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LEGAL TRANSPLANTS IN TAXATION: BENEFITS AND HANDICAPS

Abstract

The ideological background of legal transplant dates more than five decades ago, when the developed countries insisted on transplanting legal solutions, remedies and legal acts in other countries, with the support of the legal theory. Transplant effectc were surprisingly various, from warm embracement to cold rejection, due to surrounding political and legal environment. In the taxation, the transplants are more likely to be seen in the western developed economies, and later adopted by numerous countries, based on needs for improving the legal systems or aiming for solid tax ideas. Main question in this paper is to which extent the tax transplants are functional and sustainable in the incomparable tax systems, and furthermore, is it possible that a single tax type like the Value Added Tax or the Personnel Tax could be treated as tax transplant and copied in a country with unappropriated tax system. The question is correlated with other queries due to the various legal and economic environments of the countries.

Key words: law, legal transplants, tax law, value added tax, income taxation.

I. INTRODUCTION

When we talk about transplants, the very first thing that crosses our minds is the medical transplantation as a synonym for the highest human generosity The term legal transplant has roots in the comparative law and in the comparative tax law, accordingly. Despite the well-known quote of Montesquieu in "The Spirit of the Laws", who argued that: "[Laws] should be so specific to the people for whom they are made, that it is a great coincidence if those of one nation can suit another", it seems that legal norms frequently travel across both time and space.

Regarding the question, "Where should the legislator turn for the new law?", some reasonable answers would seem to be: "Look at what they do in country X, repeal your own laws and follow their example", "What do other countries do in other places?", "If country X could achieve this by legislation, therefore so can we", or "why not look abroad for some ideas to use at home?" (Watson, 1976).

There are few alternatives how countries learn to tax. Firstly, the legislator could try and invent a solution by comparing the potential solutions with the current situation. Secondly, in the process

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of tax reform, the country can use "internal comparison" to create an idea to solve the legal problem because the same sort of problem may have already been solved in a different branch of the law in the same legal system. Thirdly, the reformer can look at solutions adopted by the legal system in the past (historical comparison.). And last, but not least, lawmakers can try and learn how the problem has been solved in other jurisdictions and if they consider a foreign solution to be appropriate, they can borrow it for their own tax system.

There are few concepts in legal literature, that have enjoyed such a remarkable attention as the concept of "legal transplants" that is used to denote the phenomenon of borrowing legal rules and institutions from one legal system and transferring them into another. With its vivid descriptions taken from the world of anatomy and surgery, the metaphor "legal transplant" has been successful in conveying a wide-spread perception of law as quasi-organic matter, as well as the general idea about the complex and sensitive nature of any attempt to make laws and legal institutions that have evolved in one particular legal and institutional environment, work outside their natural "habitat".

Usually, we find the legal transplantation defined as "adoption into the national legal system by the "adopter" country, of a rule originating in a foreign state (the "originator" country)". In other words, legal transplantation is a process through which the adopter implements a rule formulated in and for the originator country.

The "legal transplants" theory was brought to the center of scholarly interest by the famous debate in the mid-1970s between Otto Kahn Freund and Alan Watson. Moreover, the term "Legal transplants", formulated by Alan Watson in his well-known book *Legal Transplants: An Approach to Comparative Law*, have become an important matter of research curiosity in the 1970s.

Legal transplants are not just embodiments of mostly malicious dependency, but also examples of reverence for well-developed legal solutions that are worthy of being introduced in another country. By using this functional approach, comparative tax research primarily looks at legal transplants and views domestic tax reforms as the result of the circulation of tax policy paradigms among countries. The 1990s are characterized by a new wave of engagement of foreign development aid agencies and international organizations in legal reform and transition. International economic organizations like the World Bank and the International Monetary Fund, but also national development aid agencies and private organizations, embarked on ambitious projects of legal assistance, with commercial, civil and criminal laws, and even constitutions being "exported" "en masse" from developed countries to transition economies. Given the urgency of the task of achieving political and economic reform, legal transplants and borrowings were seen as efficient way to reshape broad areas of tax law and legal regulation needed for the functioning of the market economy and for the establishment of rule of law and democratic institutions.

The purpose of this paper is to analyze why modern countries still look for legal solutions into the comparative tax law. Main query is to what extend the transplanted rule is suitable and also sustainable in the new legal environment and moreover, which are the factors that determinate the benefits and handicaps of the legal transplantation? In order to give a proper answer, the paper is divided into three chapters. In Chapter 1, authors discuss the literature review on the concept of legal transplants, the determinants for successful transplantation and the types of legal transplants. Chapter 2 focuses on the process of legal transplantation in the Macedonian tax system with the purpose of exhibiting the *pros* and *cons* of establishing "foreign" rules into the domestic legislation. The final remarks and recommendations follow.

II. LITERATURE REVIEW OF THE THEORETICAL BACKGROUND OF LEGAL TRANSPLANTS

Tax law appears to be united at a global level in terms of the choice of taxes (income, property, sales or consumption), the fundamental principles (fairness, efficiency and simplicity) and the levels of tax burden. Facing the same essential tax problems, countries tend to adopt similar laws to solve these problems, which results in convergence. The convergence of tax laws has reached such a stage that it is unthinkable for any country to adopt a new consumption tax that is vastly different from the VAT. Thus, in the area of VAT, there is a remarkable degree of similarity in over 100 countries. It is equally unthinkable for any country to create an income tax system for the first time that deviates from the accepted international norms. Convergence in tax policy amongst members of the European Union and the OECD is perhaps the most comprehensive. Some tax rules and norms are virtually universal; for example, the arm's length principle is found in virtually every bilateral tax treaties and the domestic law of most countries worldwide. Global tax issues, such as base erosion, profit shifting and aggressive tax planning, are expected to lead to further connection in tax laws governing the taxation of multinational corporations.

Tax science is capable of being borrowed and duplicated. Tax processes in a country are defined by its general political, legal and institutional culture, and thus vary from country to country. Many tax rules or principles are outcomes of tax processes in the country of origin and their implementation depends on a certain set of administrative processes. The transplantation of a tax rule or principle is likely to fail if it is done without the necessary processes, or at least, without a full appreciation and accommodation of the differences in processes (Li, 2015).

Practically, a tax transplant occurs when a tax structure or arrangement originating in one country is imported into one or more other countries through the implementation of statutes, administrative guidelines or case law, or some combination of the above, with the result that domestic tax reforms often are the result of tax transplants. Tax transplants can be introduced in the importing country through arrangements varying along a continuum, which goes from a "top-down pattern" to a ""bottom-up pattern". In a "*top-down pattern"* of tax design, a tax transplant is introduced by either legislation or administrative guidelines (possibly in conjunction with case law and/or opinions of scholars). In a "*bottom-up pattern"* of tax design, a tax transplant is introduced in a spontaneous way through case law, without recourse to legislation or regulations. However, "tax designers" should take into account the impact of basic transplant scenarios on the importing tax system, because the change of rules which occurs in a transplant impacts the tax system at all levels.

Some controversies have surrounded not only the empirical question of the actual existence and spread of legal transplants, but also the evaluative question of the success, as well as the normative question of the desirability and necessity of legal transplants. Skeptics like Pierre Legrand, from a culture perspective, have provocatively proclaimed "the impossibility of legal transplants", rejecting the possibility for displacement from one jurisdiction to another of anything else but "meaningless form of words". In this view any encouragement of legal transplants is "reducing law to rules and rules to bare propositional statements (Legrand, 1997). Gunther Teubner, a legal sociologist, considers the "legal transplant" metaphor to be misleading and advances "legal irritants" as an alternative concept. Building his own theory of law as an auto-poietic self-referential system, Teubner argues that when the rules once transferred in a different national context would hardly remain unaffected by the new environment. Notably,

they will not only interact with the host legal system, but will also trigger change in other loosely or tightly coupled societal sectors and production regimes, causing divergent and often unpredicted effects in the host legal and social environment (Teubner, 1998).

1. Reasons for Legal Transplantation: Why Do Countries "Borrow" the Tax Rules?

In most of the legal literature we detect trends to rely on vague explanations for the cause of the transplant, such as economic liberalization or the prestige of foreign laws. More empirical analysis are made by Berkowitz, Pistor and Richard (2003), who take into account several objective factors, such as: a legal culture from which a transplant is taken, legal heritage of a recipient, or general efficiency of a model, suggesting that transplantation is more likely between culturally, institutionally, or economically similar countries. On the other hand, Miller's analysis is much more subjective, focusing on motivation (2003).

The transplantation or reception of a foreign legal idea can occur for various reasons. Firstly, on an *involuntary* basis, mostly due to colonization. Secondly, on a *voluntary* basis, due to a great respect of the donee for the donors laws. Thirdly, as cause of unification of law, or because there is a harmonization on the topic to which the state has acceded, such as obligations of EU member states, international tax law conventions, etc. Fourthly, to solve a problem of a legal reform which was shared by the donor and the donee and which has been solved more successfully by the donor. Fifthly, transplantation or reception can occur because a foreign solution is seen to have functioned effectively in practice. Much modem legislation is a "process of trial and error", and one country can profit from the experience of other systems, even if one merely learns in this way how to avoid the mistakes that donor has made (Buijze, 2016).

2. Determinants of Successful Legal Transplantation

Predictions of economic efficiency of a certain model cannot be based only on another country's experience, as legal solutions that lack their foundations in a given society or given country's legal culture, prove to be less effective in a recipient country than in donor country. This thesis encouraged searching for explanations in the following two questions: 1) do legal transplants always work?, and 2) if sometimes they work and sometimes they do not, what is the factor that makes the difference between these two cases?. In fact, it would be possible to classify any existing legal system as a legal transplant (e.g. most of European legal systems share some major features of private law with Roman traditions), but the transplantation that happened in 19th or 20th century, taking into account that three legal families – English, German and French – were the ones that dominated implementation of entire codifications in other European countries. Another important factor that has to be taken into account is the fact that transplants can be classified as receptive or unreceptive transplants. The classification can be presented as a scale, on which more receptive transplants are characterized by two features: adaptation and familiarity.

Adaptation can be measured as a degree to which social idiosyncrasies of the receiving country were taken into account in the process of implementing foreign legal regulations. Thoughtful adaptation requires legislators not only to contemplate about the choice of model, but also about possible changes to some regulations or about introducing exemptions in order to represent the needs of a certain country. Familiarity is strictly connected with taking into account the legal heritage of a country. Of course, virtually all European legal systems can be traced back to ancient Roman law. As the entire world can be divided into very few big legal families, but it is a

matter of common knowledge that most of the modern solutions in different branches of law (commercial, business, criminal, constitutional) are borrowed from Western legal family, having its deepest roots in ancient Rome.

In cases when the reformer borrows a solution from abroad, he must be careful to discover whether and to what extent the solution needs to be adapted. Adaptation may be necessary due to differences between the donor and the donee - differences of a legal nature or of a historical, political, social, economic, cultural or environmental nature. The danger of foolish imitation would seem to necessitate scrutiny by the reformer of two factors: a) the legal, historical, political, social, economic, cultural, environmental context of the *proposed* rule within the *donee's* system; and b) the legal, historical, etc., context of the *existing* rule within the *donor's* system.

Many questions of great importance arise from the need for adaptation legal transplantation in local conditions. For example, when a foreign law could be transplanted; or how much adaptation is required to local conditions; how detailed must the reformer's scrutiny be of factor (a)? Of factor (b)? Other questions are, which elements in each of the factors are most important, the legal context or the historical context, or the political context, etc.

When making a statement it is very easy to get it wrong: "Error of law is probably more common in comparative law than in any other branch of legal study". Moreover in 1973, Otto Kahn-Freund proposed a context-sensitive approach to legal reform based on legal borrowings, making reference to the various groups of "environmental" criteria, which in Montesquieu's view determined the "spirit of the laws": geographical, sociological and economic, cultural, and political (Kahn- Freund, 1974). He emphasized the changing importance of different environmental criteria over time. Thus, the significance of geographical, but also in his view of economic and sociological factors was diminishing, in line with changes in technology, communications and ways of living, whereby even culture and religion were no longer insurmountable barriers for legal transfers. On the other hand, Kahn-Freund saw the importance of political and ideological factors to be increasing. Having his main research interests in the area of labor law and industrial relations, he underlined the importance of taking into account the socio-political context (constitutional and political order) in the "donor" and the "recipient" country, in particular in areas where pressure groups and political interests exert powerful influence.

In contrast, comparative legal historian Alan Watson insisted on the possibility of 'transplanting' law without knowing or even without caring about the context of the transplanted legal rules in the 'donor' country. This argument is likely appropriate in contemporary tax environments.

Depending on processes of change and adaptation of transplanted law statutes, the degree of voluntary choice, the familiarity with the country from which law is taken, migration processes etc, the transplants are divided into receptive and non-receptive. The important issue thus is not "from where law has been borrowed" but rather "in what way law has been developed and borrowed". The main claim of Berkowitz et al. is that "[t]he way in which a country received its formal laws is a much more important determinant of the current effectiveness of its institutions than the particular legal family it adopted". The experiences of countries, in which legal transplants proved to be economically and legally inefficient, authors labeled as "the Transplant Effect" - the lack of socio-legal order provided by regulations and of good prospects for socioeconomic growth within the framework of the transplanted provisions.

We can claim accordingly, that a well-prepared, thoughtful transplantation of less efficient legal solutions, done with respect for previous social conditions and legal heritage, as well as

supplemented with sufficient education of lawyers, other experts and citizens in general – will be actually more beneficial than naïve, blind promulgation of solutions based in a more efficient legal culture. The results lend strong support to the initial assumption that countries where law has developed internally as a response to local conditions or where the population has been familiar with the main legal principles of the transplanted law (due to emigration flows and long term colonization with massive presence by the colonizers) show higher level of legality.

3. Legal Transplants Typology

Although a comprehensive classification of legal transplants introduced in different parts of the world probably cannot be proposed, an interesting attempt to apply sociological tools for a useful typology was made by Jonathan M. Miller (2003). Examining motivations on which a given legal transplant is founded, he identifies four types of transplants, indicating that a vast majority of examples represent a blend of more than one type. According to Miller's typology, the most important types are: 1) the Cost-Saving Transplant; 2) the Externally-Dictated Transplant; 3) the Entrepreneurial Transplant, and 4) the Legitimacy Generating Transplant.

According the first ideal-type causal mechanisms of legal transplantation, emulation, a process that is sometimes referred to as "lesson-drawing", literature defines the cost-saving transplants. It suggests that legal transplantation occurs when lawmakers, confronted with a problem, look across national borders for effective and transferable solutions. In other words, the *Cost-Saving Transplant* is a type of regulation that is borrowed from another country's legal system primarily to avoid an expensive process of developing an original solution. This type of transplantation is usually connected with developing countries that rarely make up their own regulations, mostly due to the lack of financial resources. It is possible, however, to cast doubt on this assumption, as many national law regulations (such as environmental law, health and social insurance, child care etc.) are virtually no more than implementing acts of some previous supranational or international resolutions, which actually makes them similar to the other type of legal transplants, the Externally-Dictated ones. Additionally, not only saving money at the very moment of introducing legislation is important, but there are also possible future financial advantages for the national budget. We can surely assume that almost all transplants are Cost-Saving Transplants.

Externally-Dictated Transplant is probably the most common motivation for implementation of foreign legal regulations throughout the history. The common feature of Externally-Dictated Transplants is an actual relation of dependency between the donor and the recipient. Coercion, the second ideal-type mechanism, occurs when a state promotes its rules through the use of material power, whether military or economic. We distinguish between two types of coercive legal transplantation processes. Imperialistic transplantation, also called "direct imposition" (Dolowitz, et al, 2000), involves the imposition of foreign legal rules without the consent of the adopter country. The more common "indirect imposition" occurs when the mere threat of negative sanctions provides the incentive for countries to voluntarily transplant exogenous rules. One of the ideal-type mechanisms for legal transplantation is socialization, defined as a process directed toward the internalization of the principles, beliefs, and norms of a foreign community. This process of legal transplantation relies on the flexibility of idea may actively transfer through a wide variety of entrepreneurs, including NGO activists, university professors, business organizations and legal communities. The most powerful of those entrepreneurs can most successfully diffuse their ideas. As a result, there is the third type of transplantation, the *Entrepreneurial Transplant*. The theory about a class of transplants that appear due to effort of

individuals or groups (mostly NGOs, but also companies) to introduce and encourage some foreign regulations, was adapted by Miller from Yves M. Dezalay and Bryant Garth (Dezalay et al, 2002). These individuals or groups can be people from developing countries who obtained their degrees abroad and later came back to their homeland. They are perceived as experts and as such, they can therefore influence legal changes, in spite of the fact that they do not possess any formal power. Their incentive might be very different – from a very sincere conviction that some legal solutions adopted from abroad are necessary for better development of the country, to the less disinterested ones, such as creating a niche – a branch of law in which there will be very few educated lawyers at the time of its introduction. If this branch is entirely adopted from another country's legal system, in which the "entrepreneur" was educated, it gives him an edge over competitors.

The Legitimacy-Generating Transplant is a transplant from a developed country to a developing one, sometimes even one with rudimentary legal institutions. Obviously, there are times when the law imposed due to high respect for a certain jurisdiction will be of inherent value. But on the whole, the danger with great respect for certain jurisdictions is that it is usually excessive. Due to this excessive respect, solutions from that country may be adopted although they are not the best solutions available (known as Transplant Bias). Having in mind the regulatory competition, lawmakers adopt foreign rules, whether or not effective in addressing domestic issues, in order to better position their country in a competitive world (Radaelli, 2004). Regulatory competition usually presents itself in one of two opposing versions. The "race to the bottom" version assumes that lawmakers adopt the lowest regulatory standards of competing countries, such as minimal levels of labor and tax regulations, to avoid capital flight (Drezner, 2001). By contrast, the "race to the top" generally focuses on reputational, rather than economic, competition. Under this second version, countries seek the cutting edge of legal creativity in order to generate legitimacy or political rent, a trend especially prevalent in the areas of consumer rights and environmental protection.

III. TRANSPLANTATION OF LEGAL RULES IN THE MACEDONIAN TAX SYSTEM

In the case of Republic of North Macedonia, the process of legal transplantation has gone hand-by-hand with the tax reforms that have been undertaken since declaring country`s independence in 1993. As a result, almost every tax rule has been introduced as a legal transplant due to different factors depending whether it is about indirect or direct taxation.

When it comes to indirect taxation, Republic of North Macedonia accepted the EU model of consumption tax. According the country`s strong determination for EU integration, Macedonian legislator decided to introduce a consumption tax that will be in line with the EU tax law, on one hand, and compatible with value added taxes of the EU member states in order to facilitate the proper functioning of the single market and free movement of goods and services. In other words, Republic of North Macedonia had faced an additional pressure in "importing" indirect tax rules as a precondition for accession to the EU. Namely, most studies of legal transplantation focus on cases in which countries share an interest in harmonization. While one country might benefit more than another from harmonization, there exists an underlying assumption that harmonization of tax regulations contributes to the common good. In those cases, legal transplantation can provide an absolute gain for all jurisdictions even if benefits remain unevenly distributed among them (Morin et al., 2014).

Republic of North Macedonia introduced the EU VAT with tax credit method back in 2000, much earlier than required but as a symbol of the Macedonian motivation to join the European Union. Macedonian VAT was created as the one established the 6th EU VAT Directive. So, in the context of this paper, we can surely summarize that the translation of the acquis to the Macedonian tax system can be primarily described as the Externally-Dictated Transplant. For quit long period of time, North Macedonia had an European VAT model, although the Law has been amended for more than 25 times in order to adapt the legal norms on the Macedonian socio-economic conditions and circumstances. One crucial amendment from 2014 that decreased the amount of total turnover for obligatory VAT registration has moved the country few steps away from the EU VAT, but new law changes were introduced in the beginning of 2020 (amount of 2 million denars total turnover for obligatory VAT registration, and shorter period of 2 years for VAT registration) that will bring North Macedonia back on the EU track. Yet, in the area of indirect taxation we have successful transplantation where the benefits, given as comparable type of consumption tax, are much bigger than handicaps.

Opposite to VAT, the situation is rather different in the area of income taxation. There is no harmonization and absence of directives since EU has no jurisdiction in direct taxation. Therefore, income tax transplantation has largely been rule-specific. However, EU and OCED have implemented few joined actions especially in the field of international tax collaboration and fight against tax evasion and tax avoidance. As in most cases, North Macedonia want to become part of respective (supra) international organizations in order to facilitate its economic development and increase its international importance through development of intensive tax cooperation with the countries worldwide. The process of adoption of these international tax rules can be therefore characterized by some features of the Cost-Saving Transplant and the Legitimacy-Generating Transplant. The cost-saving effect comes from introduction of several well-developed regulations that assist free trade and that proved to be efficient in large number of countries. Legitimacy of regulations and, as a result, increased prestige of the country, comes from the fact that the EU and OECD are reputable unions of developed states.

The Macedonian approach of income tax transplantation tends to be more principled, process-driven and evidence-based regarding the fact that modern taxation was created in Western countries where the rule of law, market and social contract co-existed and operated in tandem. Macedonian Income Tax Laws are still mot in line with the recent EU and OECD work. There is an urgent need for further and more detailed implementation of the EU Anti Tax Avoidance Directive and the OECD BEPS Inclusive Framework.

In this moment, Macedonian tax system is not ready for such serious interventions, and as a result, in first instance Macedonian authorities should look at the legal solutions from the neighbor countries (Serbia, Bulgaria, and Croatia) because of the various similarities among the "donor" and the "recipient". Implementing these rules from the comparative tax law would indisputably mean cost efficiency and time saving for North Macedonia. Still, key handicaps remain the political will for establishing these anti-tax avoidance rules and the tax culture among Macedonian taxpayers.

IV. CONCLUSION

Laws in different countries are not typically written from a scratch, but rather transplanted, voluntarily or otherwise, from a few legal families or traditions". "In time of dramatic change,

there is no time carefully to craft 'organic', home-made legislation" and "it [at least in some areas of facilitative law] …makes sense not to try to reinvent the wheel" (Watson 1974). Many legal and practical solutions set by other countries to similar problems not only help one country to better understand better the own rules, but also help in finding new and better solutions to similar problems in the legal environment of the country. For example, all countries were looking for solutions from other legal systems before drafting e-commerce tax legislation, and it would have been unpractical if all of them invented uncorrelated e-commerce tax rules.

Policy implication of these results are vital for good functioning, because the legal reform strategy should aim to improve the legality by carefully choosing tax rules whose meaning can be understood and whose purpose can be appreciated by domestic law makers, law enforcers, economic agents, and taxpayers. In short, the legal reform must ensure that there is a domestic demand for the new law, and that the supply can match the demand. The close fit between the supply and demand for formal tax rules appears to be a crucial condition for improving the overall effectiveness of tax system and tax institutions, which over time will foster economic development.

While further research is necessary before making practical policy recommendations, a cautious suggestion would be that legal borrowing should take place either from a country with a similar legal and tax heritage, or substantial investments should be done in legal information and training, prior to adoption of a law. All of the actions should be done, so that domestic agents can enhance their familiarity with the imported law and make an informed decision about how to adapt the law to local conditions. This would at least increase the possibility that the new law will be useful and sustainable in the practice. However, it is hopeless to expect that an effective transplant strategy will have fast and direct or even immediate impact on the economic development in the country, only by itself.

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