANI 3–45 (2005).

63. ALAN J. AUERBACH & LAURENCE J. KOTLIKOFF, DYNAMIC FISCAL POLICY 10 (1987).

64. *See* Fennell & Stark, *supra* note 59, at 16–18 (reviewing studies showing little support for the lifecycle hypotheses, and emphasizing the direct relationship between consumption and income within time).

65. *Id.* at 9.

66. *See id.* at 11, 13–16 (discussing the behavioral life-cycle model); *see generally* Hersh M. Shefrin & Richard H. Thaler, *The Behavioral Life-Cycle Hypothesis*, 26 ECON. INQUIRY 609 (1988) (discussing "behavioral features" that should be included in economic analysis to "enrich" the life-cycle model).

67. *See* Fennell & Stark, *supra* note 59, at 11–12.

68. *See, e.g.*, Andrés Erosa & Martin Gervais, *Optimal Taxation in Life-Cycle Economies*, 105 J. ECON. THEORY 338, 338–39 (2002) (concluding that the optimal tax scheme would be taxing consumption—which indirectly taxes leisure—and labor income at different tax rates over a taxpayers' lifecycle); Daniel V. Gordon & Jean-François Wen, *Tax Penalties on Fluctuating Incomes: Estimates from Longitudinal Data*, 25 INT'L TAX PUB. FIN. 430, 454–55 (2018) (concluding that the optimal tax scheme would be taxing consumption—which indirectly taxes leisure—and labor income at different tax rates over taxpayers' lifecycle).

69. *See* I.R.C. § 441(a) (stating "[t]axable income shall be computed on the basis of the taxpayer's taxable year"); Income Tax Act, R.S.C., 1985, c. 1, s. (2)(1) (5th supp.) (stating that in Canada, the tax year is also calculated annually).

70. *Glossary of Tax Terms*, ORG. FOR ECON. CO-OPERATION AND DEV., http://www.oecd.org/ctp/glossaryoftaxterms.htm, (last visited May 16, 2021) (defining "taxable year" as "[t]he period (usually 12 months) during which the tax liability of an individual or entity is calculated").

71. I.R.C. § 6072(a) (stating that in the case of a calendar year, a tax return should be filed not later than April 15).

the year.[72] Finally, a taxable year can be either a calendar or a fiscal year—both of which consist of a twelve month period but commence and end on different dates.[73]

Notwithstanding the criticism of measuring income on a lifetime basis, measuring tax liability annually is merely a matter of convenience. It makes tax calculation simpler, but sometimes even the law itself deviates from the annual calculation.[74] This Article asserts that, in some cases, we should abandon the taxable year and measure individuals' ability to pay over a longer period (somewhat in line with lifecycle theory). Basing individuals' ability to pay on a period longer than a taxable year better reflects their financial security and aligns with tax rationales.

Similarly, in the case of long-term unemployment, tax law should consider a period longer than one year to measure the low income of the unemployed. Let us consider an individual who worked for six months in 2020, became unemployed, and was then entitled to six months' unemployment benefits. This individual would be subject to tax liability in 2020 for both his salary and unemployment compensation. However, if this individual remained jobless for at least one year in 2021 and afterwards—due to, for example, the global pandemic—his tax liability in that year would be null (assuming no other income). If on the other hand, he only lost his job at the beginning of 2021, it is plausible to assume that his total tax liability would be very low, because it would be spread over a period of twelve months. This example illustrates that calculating the tax liability of a chronically unemployed individual can be subject to extreme variation to the point of being arbitrary.

In the short term, unemployment benefits are seen as a substitute for work, but their true nature—which impacts equity—can be revealed only after a longer period of examining whether the unemployed got back to work. The chronically unemployed cannot be treated similarly to the "regularly" unemployed who eventually rejoin the workforce. Tax law should take this economic nadir of the chronically unemployed into consideration. Assessing this individual's ability to pay over a period of one year can be erroneous. Because chronic unemployment is a continuation of the "regular" unemployment period, tax law should assess tax liability over the full period of unemployment rather than over a random annual period.

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72. I.R.C. § 443(a)(2).

73. I.R.C. § 441(b) (stating that "[f]or purposes of this subtitle, the term 'taxable year' means—(1) the taxpayer's annual accounting period, if it is a calendar year or a fiscal year; (2) the calendar year, if subsection (g) applies"); *id.* § 441(d) (stating that "calendar year" is "a period of 12 months ending on December 31"); *id.* § 441(e) (stating that "fiscal year" is "a period of 12 months ending on the last day of any month other than December").

74. I.R.C. § 1341; *see* I.R.C. § 1212(a)(1)(A)–(B) (explaining carryover and carryback of capital losses).

C. The Two-Tier Reciprocity Principle

Before this analysis continues, discussing the lifecycle argument and our research question, we must distinguish between the three taxation periods relevant to our discussion: employment, regular unemployment, and chronic unemployment. Keeping these three periods in mind, the question becomes: should we tax unemployment benefits given to an unemployed person who became chronically unemployed? And if yes, how?

In order to assess the proper taxation of the chronically unemployed, this Article adopts the *reciprocity principle*, proposing three taxation periods that reflect reciprocal relationships between a taxpayer and society and examining the reciprocity between two adjacent relationships. The principle of reciprocity applies between society and the taxpayer during the employment and the regular unemployment periods, and should continue to apply during the regular and chronic unemployment periods. As mentioned previously, tax payment during the employment period serves as unemployment insurance. Classifying unemployment benefits for tax purposes is not self-evident and should not be seen as a regular income in an isolated period. Unemployment benefits should be understood on the basis of the reciprocity principle and three tax periods as discussed in this Article.

It is claimed in this Article that adopting a tax mechanism that alleviates the tax burden on the unemployed during long-term unemployment promotes the reciprocity principle,[75] which is a basic concept in ethics theories[76] (and simultaneously reflects equitable taxation according to the ability-to-pay principle). Each reciprocity theory looks for a different common ground to justify individuals' cooperation.[77] One option is to justify reciprocity on the basis of the social contract.[78] Rawls, for example, believed in the social contract as a justification for the state, and thus its citizens had a duty to comply with the law.[79] An organized society that espouses principles of justice is the key element for the social contract. As previously stated, this Article adopts the reciprocity

75. *See* Alvin W. Gouldner, *The Norm of Reciprocity: A Preliminary Statement*, 25 AM. SOC. REV. 161, 171–76 (1960) (discussing the universality of the reciprocity principle).

76. Rawls' moral philosophy is based, in part, on the reciprocity principle. [Rawls, *supra* note 54, §18.3. Note that some scholars claim that a reciprocity principle requiring an exchange of value cannot serve as a baseline in moral theories, since, for example, disabled persons cannot be productive. *See, e.g.*, Allen Buchanan, *Justice as Reciprocity Versus Subject-Centered Justice*, 19 PHIL. & PUB. AFFS. 227, 230–31 (1990); Andrew Lister, *Justice as Fairness and Reciprocity*, 1 ANALYSE & KRITIK 93, 93–94 (2011).

77. *See* Lawrence C. Becker, *Reciprocity, Justice, and Disability*, 116 ETHICS 9, 18–19 (2005).

78. The Social Contract is also part of Hobbes', Locke's, and Rousseau's moral philosophies. *See* THOMAS HOBBES, LEVIATHAN 67–68 (George Routledge and Sons 2d ed. 1886); JOHN LOCK, THE SECOND TREATISE OF GOVERNMENT 51–53 (Richard Cox ed., 1982); JEAN-JACQUES ROUSSEAU, THE SOCIAL CONTRACT AND THE FIRST AND SECOND DISCOURSES 163–64 (Susan Dunn ed., 2002).

79. *See generally,* JOHN RAWLS, A THEORY OF JUSTICE (1999).

principle mainly from Rawls' perspective, given his concern with the growing problem of global inequity and the presence of the least advantaged in society[80]—in our case, the chronically unemployed.

The premise of this Article is that reciprocity should be grounded in law and not merely social norms. A legal form of reciprocity grants individuals rights, but also imposes duties. As discussed earlier, the reciprocity principle is a key feature in the social contract theory, and each individual carries rights and duties in a cooperative society.[81] In a well-organized society, individuals have explicitly or implicitly consented to give up some rights in exchange for others in order to live in an organized society that can protect their rights. Individuals are aware that their cooperation has two facets—losses and gains—with the latter outweighing the former. For example, an individual must pay taxes, and surrender some of his property; but, in exchange, he receives a well-organized society and enjoys public goods and services.

To live in an organized state, members of society are willing to abandon some rights in order to be secure (and to secure their rights). This tradeoff is enabled by the enlightenment-era social contract that Rawls revived in the twentieth century. Rawls believed that the most reasonable principles of justice are those based on mutual consent—on a social contract.[82] These principles recognize the basic rights of freedom and equality and strive to minimize the gap for the sake of the poorest in society. According to Rawls, the basic premise of justice as fairness is the idea that society is a set of rules ensuring fair, long-lasting cooperation for generations.[83] This premise rests on two related ideas: that individuals are free and equal, and the well-ordered society.[84] With these ideas, is his argument that the difference principle,[85] as a distributive one, is part of the reciprocity principle?[86] Accordingly, better-off individuals would not continue to increase their wealth unless it also advances the least advantaged in society or at least does not harm their position.

80. RAWLS, *supra* note 54, at § 13.1; JOHN RAWLS, A THEORY OF JUSTICE 83–86 (1999). While Rawls does not provide an exact definition of the least advantaged, some scholars argue that the situation of the least advantaged is not to be measured by purely economic but also by social parameters. *See, e.g.*, M. W. Jackson, *The Least Advantaged Class in Rawls's Theory*, 12 CAN. J. POL. SCI. 727, 728 (1979); Roy C. Weatherford, *Defining the Least Advantaged*, 33 PHIL. Q. 63, 67 (1983).

81. *See* Gouldner, *supra* note 75, at 168 (contrasting reciprocity with the concept of complementarity, where the right of one individual is the duty of the other).

82. RAWLS, *supra* note 54, at §6.3.

83. *Id.* § 2.2.

84. *Id.* §§ 2.1, 3.1, 7.

85. *See id.* §§ 13.1, 18.1 (explaining that the difference principle is part of the second principle of justice, and stating "[s]ocial and economic inequalities are to satisfy two conditions: first, they are to be attached to offices and positions open to all under conditions of fair equality of opportunity; and second, they are to be to the greatest benefit of the least-advantaged members of society").

86. *See id.* §18.3 (explaining that "the difference principle is essentially a principle of reciprocity").

The reciprocity principle is also applicable when examining individuals' duties, such as tax payments, and the rights of the unemployed (and specifically the chronically unemployed who are parallel to Rawls' least advantaged). On the one hand, the unemployed were productive during their working period and contributed to the state; and now, when unemployed, the state helps them. Tax payment, in general, is an example of reciprocity[87]—individuals ought to pay taxes in order to live in a well-organized society, where taxes are used to finance public goods and services for the benefit of the society, even if taxes are unrequited.[88] As elaborated below, taxation of the chronically unemployed does not fully comply with the reciprocity principle. In general, an employee must regularly pay his taxes during his employment period (Period I). These payments are necessary to live in a well-organized society and are partly aimed at ensuring his unemployed benefits in case he becomes unemployed, as discussed in Part III. The worker's duty to pay taxes is weighed against his future right to receive financial assistance from the state once he becomes unemployed, and the current right of other individuals in society if they are considered chronically unemployed.

The reciprocity between the individual and the state continues to exist also during his regular unemployment (Period II). During this period, he is entitled to unemployment benefits. The taxes paid during Period I are returned to the unemployed in the form of insurance benefits, which are in turn taxed because they are linked to his employment period and contribute to his wealth during unemployment. At this stage, the unemployed individual receives support from the state, and, in exchange, he continues paying taxes on the insurance benefits. This is the case in many developed countries, as described in Part II. Thus, the tax payments during Period I are used to finance the insurance benefits of the unemployed during Period II and constitute the first reciprocity phase, as defined throughout this Article.

The above discussion emphasizes that the reciprocity principle is already indirectly assimilated into the tax discourse. This Article suggests extending the principle over different periods in an individual's lifecycle in order to conform with the equity principle. To do so, we must differentiate between "regular" and chronic unemployment. Thus, the situation changes in Period III, when the individual is no longer regularly, but rather chronically, unemployed. Recall that the chronically unemployed are unemployed individuals who seek work but

87. *See, e.g.*, Becker, *supra* note 77, at 22 (stating reciprocity does not require an equivalent value).

88. *See* ORG. FOR ECON. CO-OPERATION AND DEV., *Glossary of Statistical Terms, Taxes*, SNA 7.48 [8.43] (Nov. 18, 2001), http://stats.oecd.org/glossary/detail.asp?ID=2657 (defining taxes as "compulsory, unrequited payments, in cash or in kind, made by institutional units to government units; they are described as *unrequited* because the government provides nothing in return to the individual unit making the payment, although governments may use the funds raised in taxes to provide goods or services to other units, either individually or collectively, or to the community as a whole") (emphasis added).

cannot find a job after exhausting their rights to unemployment insurance.[89] As seen before, many unemployed became chronically so due to the global economic crisis that accompanied the COVID-19 pandemic. Because the period of entitlement for unemployment benefits varies across countries, each state should set its own time for commencing Period III, while taking economic considerations into account.[90] Whether this period starts after six or twelve months of unemployment, using Rawls' terminology this group is considered the least advantaged in society because, at this stage, they cannot financially contribute to society.

Cooperation between the state and the individual at this stage is necessary because their relationship is productive at its origin. Before, during Period I, the individual was a productive worker who contributed to the state by paying taxes (among other things), and, in Period III, he continues to be unemployed, involuntarily. One can even say that the state has failed to help him rejoin the working force and now has the duty to secure him. The premise of this claim is that the unemployment is not voluntary; otherwise, this would cease to be a reciprocal relationship and become an exploitative use of social resources.[91] When unemployment is chronic, the state has failed in its duty to support individuals in critical times and help them find a proper job. In order to preserve the reciprocity principle, the state should therefore restitute the tax collected from the unemployed during Period II. The reciprocity at this stage strengthens redistribution, but this move—this aspect of reciprocity—is absent from current law.

The reciprocity principle is based on redistribution rationales, but it is supported by the lifecycle theory discussed above.[92] Unemployment benefits are taxed because they are considered a substitute for wages and their taxation supports the equity principle. The principle of reciprocity is reinforced by the lifecycle theory and their combination leads to the state's duty to restitute the tax collected from unemployment benefits. This give-and-take relationship between an individual and the state should not be simultaneous but subsequent—in other words, the activity in Period I projects on Period II, and the latter projects on Period III, creating two phases. The first phase refers to the reciprocity between the first two periods, and the second phase to the reciprocity between the last two.

Naturally, the duration and even occurrence of these periods vary individually. Some individuals never face unemployment at all, whereas others face both regular and chronic unemployment. Therefore, basing the taxation of unemployment benefits on the technical dichotomy of employed-vs.-unemployed, detached from the individual's real life—and from his actual

89. *See* Burtless, *supra* note 8.
90. *See supra* notes 7–10 and accompanying text.
91. *See, e.g.*, Gouldner, *supra* note 75, at 166–67.
92. *See supra* Part IV.B.

economic situation—undermines the reciprocity principle and the core principle of good taxation: equity. The unemployment benefits given to the unemployed are not given out of context. They are paid in Period II as a compensation for working during Period I. State support stops when the unemployed go back to work. In this case, the relevant period is again Period I, which may last for a long time and is not a fixed interval.

The state should continue supporting the unemployed individuals, from a tax perspective, if it has failed to integrate them in the working force, which brings us to Period III. If we had known the duration of Period II and III in advance, it is plausible to assume that we would not have taxed those individuals because the unemployment compensation should have served throughout this time and averaging this income over a long period probably would not reach tax liability. Because we cannot predict the future of the unemployed during Period II, however, the state should—and does—continue taxing unemployment benefits during Period II, but reimburses them during Period III if the unemployed individual becomes chronically so. The individual's real ability to pay can be gauged only by combining Periods II and III. To do so we must disregard the calendar year because it is a technical standard and chronic unemployment may be shorter, but usually longer, than one calendar year.

To conclude, tax law should differentiate between "regular" unemployment and chronic unemployment. Taxing chronic unemployment cannot be done over one calendar year, regardless of prior income and taxation.

D. Recommendations for the Proper Taxation of Chronically Unemployed

Based on the above analysis linking the reciprocity principle with lifecycle theory, we would like to recommend the proper taxation of the chronically unemployed. To do so, unemployment cannot be treated as a single period, but must be reconsidered using the three possible periods in a taxpayer's life. The main problem arises when an unemployed individual becomes chronically unemployed. This Article follows the current law and the mainstream claim that unemployment benefits should be taxed in order to achieve equity. A failure to tax these benefits would result in discrimination against working people with the same income as the unemployed, who are subject to taxation.[93] However, a critical problem regarding chronic unemployment is that during their regular unemployment period (Period II), it is impossible to know if unemployed individuals will become chronically unemployed. Since no one, including the individual himself, knows in advance if the unemployed taxpayer becomes chronically so, the proposal is not ex ante but ex post. Therefore, this Article's recommendation refers to the second reciprocity phase, after the taxation of the benefits paid to the regularly unemployed.

Note that this proposal is limited to answering the question of how unemployment benefits should be taxed when an unemployed taxpayer becomes

93. *See supra* Part IV.A.

chronically so. Therefore, this approach follows the common law in continuing to tax unemployed benefits but diverges from current practices by proposing to accumulate the unemployed benefit taxes in a special state fund, which should be gradually reimbursed to the chronically unemployed.[94] The fund should pay interest on all accumulations and compensate beneficiaries on a monthly rather than annual basis in order to serve as a substitute for a steady income. The amount of reimbursement depends on several factors, such as the duration of the unemployment and the extent of unemployment benefits. Every month, it should average the total income of the unemployed during a period of the last twelve months.[95] Therefore, theoretically, the reimbursed amount can change every month. As long as the chronic unemployment starts at an early stage, and as long as the unemployment benefits are higher, the reimbursement will be paid out more gradually and spread over a longer period. In some cases, the reimbursement can also be a single payment, at an amount considered as gross income and included in the individual's annual tax calculation. The reimbursement should conclude whenever the chronically unemployed individual starts working, and the amount that is left in the special state fund should be transferred to the treasury after a predetermined period.[96]

Officially, the fund belongs to the unemployed: if the unemployed individual becomes chronically unemployed, he may gradually receive the aforesaid payments out of the fund. However, the treasury receives the remainder of the fund once the chronically unemployed individual returns to work. Although officially the funds belong to the unemployed during the second stage of reciprocity, *pecunia non olet*.[97] Thus, the state can use those funds and we analogize the state here to a financial institution. If necessary, the state can use the unemployed funds for its purposes, similar to a bank using customer's accounts according to certain reserve requirements. The difference, however, lies in the fact that the state is the sole owner of the money left in the funds after the chronically unemployed rejoin the labor market. This may also induce the state to assist chronically unemployed individuals to return to work. Using the fund as a channel to balance the payments to and from tax authorities may seemingly complicate a tax system that usually depends on an annual base tax

94. It should be noted that if the unemployed person is unemployed for a very long period, and all the funds were refunded to him, tax law no longer has a role in assisting this person and the state should use other social programs to assist him. *See* discussion *supra* Part I.

95. *See, e.g.*, William Vickrey, *Averaging of Income for Income-Tax Purposes*, 47 J. POL. ECON. 379, 379 (1939); *see generally* Lily L. Batchelder, *Taxing the Poor: Income Averaging Reconsidered*, 40 HARV. J. ON LEGIS. 395 (2003).

96. The period in which the fund's money is be transferred to the treasury should be based on statistical data. If empirical data show that chronically unemployed tend to keep their new job for a long period, the fund can be automatically transferred to the state and vice versa. In addition, we may think of a different alternative: using this amount as an additional incentive for the unemployed for rejoining the labor market and holding a stabile position. This latter alternative requires further empirical research and is beyond the scope of the tax discourse.

97. In Latin, "money does not smell."

calculation. Nevertheless, in a world with digital payments and electronic correspondence between tax authorities, the additional fund can be easily implemented.

Since this Article limits itself to taxation and proposes to continue taxing the unemployment benefits as under the current law, it suggests accumulating unemployment benefit taxes in a special fund and reimbursing them ex post in cases where the unemployed move to Period III and become chronically unemployed.

V. Conclusion

In our rapidly changing world, with the digital economy and global crises, unemployment—and particularly long-term unemployment—is still a macroeconomic problem. This Article examines the proper policy of taxing long-term unemployment, which has become more acute in light of the coronavirus pandemic. This Article argues that tax systems should take into consideration whether the unemployed reenter the labor market or not. It focuses on security benefits paid out of unemployment insurance programs to unemployed who become chronically so. Because unemployment insurance programs are well rooted in many developed countries, our recommendations are practically relevant to all of those jurisdictions.

In order to assess the proper taxation of the chronically unemployed, this Article adopts the reciprocity principle, reinforced by lifecycle theory, which examines taxpayers' ability to pay over a longer period, as opposed to an arbitrary assessment of income over a one-year period. In cases of continuous unemployment, a proper tax should estimate the income liability of the unemployed over a more reciprocal-representative period and not over one calendar tax year.

The Article further proposes three taxation periods reflecting reciprocal relationships between a taxpayer and society—employment, regular unemployment, and chronic unemployment—and then examines the reciprocity between two adjacent periods. It focuses on the second reciprocity period, where the unemployed become chronically so, and provides an ex-post mechanism to implement the principle of reciprocity even in this period.

Unemployment benefits are provided as a substitute for wages and coincide with the principle of reciprocity. The true nature of unemployment benefits, however, can only be observed over time and not in advance. If the unemployed cannot get a job for a long period (e.g. during a recession), and may be considered chronically unemployed, it is doubtful whether unemployment benefits continue to be equivalent to salaries. In that case, such benefits may be considered more as unemployment assistance or work disablement, and it would be incorrect to randomly tax such income in each tax year separately.

The Article supports the general taxation of unemployment benefits of "regularly" unemployed individuals; however, equity is compromised when tax law does not differentiate between unemployment benefits received by regularly and by chronically unemployed. Note that this Article limits itself to the proper taxation of the chronically unemployed following the framework of the current law. It does not seek to reform social benefits for the chronically unemployed, nor does it claim that tax law is the best method to address chronic unemployment. Realistically, more effective mechanisms outside the scope of taxation are available. However, the current law of taxing the chronically unemployed is incompatible with the equity principle and requires some amendments.

Therefore, the Article's proposal is limited to answering the question of how unemployment benefits should be taxed when an unemployed taxpayer becomes chronically so. Therefore, it proposes accumulating the unemployed benefit taxes in a special state fund, which should be gradually reimbursed to the chronically unemployed. In a digital economy, this fund could easily be implemented, and this alternative mechanism introduces social considerations of assisting the least advantaged—in our case, the chronically unemployed—into mainstream tax discourse.