



CHAPTER SEVEM

Legal, Ethical, and Tax Issues

Instructor: Wuman Luo

luowuman@ipm.edu.mo

Office: A323

Introduction

- **Apple App Store** gives iPhone and iPad users an easy way to purchase apps generating more than \$10 billion in revenue for Apple each year
- In 2013 Apple agreed to refund charges made due to their 15-minute purchase authorization clause
 - FTC investigation led to Apple paying \$32.5 million in claims and changing the 15-minute purchase terms
- In 2015 the FTC began another investigation against Apple for potential anticompetitive practices
 - Investigation is ongoing and could lead to a U.S. Justice Department investigation

The Legal Environment of Electronic Commerce

- All businesses must **comply with** the same laws and regulations and face the same set of penalties
- Web businesses face **additional** complicating factors
 - Web extends reach beyond traditional boundaries
 - Subject to more laws more quickly than brick-and-mortar business
 - More interactive and complex customer relationships
 - Online communications facilitate strategic alliances and supply web relationships
 - Law violations or ethical breaches can lead to rapid and intense reactions almost instantly

Borders

- In the physical world of traditional commerce, **territorial borders** mark the range of culture and reach of applicable laws very clearly
 - Geographic influences of culture limit acceptable ethical behavior and affect laws both directly and indirectly
- Relationship between geographic and legal boundaries defined by four variables
 - Power, effects, legitimacy, notice

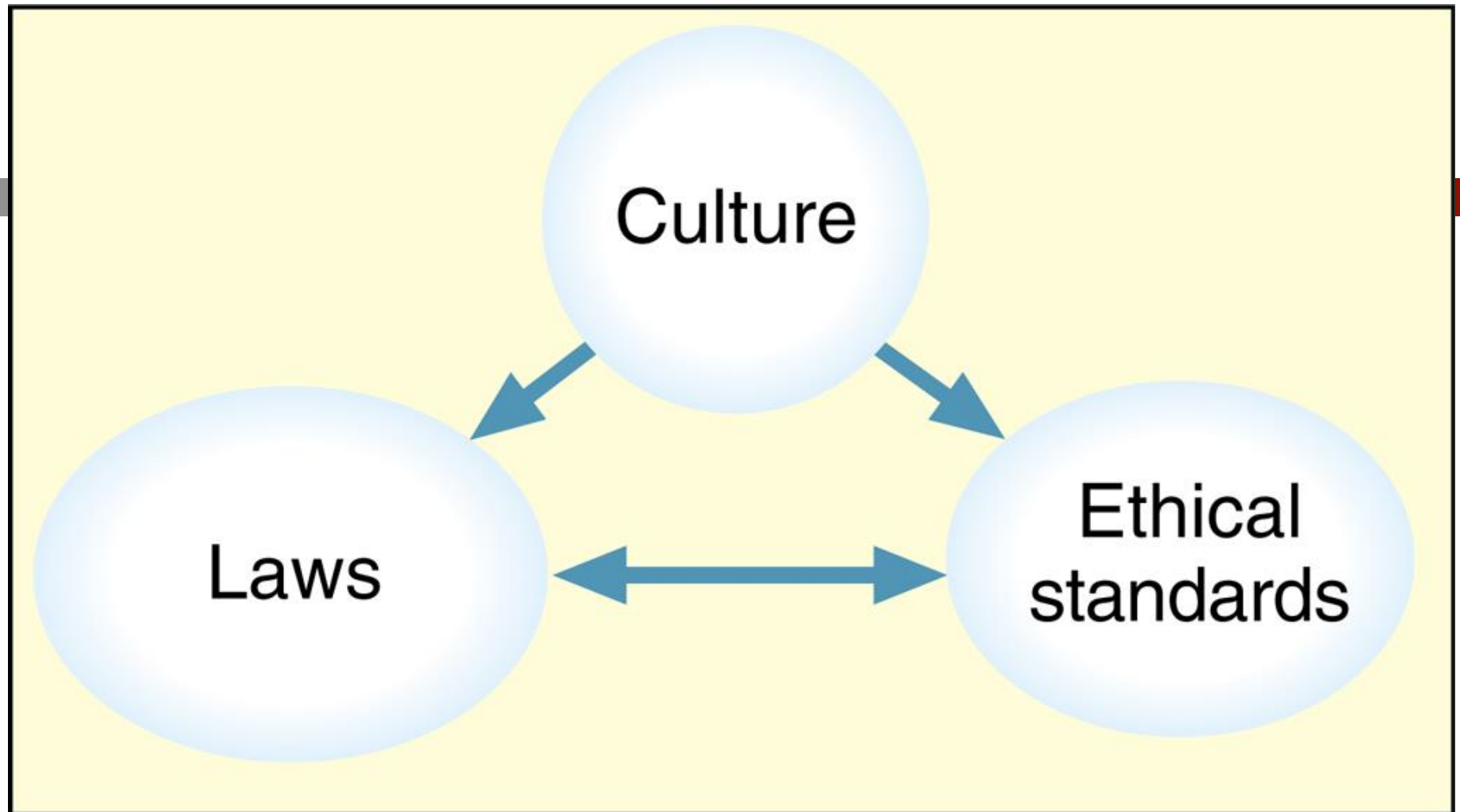


FIGURE 7-1 Culture helps determine laws and ethical standards

Power and Effects

- **Power** is the form of control over physical space and people and objects that reside in that space
 - Defining characteristic of statehood
 - **Jurisdiction** is government's ability to exercise power
 - Limited to that which is accepted by the geographical culture
- **Effects** are the impact of a person's behavior
 - Generally stronger on things that are physically closer
 - Laws based on traditional effects-based measures do not work as well for online businesses

Legitimacy and Notice

- **Legitimacy** is the idea that those subject to laws should have some role in formulating them
 - Online businesses face a variety of regulations
- **Notice** is the expression of a change in rules
 - Easy for physical boundaries but not easy online
- Constructive notice of new laws and norms is received when an international border is crossed
 - Ignorance of law: not sustainable defense
 - Creates problems for online businesses when unknown customers from other countries access Web sites



FIGURE 7-2 Physical geographic boundaries lead to legal boundaries

Jurisdiction on the Internet


- Difficult due to lack of geographic boundaries
 - Governments enforcing Internet business conduct laws must establish jurisdiction over conduct
- Contract is a promise between two or more entities providing for an exchange of value between them
 - Breach of contract occurs if either party does not comply with contract terms
- **Tort** is an intentional negligent action taken by a legal entity that causes harm to another legal entity
- Sufficient jurisdiction requires both subject-matter jurisdiction and personal jurisdiction

Subject-Matter and Personal Jurisdiction

- Subject-matter jurisdiction is a court's authority to decide particular dispute type
 - U.S. federal courts have subject-matter jurisdiction over issues governed by federal laws
 - U.S. state courts have subject-matter jurisdiction over issues governed by state laws
 - Rules are clear and easy to apply (few disputes)
- Personal jurisdiction is determined by residence of the parties
 - If defendant is a state resident where is court located the determination is straightforward

Personal Jurisdiction (cont'd.)

- An out-of-state person or corporation can voluntarily submit to a state court jurisdiction
 - Forum selection clause indicates a contract will be enforced according to a particular state's laws
- Long-arm statutes create personal jurisdiction over nonresidents committing tortious acts
- Tortious acts are exceptions to personal jurisdiction
 - Negligent tort is unintentionally selling a harmful product
 - Intentional tort is knowingly or recklessly causing injury to a buyer



These terms of use shall be governed by and construed in accordance with the laws of the State of Washington, without regard to its conflict of laws rules. Any legal action arising out of this Agreement shall be litigated and enforced under the laws of the State of Washington. In addition, you agree to submit to the jurisdiction of the courts of the State of Washington, and that any legal action pursued by you shall be within the exclusive jurisdiction of the courts of King County in the State of Washington.

FIGURE 7-3 A typical forum selection clause

Jurisdiction in International Commerce

- Governed by treaties between countries in dispute
- U.S. determines personal jurisdiction for foreigners in the same manner as domestic long-arm statutes
- Non-U.S. entities can be sued in U.S. courts
 - Foreign courts can enforce U.S. court system decisions against U.S. corporations and individuals
- Judicial comity is enforcing other countries' laws out of a sense of comity (friendly civility)
- Complex issue that is rapidly changing and should be considered when conducting business online

Conflict of Laws

- Business governed by various federal, state, and local laws
- Conflict of laws occurs when laws address the same issues in different ways
- Online businesses span many localities, states and usually look to federal laws for guidance
 - May lead to problems with state and local laws
- Example: direct wine sales industry
 - More information: Free the Grapes wine industry trade association Web site

Contracting and Contract Enforcement in Electronic Commerce

- Contract is formed when one party accepts the **Offer** of another party
 - Offer is a commitment with certain terms made to another party that can be revoked
- **Acceptance** is the expression of willingness to take offer including all stated terms
- **Consideration** is the agreed-upon exchange of something valuable such as money, property, or future services
- Implied contract can be formed when parties act as if a contract exists, even if unwritten

Creating Contracts: Offers and Acceptances

- Every type of agreement or exchange between parties is a type of contract
 - Example: consumer buying item at a supermarket
- Key element of traditional and Internet business
- Internet communication offers and acceptances
 - Occur by exchanging e-mail, engaging in EDI, and filling out Web page forms
 - Can be combined with traditional methods
- Courts tend to view offers and acceptances as actions that occur within a particular context




Step	Contract element	Participant	Action	
1.	Invites offers	Seller	Promotes product through Web page and states conditions under which offers will be accepted (for example, price and shipping terms)	
2.	Offer	Buyer	Clicks button to make offer to purchase product	
3.	Acceptance	Seller	Accepts buyer's offer, processes payment, and ships product	

FIGURE 7-4 Contracting process in an online sale

Use and Protection of Intellectual Property in Online Business

- Intellectual property includes all products of the human mind, both tangible and intangible
 - Protections afforded by copyrights and patents, trademarks registration, service marks
- Right of publicity is the limited right to control others' commercial use of an individual's name, image, likeness, and identifying aspect of identity
 - Limited by U.S. First Amendment provisions
- Online businesses must avoid infringement of intellectual property rights by using unauthorized content on Web sites or in domain names

Copyright Issues

- Copyright is a right granted by government to the author (creator) of literary or artistic work
 - Gives author (creator) sole and exclusive right to the work (print, publish, sell) for a specific length of time
 - Includes virtually all forms of artistic or intellectual expression
 - Idea contained in an expression cannot be copyrighted (for example, mathematical calculations)
 - Collection of facts can be copyrighted if arrangement rises to level of an original work
 - Example: Yahoo! Web Directory

Copyright Issues (cont'd.)

- U.S. law no longer requires registration
 - Work created after 1989 is copyrighted automatically by virtue of copyright law
- Most U.S. Web pages protected by automatic copyright provision (create an original work)
 - Copying page generally an allowable use
- Fair use of a copyrighted work is an exemption from infringement
 - Allows copying it for use in criticism, comment, news reporting, teaching, scholarship, or research

Title 17, Chapter 1, § 107 of the United States Code

Limitations on exclusive rights: Fair use

Notwithstanding the provisions of sections 106 and 106A, the fair use of a copyrighted work, including such use by reproduction in copies or phonorecords or by any other means specified by that section, for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include

- (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;
- (2) the nature of the copyrighted work;
- (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
- (4) the effect of the use upon the potential market for or value of the copyrighted work.

The fact that a work is unpublished shall not itself bar a finding of fair use if such finding is made upon consideration of all the above factors.

FIGURE 7-6 U.S. law governing the fair-use exception

Copyright Issues (cont'd.)

- Specific factors in fair use
 - Nonprofit educational uses have better chance of qualifying than commercial uses
 - Court may consider painting using different standards than sound recording
 - Small sections qualify when entire work might not
 - Court may consider amount of damage caused to value of copyrighted work
- Good Web site sources to determine fair use
 - University of Texas Copyright Crash Course
 - Stanford Copyright & Fair Use

Copyright Issues (cont'd.)

- Copyright law difficult to apply due to elements such as fair use
 - Internet has made situation worse
- Vicarious copyright infringement occurs when an entity capable of supervising infringing activity obtains a financial benefit from it
 - Example: Napster held liable for failing to monitor its network and indirect profit from the infringement
- Music purchased in digital form is often sold with specific restrictions on copying and sharing, even for personal use

Patent Issues

- Patent is an exclusive right granted by government to an individual to make, use, and sell an invention
 - Protection for 20 years in the United States or inventor can patent the design for 14 year
 - Invention must be genuine, novel, and useful
 - Not obvious given current technology state
 - Software patents not considered useful because technology obsolete before patent protection secured
 - Process is expensive and takes several years

Patent Issues (cont'd.)

- Business process patent protects specific set of procedures for conducting a particular business activity
 - Enforcing rights not clear (Amazon vs. Barnes and Noble and MercExchange vs. Ebay)
 - Only common in the United States
- Patent assertion entities or patent trolls purchase patents they believe are being infringed
 - Threaten to sue infringers for cash settlement
 - Several governments have introduced legislation to limit patent trolls with limited success

Patent Issues (cont'd.)

- Business process patent protects specific set of procedures for conducting a particular business activity
 - Enforcing rights not clear (Amazon vs. Barnes and Noble and MercExchange vs. Ebay)
 - Only common in the United States
- Patent assertion entities or patent trolls purchase patents they believe are being infringed
 - Threaten to sue infringers for cash settlement
 - Several governments have introduced legislation to limit patent trolls with limited success

Trademark Issues

- Trademark is a distinctive mark, device, motto, or implement that a company affixes to goods it produces for identification purposes
 - Service mark identifies the services provided
 - Registered with governments (state and/or federal)
- Trade name is the name business uses for identify
 - Protected under common law, not trademark law
- Statutory law arises when elected legislative bodies pass laws (statutes)
- Web site designers must not use any trademarked name, logo, or other mark without permission

Domain Names and Intellectual Property Issues

- Cybersquatting is registering a trademarked domain name hoping owner will pay money to acquire URL
 - Prevented by the U.S. Anticybersquatting Consumer Protection Act since 1999
 - Disputes settled by the World Intellectual Property Organization but critics claim enforcement has not been consistent
 - Rules in favor of trademark owner over 90% of the time
 - No central authority for decision appeals

Domain Names and Intellectual Property Issues (cont'd.)

- Name changing (typosquatting) occurs when someone purposely registers misspelled variations of well-known domain names
- Name stealing is unauthorized changes to domain name ownership
 - Domain name ownership change occurs when information maintained by public domain registrar changed in registrar's database
 - Allows name stealer to manipulate the site
 - Occurs when safeguards not in place
 - Main purpose is to harass site owner

Online Crime: Jurisdiction Issues

- Web crimes are online versions of physical world crimes and new online crimes
 - Theft, stalking, pornography distribution, gambling
 - Commandeering computer to attack other computers
- Law enforcement jurisdiction obstacles
 - Prosecuting across international boundaries difficult
 - Advance fee fraud
 - Distribution of pornographic material
 - Online gambling
 - Unlawful Internet Gambling Enforcement Act (UIGEA) of 2006 provides clearer jurisdiction

New Types of Crime Online

- Difficult to apply pre-Internet laws to criminal actions on the Internet
 - Most stalker laws are triggered by physical action which are not effective against online stalkers
 - Cyberbullying is using technology to harass, humiliate, threaten, or embarrass another
 - Laws have lagged behind technology but states are starting to pass laws that address online offenses
- Sexting is sending sexually explicit messages or photos using a mobile phone
 - Can lead to serious criminal liability if minors involved

New Types of Crime Online (cont'd.)

- Infiltrating competitor computer systems with intent of stealing data, creating operational disruptions
 - Criminal extortion example: Myron Tereshchuk was convicted for threatening MicroPatent with confidential client information disclosure
- National Retail Federation partnered with eBay and FBI to combat stolen items from being sold online
- Internet can help law enforcement track criminals
 - Some brag on social networking sites or leave clues in online profiles

Ethical Issues



- Web sites conducting electronic commerce should adhere to same ethical standards other businesses follow
 - Failure to do so will result in damaged reputation, long-term loss of trust, and loss of business
- Web advertising or promotion should include only true statements and omit misleading information
 - Product comparisons should be supported by verifiable information

Ethics and Online Business Practices

- An ethical lapse reported and passed among customers can seriously affect company's reputation
 - Examples: Amazon.com arrangements with publishers for book promotions, eBay firearm sales, Apple Apps store software approval time
- Organizations face an ethical issues when collecting e-mail addresses from site visitors
 - In the U.S., no legal obligation to limit the use of information collected on Web sites
 - May use information for any purpose, including sale
 - Concern of individuals and privacy right advocates

Privacy Rights and Obligations

- Issue of online privacy continuing to evolve
 - Many legal and privacy issues are unsettled and remain hotly debated in various forums
- Electronic Communications Privacy Act of 1986 is the main law governing privacy on the Internet today
 - Written pre-Internet to deal with telephone lines
- No law enacted to address online privacy has survived constitutional challenge
 - 1999 FTC report concluded no federal laws regarding privacy were needed
 - Created privacy advocacy group outrage

Privacy Rights and Obligations (cont'd.)

- Direct Marketing Association (DMA) established a set of privacy standards for members
 - Lobbies on behalf of members who do not want any privacy laws that would impact business
- Significant ethics issues in online privacy area
 - Laws not keeping pace with Internet, Web growth
 - Nature and degree of personal information recorded threatens visitors privacy rights
 - Many examples of personal information lost or stolen
 - Security breaches continue to increase

Privacy Rights and Obligations (cont'd.)

- Worldwide cultural differences provide different electronic commerce privacy expectations
 - Most European countries prohibit companies from exchanging data without express consent
- Major controversy in U.S. is opt-in vs. opt-out issue
 - Opt-out: Common method where customer must deny permission or opt-out of having their information used
 - Opt-in: Less common method where customer must specifically give permission to have information used
 - Preferable as it gives customer privacy protection

Many of our site visitors and customers enjoy receiving our newsletter, periodic notices of sales and special product offerings, and offers from other companies that we have chosen to ensure that they will be of interest to our site visitors. Please check the boxes below to add your e-mail address to our distribution list for any or all of these electronic mailings.

- ☐ Weekly e-mail newsletter
- ☐ Periodic notices of sales and special product offerings
- ☐ Offers from other companies

Figure 7-7 Example Web page showing opt-in choices

Many of our site visitors and customers enjoy receiving our newsletter, periodic notices of sales and special product offerings, and offers from other companies that we have chosen to ensure that they will be of interest to our site visitors. Please check the boxes below if you do not wish to be added to our distribution list for any or all of these electronic mailings.

- ☐ Weekly e-mail newsletter
- ☐ Periodic notices of sales and special product offerings
- ☐ Offers from other companies

Figure 7-8 Example Web page showing opt-out choices

Privacy Rights and Obligations (cont'd.)

- Privacy advocates urge electronic commerce Web sites to be conservative and follow guidelines
 - Use data collected for improved customer service or other customer benefits
 - Do not provide customer data to others outside your company without customer's permission
 - Clearly describe and explain what data is collected and how it is used
 - Give customers the right to have their data deleted
 - Train employees how to keep data secure

Taxation and Electronic Commerce



- Web businesses must comply with multiple tax laws
- Several types of taxes
 - Income taxes levied on net income
 - Transaction taxes (transfer taxes) levied on products or services company sells or uses
 - Sales taxes, use taxes, excise taxes
 - Property taxes levied on personal property, real estate

Nexus

- Connection between tax-paying entity and government
 - Similar concept to personal jurisdiction
- Activities creating nexus (United States) are determined by state law that vary from state to state
 - Frequent litigation has resulted in fairly complex laws
 - Determining nexus difficult if company conducts few activities in the state
- Business conducted in more than one country
 - May establish nexus with a country and be liable for filing tax returns in that country

U.S. State Sales Taxes

- Transaction tax on goods sold to consumers, usually called a sales tax
- Businesses establishing nexus with a state must file sales tax returns and remit sales tax collected from customers
- Business not required to collect taxes from out-of-state customers unless nexus established
- Use tax is a tax levied by a state on property used in that state that was not purchased in that state

U.S. State Sales Taxes (cont'd.)

- Large companies use complex software to manage sales tax obligations
- Purchasers exempt from sales tax include charitable organizations and businesses buying resale items
- Amazon laws require online retailers to collect taxes on sales made in their states
 - Supreme Court refused to hear a case challenging these laws which are being considered in many states
- Streamlined Sales and Use Tax Agreement (SSUTA) would simplify state sales taxes

Import Tariffs

- Countries regulate import and export of goods
 - Sometimes goods can only be imported if tariff paid
- Tariff (customs duty, duty) is a tax levied on products as they enter country
- Many reasons for imposing tariffs
- Goods ordered online are subject to tariffs when crossing international borders
- Products delivered online are also subject to tariffs
 - Example: downloaded software

European Union Value Added Taxes

- European Union (EU) uses transaction taxes with Value Added Tax (VAT) the most common
- 2003: VAT applied to sales of digital goods
 - EU-based companies must collect VAT on digital good sales no matter where in EU products are sold
 - Non-EU companies selling in the EU must register with EU tax authorities and collect and remit VAT if sales include digital goods delivered into the EU
 - New 2015 rules require non-EU sellers to collect VAT at rate levied in buyer's country prompting many to sell goods directly to a EU distributor for resale