



Chapter 6

Legal Systems

Learning Objectives

1. Understand how the legal systems of different countries differ and the influence of the legal systems on international business.
2. Have a general idea of the principles and features of the common law system, the civil law system and the religious law system.
3. Have a general idea of different contract laws and intellectual laws in different countries.
4. Have a general idea of the principles and features of the international taxation laws.

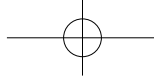
Opening Case

Spotting the Pirates

File-sharing rates vary hugely from country to country—with consequences for local media industries and global cultural trade

At least two music shops were looted during the riots that swept Britain earlier this month. In north London, a warehouse containing CDs and DVDs was set on fire. This was devastating for shopkeepers and local residents. But the British media industry may note, cheerily, that its products are still seen as valuable enough to risk a prison sentence. In many countries it is hard to conceive of looters stealing music or films from a store. In a few, it is difficult to imagine that a warehouse filled with recorded music would even exist.

Since 2000, when the file-sharing service Napster first became popular, digital piracy has



dogged the media industry. Over time piracy has become more diverse and sophisticated. In some countries, rather than swapping files on peer-to-peer networks, people now stash their loot in private “cyber-lockers”. As broadband speeds have increased, pirates have gone from downloading single songs to grabbing artists’ entire catalogues. Watching pirated television shows and films online has become more popular too.

Yet piracy has not exactly swept the world. It is endemic in some countries but a niche activity in others. In some places the tide is flowing; in others it appears to be ebbing. In response, media firms are moving their resources from country to country, with potentially large consequences for the global flow of popular culture.

Media piracy is more common in the developing world than in the rich world. The most piratical countries are places like Nigeria and Russia, where virtually all media downloaded illegally are sold in the forms of knock-off CDs and DVDs. But there is also great variation among rich countries. Piracy is far more widespread in the Mediterranean than it is in Northern Europe, including Britain. America may be the least piratical country of all—oddly, since Napster was born there.

One reason is cost. A recent study for America’s Social Science Research Council found that DVDs of *The Dark Knight*, a Warner Bros blockbuster, were selling in Russia for the equivalent of \$75 (if adjusted to take account of differences in GDP per head). In India the DVD was on sale for the equivalent of \$663. Legal differences are another reason. In Germany it is easy to fine somebody downloading music illegally; in Spain it is almost impossible. A final cause, the most intangible but probably the most powerful, is culture. In some countries copying is broadly regarded as theft; in others it is not.

Media companies care less about the causes than about the consequences. Consider Spain, which is Western Europe’s leader in piracy. Last year IDC, a research firm, found that 92% of 16- to 24-year-old Internet users (and fully 70% of 45- to 55-year-olds) in Spain admitted to using peer-to-peer networks. Music sales have collapsed. In 2010 barely 10 million CDs were sold in the country—down from 71 million in 2001. Digital sales are puny, too. “You can have a number-one album in Spain with 3,000 sales,” notes David Kassler, who manages EMI’s operations in Europe.

The result is that big labels have pruned their Spanish operations. Universal Music has shed a third of its Spanish staff. Max Hole, who runs Universal’s businesses outside America, says the firm is “holding out” in Spain, but largely in the hope that it will discover an artist who appeals to Hispanics in the United States. Mr. Kassler says EMI is spending five or six times as much in Germany, a low-piracy market where music sales are declining more gently—by 11%



between 2006 and 2010.

DVD sales have collapsed in Spain too. Xavier Marchand of Alliance Films, an independent movie outfit, says that Spain has become a “1950s market” where almost all the money is made from cinema showings and broadcast-TV rights. Jeff Blake, vice-chairman of Sony Pictures, says it still makes sense to release big-budget family films like *The Smurfs* in Spain. Such films are reliable box-office magnets and sell relatively well on DVD because parents use them as electronic babysitters. But dramas aimed at young men are dicier. As a result, says Mr. Blake, the Spanish “get fewer films on fewer screens, with less marketing support behind them”.

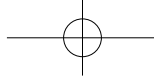
As media companies pull out of Spain, they are beefing up in South Korea. That country is the world’s 12th biggest music market, a notch behind Spain. It will almost certainly overtake the Mediterranean country this year. The South Korean recorded-music sales, which collapsed in the first half of the last decade, have risen for each of the past three years. Sales were worth 207 billion *won* (then \$179 million) in 2010—up from 134 billion *won* in 2007.

South Korea has the world’s toughest anti-piracy laws. Almost every measure under discussion elsewhere—threatening to cut pirates’ broadband connections; blocking pirate websites; forcing youthful downloaders into education programs; clamping down on cyber-lockers—has been done in South Korea. Legal music-streaming and downloading websites have sprouted, providing many more honest ways of getting hold of music. The South Korean experience may be unique: anti-piracy laws have not had such a clear effect elsewhere.

A few years ago international music firms had almost no presence in the country. Now they are coming back, according to Mayseey Leong, regional director of the IFPI, a music industry umbrella group. Universal Music began investing in the South Korean music in 2009. Sony Music has launched *The Secret Garden*, a music-heavy TV show, and used it to tout new singles. Warner Music Group has signed JYJ, a Korean boy band, and is exporting its schmaltzy pop to the rest of Asia.

As music firms move resources from one country to another, domestic markets are being reshaped. In 2010 South Korean groups accounted for 76% of CD sales in that country, the highest share for at least eight years. In Germany, too, domestic acts’ share of the recorded-music market has risen steadily, from 29.5% in 2001 to 49% in 2010. In Spain the balance has not changed much. But the number of albums by new Spanish artists to reach the annual top 50 has collapsed, from ten in 2003 to none in 2009 and 2010, according to the IFPI.

The same is not, however, true of film. In many countries, including Spain, the domestic film business is subsidized by the government, limiting the impact of declining DVD sales.



In Russia, a high-piracy market, home-grown films have lost a lot of ground to Hollywood imports. But that is at least partly because Hollywood is marketing more heavily in the country: DVD sales may be virtually non-existent, but so many screens have been built that it is now worth their while.

Hollywood's global influence has, of course, long been resented. The worry for governments is that cultural industries like music will eventually go the way of film, with impoverished local outfits failing to compete with mighty international media giants. It is probably not a coincidence that the first country to enact a "three-strikes" law against media piracy was South Korea, a country with considerable pride in its exports, cultural and otherwise. Nor is it surprising that the first European country to follow suit was France, where worries about cultural purity and independence flow like wine.

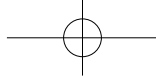
Downloading music and films illegally from the Internet appears an innocuous act—hardly as egregious as looting. But the legions of pirates are quietly reshaping world culture even so.

▲ Questions

1. How and why does media piracy differ in different countries?
2. What influences do media piracy and different relative laws exert on media industry development in different countries?

Part One

The legal system of a country is of great importance to international business. The entire legal environment in a country regulates business practices, defines business rights and obligations in business transactions. Differences in legal systems and relative business laws can affect the international business strategy, marketing and management. For a business that operates globally, understanding the different legal systems is a critical part of the process. Legal aspects help facilitate business operations. It is necessary for international businesspeople to have an understanding of the different legal systems around the world. Although different countries have different laws and regulations, the legal systems in the world can be classified into three types: common law, civil law and religious law. The development, characteristics and influences on international business of these three legal systems will be discussed in this chapter firstly. Knowledge of contract laws, laws governing intellectual property rights in



different countries, which is also significantly important for the international business, will be presented later in this chapter. In Part Two, a general introduction to international taxation law, which also influences international business greatly, will be presented.

Differences in Legal Systems

The legal system is the system for interpreting and enforcing the laws, referring to the rules, or laws, that regulate behavior along with the processes by which the laws are enforced and through which redress for grievances is obtained (Charles, 2008). The legal systems in different countries vary greatly for historical, cultural, political and religious reasons. The laws, including the rule of law, the role of lawyers and the right to judicial review, differ from country to country. In the United States, for example, it is very easy to find a qualified lawyer for the international business to settle the disputes with suppliers or customers in the court. South Korea, however, suffers from a shortage of lawyers, so many international businesses choose to settle disputes privately rather than to utilize the court.

The legal systems of the world today can be classified into three basic systems: common law, civil law, and religious law.

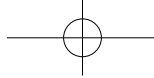
The Common Law System

The common law system is in widespread use in the UK and former Great Britain's colonies, including the United States, Malaysia, Singapore, Bangladesh, Sri Lanka, India, Ghana, Cameroon, Canada, Ireland, New Zealand, South Africa, Zimbabwe and Australia.

The common law is also known as case law or precedent. It is based on judges' decisions on particular case through history, which creates legal precedents. Other judges use legal precedents to decide similar cases. A common law system is based on the principle that it is unfair to treat similar facts differently on different occasions. The body of precedent is called common law and it binds future decisions. The court needs to look to past precedential decisions of relevant courts. If a similar dispute has been resolved in the past, the court is bound to follow the reasoning used in the prior decision. If, however, the court finds that the current dispute is different from all previous cases, judges have the authority and duty to make law by creating precedents. The new decision will become precedent, and will bind future courts.

The Civil Law System

The civil law, which is primarily contrasted with the common law, is a legal system in which laws are written into a collection, codified, and not (as in common law) interpreted by judges.



The principle of civil law is to provide all citizens with an accessible compendium of statutes which apply to them and which judges must follow. The primary source of law is the legal code; a code may also be described as a systematic collection of interrelated articles written in a terse, staccato style (Neubauer & Meinhold, 2007). Law codes are usually created by a legislature's enactment of a new statute, which embodies all the old statutes relating to the subject. Legislation is regarded as the primary source of law, and the court system is usually inquisitorial, unbound by precedent, and composed of specially trained judicial officers with a limited authority to interpret law. Juries are usually not used.

The civil law system, which is the most widespread type of legal system in the world, is applied in various forms in approximately 150 countries, including Germany, France, Japan and Russia. Along with colonial expansion, the civil law system and European civil law has been adopted in much of Latin America as well as in parts of Asia and Africa.

The Religious Law System

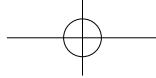
The religious law system is based on religious teachings. In the concept of religious law, the word of God is law and a religious system or document is used as a legal resource. The most important kinds of religious laws are Sharia in Islam, Halakha in Judaism, and Canon law in some Christian groups.

The Islamic law, based on the holy principles of Koran, is the most widely practiced religious law system in the world, which is followed in countries like Pakistan, Saudi Arabia, Iran and other Middle Eastern nations. The Islamic law can refer to all characteristics of civil law, including the contract law or property rights, which are of vital importance to international business. The Halakha is usually followed by traditional and conservative Jews. No country is completely governed by Halakha, but two Jewish people may choose to have an argument heard by a Jewish court. The Canon law, strictly speaking, is not a religious law because it is not found in revelation. It is normally seen as human law motivated by the word of God.

Differences in Contract Laws

A contract is a document that specifies the conditions under which an exchange is to occur and details the rights and obligations of the parties involved. Contract laws are a set of rules governing the relationship, content and validity of the contract. A contract actually is regarded as a promise or a set of promises which the law will enforce. In case there should be an infraction or breach of the terms of the contract, the aggrieved party may seek recourse via the courts.

Different countries can have different contract laws, which might affect the kind of



contracts an international business will use so as to protect its benefits in case of a dispute. The difference between a common law system and a civil law system can be demonstrated in different approaches to contract law. The common law system is based on the precedent and judges' decisions, which are badly specified. Thus contracts under the common law system tend to be very detailed and long. In civil law system, however, contracts tend to be much shorter and less-detailed, because civil law is based on a very detailed set of law codes and many issues covered in a common law contract are already covered in a civil code. International business needs to be very sensitive to the differences of contract laws under different legal systems.

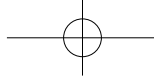
When parties from different countries enter into a contract, there is always the question of which country's laws to apply. To solve the problem, they can choose to abide by the international contract law.

International contract law refers to the legal rules relating to cross-border agreements. It is frequently used in international sales contracts. International sales contracts are governed by the United Nations Convention on Contracts for the International Sale of Goods (CIGS) from 1980. The convention, which is a compromise between legal systems of common law and civil law, was developed so as to promote international trade by developing a global set of rules for contracts. One key element of international contract law is the provision that the parties' nationality does not play any role when applying the law, thereby placing all parties on an equal position. By adopting the CIGS, a country will treat the convention's rules as part of its law. The CIGS applies automatically to all contracts for the sales of goods between different firms from countries that have ratified the convention, unless the parties explicitly choose the contract law in a specific country. About 70 countries have ratified the convention, including the world's major trading countries except Japan and the United Kingdom.

The Intellectual Property Laws

Intellectual property refers to creations of the mind for which a set of exclusive rights are recognized and the intellectual property law is the corresponding law. The ownership rights over intellectual property are established under intellectual property law while owners are granted certain exclusive rights to a variety of intellectual assets, such as artistic works, inventions and designs. Common types of intellectual property rights consist of copyrights, trademarks, patents, industrial design rights and trade secrets in some jurisdictions.

Intellectual property can be divided into two categories: industrial property, including inventions (patents), trademarks, industrial designs and geographic indications of source; and



copyright, including literary and artistic works such as novels, poems, plays, films, musical works, drawings, paintings, photographs, sculptures and architectural designs.

A patent is a set of exclusive rights granted by a national government to an inventor for a limited period of time in exchange for the public disclosure of an invention. The exclusive right that is granted to a patentee in most countries is to prevent others from making, using, selling or distributing the patented invention without permission. It is just a right to prevent others' use. Under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights, patents should be available in WTO members for any inventions, in any field of technology, and the term of protection available should be a minimum of twenty years.

A trademark is a distinctive sign or indicator used by an individual or business organization to identify or differentiate their products or services to consumers with which the trademark appears. The main purpose of a trademark is to distinguish its products or services from those of others. A trademark is typically a name, logo, symbol, design, image or a combination of all the elements. To prevent unauthorized use of the trademark, the owner of a registered trademark may commence legal proceedings for trademark infringement.

Laws relating to trademarks are different from country to country. For instance, one can register a trademark only when there is a product in the United States. The American company Stone Group, for example, can not register the trademark Stone Cola unless it has the cola. In Brazil, however, one can register a trademark without a product behind it. Any company or person can register the trademark of Stone Cola in Brazil. Then when later the American company Stone Group wants to sell Stone Cola in Brazil, the company has to buy the right to the trademark first.

A copyright refers to a set of exclusive rights granted by a state to authors, composers, playwrights, artists and publishers. This includes the right to copy, distribute and adapt the works. In most jurisdictions copyright does not need to be registered. Copyright owners have the exclusive statutory right for copying and other exploitation of the works for a specific period of time. Copyright law also applies to other uses of the works such as translations and derivative works. Copyright now covers a wide range of works, including maps, sheet music, dramatic works, paintings, photographs, architectural drawings, sound recordings, motion pictures and computer programs.

The protection of intellectual property right is greatly different from country to country. Although many countries have intellectual property laws and regulations, the enforcement of these laws and regulations are not quite satisfying.

The World Intellectual Property Organization (WIPO), established in 1967, is an agency



of the United Nations. It is “dedicated to developing a balanced and accessible international intellectual property system, which rewards creativity, stimulates innovation and contributes to economic development while safeguarding the public interest”. There are nowadays 184 members in it, all of which have signed international treaties designed to protect intellectual property.

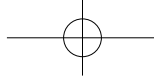
Implications for International Business Culture

An international business must not only obey the laws of its home country but also those of all the host countries in which it conducts business. The international businesspeople need to be very careful in the lawsuit if the host country’s legal system differs from the home country. For instance, due process and appeal procedures are often absent in countries of religious law system. An international business must be very cautious while operating in such countries. In Saudi Arabia, for instance, all foreign firms must have a local representative or sponsor. In case there is a dispute between the foreign firm and the local representative, the local representative can have the foreigner detained by the police. The foreigner’s rights cannot be properly protected by an independent judiciary in the country.

The protection of intellectual property rights will surely accelerate or hinder the development of some certain industries including media industry or software industry, as indicated in the opening case. International businesses have different responses to violations of their intellectual property. They can urge their governments to strive for international agreements which will ensure the protection of intellectual property rights and the enforcement of laws. Firms may also choose to stay away from countries with weak intellectual laws so as to prevent their ideas from being stolen. In the opening case, while media companies pull out of Spain, where piracy is widespread, they are beefing up in South Korea, which has the world’s toughest anti-piracy laws.

Key Terms

- civil law 大陆法（系）
- common law 普通法（系）
- contract law 合同法
- copyright 版权
- intellectual property rights 知识产权
- patent 专利
- religious law 宗教法（系）
- trademark 商标



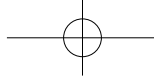
Summary

This part has reviewed how the legal systems of different countries vary. The following points have been made:

1. The legal system of a country is of great importance to international business.
2. The legal system is the system for interpreting and enforcing the laws, referring to the rules or laws, that regulate behavior along with the processes by which the laws are enforced and through which redress for grievances is obtained.
3. Common law is also known as case law or precedent. It is based on judges' decisions on particular case through history, which creates legal precedents. Other judges use legal precedents to decide similar cases.
4. The common law system is in widespread use in Great Britain and former Great Britain's colonies.
5. Civil law, which is primarily contrasted with common law, is a legal system in which laws are written into a collection, codified and not interpreted by judges.
6. The religious law system is based on religious teachings. In the concept of religious law, the word of God is law and a religious system or document is used as a legal resource.
7. Contract law is a set of rules governing the relationship, content and validity of the contract.
8. Different countries can have different contract laws, which might affect the kind of contracts an international business will use so as to protect its benefits in case of a dispute.
9. Intellectual property refers to creations of the mind for which a set of exclusive rights are recognized and the intellectual property law is the corresponding law.
10. The protection of intellectual property rights is greatly different from country to country. Although many countries have intellectual property laws and regulations, the enforcement of these laws and regulations is not quite satisfying.

Critical Thinking and Discussion Questions

1. What's your understanding of the definition and importance of the legal system?
2. What are the respective features and principles of the common law system, the civil law system and the religious law system?
3. Can you describe how different legal systems influence the operation of an international business?



4. What's your understanding of the definition of intellectual property rights?
5. Why is the protection of intellectual property rights important for an international business?
6. How might piracy hinder the development of some industries?

Research and Group Work

Work in groups of four or five members and each group is assigned a different type of firm. Types of firms include food retailers, steel producers, computer manufacturers, beer producers and filmmakers. Your group is a top management team of a Chinese firm. The firm has decided to expand into the United States and has selected the local community as its first point of entry. Your task is to find out what legal barriers the firm may encounter and to develop a general strategy to deal with them. Use whatever resources available.

Part Two

International Taxation Laws

International taxation is the study or determination of tax on a person or business subject to the tax laws of different countries or the international aspects of an individual country's tax laws. Governments usually limit the scope of their income taxation in some manner territorially or provide for offsets to taxation relating to extraterritorial income. The manner of limitation generally takes the form of a territorial, residential or exclusionary system. Some governments have attempted to mitigate the differing limitations of each of these three broad systems by enacting a hybrid system with characteristics of two or more.

Many governments tax individuals and/or enterprises on income. Such systems of taxation vary widely, and there are no broad general rules. These variations create the potential for double taxation (where the income is taxed by different countries) and no taxation (where the income is not taxed by any country). Income tax systems may impose tax on local income only or on worldwide income. Generally, where worldwide income is taxed, reductions of tax or foreign credits are provided for taxes paid to other jurisdictions. Limits are almost



universally imposed on such credits. Multinational corporations usually employ international tax specialists, a specialty among both lawyers and accountants, to decrease their worldwide tax liabilities.

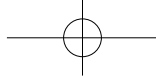
With any system of taxation, it is possible to shift or re-characterize income in a manner that reduces taxation. Jurisdictions often impose rules relating to shifting income among commonly controlled parties, often referred to as transfer pricing rules. Residency based systems are subject to taxpayer attempts to defer recognition of income of related parties. A few jurisdictions impose rules limiting such deferral (“anti-deferral” regimes). Deferral is also specifically authorized by some governments for particular social purposes or other grounds. Agreements among governments (treaties) often attempt to determine who should be entitled to tax. Most tax treaties provide for at least a skeleton mechanism for resolution of disputes between the parties.

Introduction

Systems of taxation vary among governments, making generalization difficult. Specifics are intended as examples, and relate to particular governments and not broadly recognized multinational rules. Taxes may be levied on varying measures of income, including but not limited to net income under local accounting concepts, gross receipts, gross margins, or specific categories of receipts and less specific categories of reductions. Unless otherwise specified, the term “income” should be read broadly.

Jurisdictions often impose different income-based levies on enterprises than on individuals. Entities are often taxed in a unified manner on all types of income while individuals are taxed in differing manners depending on the nature or source of the income. Many jurisdictions impose tax at both an entity level and at the owner level on one or more types of enterprises. These jurisdictions often rely on the company law of that jurisdiction or other jurisdictions in determining whether an entity’s owners are to be taxed directly on the entity income. However, there are notable exceptions, including US rules characterizing entities independently of legal form.

In order to simplify administration or for other agendas, some governments have imposed “deemed” income regimes. These regimes tax some class of taxpayers according to tax system applicable to other taxpayers but based on a deemed level of income, as if earned by the taxpayer. Disputes can arise regarding what levy is proper. Procedures for dispute resolution vary widely and enforcement issues are far more complicated in the international arena. The ultimate dispute resolution for a taxpayer is to leave the jurisdiction, taking all property that



could be seized. For governments, the ultimate resolution may be confiscation of property, dissolution of the entity, or even the death penalty.

Other major conceptual differences can exist between tax systems. These include, but are not limited to, assessment vs. self-assessment means of determining and collecting tax; methods of imposing sanctions for violation; sanctions unique to international aspects of the system; mechanisms for enforcement and collection of tax; and reporting mechanisms.

Taxation Systems

Governments usually limit the scope of their income taxation in some manner territorially or provide for offsets to taxation relating to extraterritorial income. The manner of limitation generally takes one of the three forms:

- Territorial: taxation only of in-country income.
- Residential: taxation of all income of residents and/or citizens.
- Exclusionary: specific inclusion or exclusion of certain amounts, classes or items of income in/from the base of taxation.

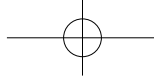
Some governments have attempted to mitigate the differing limitations of each of these three broad systems by enacting a hybrid system with characteristics of two or more. For example, they may tax based on residency but provide a specific amount of exclusion for certain foreign income. Alternatively, they may tax income sourced in the country as well as that remitted to the country. Most countries tax gains on dispositions of realty within the country, regardless of residency or their system of taxation.

Territorial

A few countries and regions tax only income earned within their borders. For example, the Hong Kong Inland Revenue Ordinance imposes income tax only on income earned from a business or source within Hong Kong SAR. Such systems tend to tax residents and nonresidents alike. The key problem argued for this type of territorial system is the ability to avoid taxation on portable income by moving it offshore. This has led governments to enact hybrid systems to recover lost revenue.

Residential

Most income tax systems impose tax on the worldwide income of residents, and impose tax on the income of nonresidents from certain sources within the country. Residency-based systems face the daunting tasks of defining resident and characterizing the income of nonresidents. Such definitions vary by country and type of taxpayer. Examples include:



- The US provides lengthy, detailed rules for individual residency covering:
 - 1) Periods establishing residency (including a formulary calculation involving three years),
 - 2) Start and end date of residency,
 - 3) Exceptions for transitory visits, medical conditions, etc.
- UK establishes three categories: non-resident, resident, and resident but not ordinarily resident.
- Switzerland residency may be established by having a permit to be employed in Switzerland for an individual who is employed.

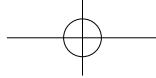
Exclusionary

Many systems provide for specific exclusions from taxable (chargeable) income. For example, several countries, notably Cyprus, the Netherlands and Spain, have enacted holding company regimes that exclude from income dividends from certain foreign subsidiaries of corporations. These systems generally impose tax on other sorts of income, such as interest or royalties, from the same subsidiaries. They also typically have requirements for portion and time of ownership in order to qualify for exclusion. The Netherlands offers a “participation exemption” for dividends from subsidiaries of Netherlands companies. Dividends from all Dutch subsidiaries automatically qualify. For other dividends to qualify, the Dutch shareholders or affiliates must own at least 5% and the subsidiary must be subject to a certain level of income tax locally.

Hybrid

Some governments have chosen, for all or only certain classes of taxpayers, to adopt systems that are a combination of territorial, residential or exclusionary system. There is no pattern to these hybrids. Following are examples:

- The US allows individuals earning income from their personal services outside the US—an exclusion of up to US\$80,000 (indexed for inflation from a key date) from compensation for such services. Compensation income in excess of this amount is fully taxable to citizens and residents.
- The UK imposes a charge to tax on individuals “resident but not ordinarily resident” in the UK based on income earned in or remitted to the UK.
- Singapore imposes income tax on resident individuals and companies on all income earned in or remitted to Singapore.



Key Terms

- double taxation 双重课税
- exclusionary tax system 排除税制
- residential tax system 居住税制
- territorial tax system 领土税制

Summary

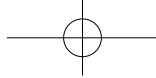
This part briefly introduces the international taxation law. Multinational corporations usually employ international tax specialists, a specialty among both lawyers and accountants, to decrease their worldwide tax liabilities. Governments usually limit the scope of their income taxation in some manner territorially or provide for offsets to taxation relating to extraterritorial income. The manner of limitation generally takes one of the three forms:

- Territorial: taxation only of in-country income.
- Residential: taxation of all income of residents and/or citizens.
- Exclusionary: specific inclusion or exclusion of certain amounts, classes, or items of income in/from the base of taxation.

Some governments have attempted to mitigate the differing limitations of each of these three broad systems by enacting a hybrid system with characteristics of two or more.

Critical Thinking and Discussion Questions

1. What's your understanding of the international taxation law?
2. Why is the international taxation law important for an international business?
3. What are referred to as transfer pricing rules?
4. What are the features of the territorial taxation systems, the residential taxation systems, the exclusionary taxation systems and the hybrid taxation systems?



Part Three Supplementary Reading

Watch Out When Contracting with Foreign Companies

Many startups have contracts with foreign-based or multinational entities. Contracting with companies based in foreign countries is getting more common every day. But when contracting with a company based in a foreign country, watch out!

Foreign laws may be radically different from the laws in the United States, including laws relating to:

- Contract formation, interpretation and enforcement.
- IP ownership.
- Available protection for confidential information or trade secrets.
- Types of rights for copyrights and patents.
- Scope of IP rights, especially “Moral Rights” for copyrightable works.
- Contract prohibitions regarding reverse engineering.
- The range of damages and potential liability for breach of contract and related claims.

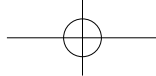
If foreign laws apply to your agreement, you may be in for some nasty surprises. You may not be agreeing to what you thought you were and the rights and legal remedies will be different from those in the United States, sometimes radically so, and not usually in a good way.

Moreover, it’s important to consider what will happen if the relationship sours and disputes about the terms of the agreement arise. What will you do if you don’t get paid and they keep your products? What will you do if the foreign company reveals your trade secrets? What will you do if the foreign corporation uses or resells the source code they allegedly created specifically for your company?

Which country’s law governs? Where can you sue or be sued? Will you be at the mercy of foreign courts or bound by the foreign law?

The beauty of contract laws is that in the actual contract between the parties you can specify what law governs the agreement and the contract’s interpretation.

The “Governing Law” section is typically at the end of the contract. To some extent, the parties can choose the applicable law. For many claims, they can specify that the law of a particular country or state will govern disputes arising out of or relating to the agreement.



Watch out for contracts drafted by foreign companies who slip in a term specifying governance by the law of their country. A contract governed by foreign laws may not mean what you think it means and your rights may be radically different from what you've come to expect under our laws.

When asked, foreign corporations who frequently do business in the US, even very large ones, will usually agree to specify US laws as the governing law. They usually already have US legal counsel and are familiar with US laws.

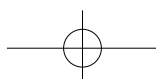
Whether you can force the issue with a company who initially refuses to agree to US law will depend on your bargaining power and their desire to do the deal. You should carefully consider the subject matter of the contract, its value and its relationship to your business when considering whether to do the deal with the risk of foreign litigation.

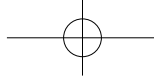
I've represented numerous domestic and foreign corporations in international disputes and I would balk at signing any agreement that designates the governing law to be anything but the law of the United States. It can be extremely difficult to really understand the ramifications of foreign law without consulting a foreign attorney. You may end up paying for lawyers in both countries. Pragmatically, sometimes a small company doing business with a foreign corporation has to cave on the issue of the governing law to get a deal done. But the businesspeople should understand that there are very expensive risks to agreeing to foreign law. Unless the startup has beaucoup capital, foreign litigation could severely jeopardize the company's financial viability. If the company's key intellectual property is involved, it may pay to consult with a foreign lawyer when negotiating to better understand your risks and potential liability.

Further, in a contract, the parties can specify what courts or dispute resolution organizations will have the power to decide future disputes. This term is usually called "Jurisdiction and Venue" or "Dispute Resolution". It may be combined with governing the law in a section called "Governing Law & Jurisdiction".

Jurisdiction is different from the governing law, which determines what law applies. Technically, jurisdiction has to do with the rights and power of the courts to apply the law. Venue is the specific location for the resolution of the dispute by a court with jurisdiction.

In a contract, to some extent, the parties can specify the specific jurisdiction and venue where resolution of future disputes between the parties related to the agreement will take place. They can also specify whether the agreement must be decided by alternative dispute resolution like arbitration. Generally, courts will uphold arbitration agreements and the court may decline to exercise their power to hear the case based on the arbitration term in the agreement.





In international agreements, arbitration may be the best way to fairly resolve disputes with foreign corporations. It is common to specify international arbitration in a location that is neutral and mid-way between the companies.

When a foreign company has no assets in the United States, it may be judgment proof because our courts lack the power to reach the foreign company's assets. In this scenario, an arbitration award may be easier to enforce than a US court's judgment and can be enforced through the New York Convention treaty in participating countries.

International arbitration and judgment enforcement may be very expensive. Arbitration may be somewhat more expensive than litigation in a US court in part because you usually need to designate three arbitrators, one from the country of each party and one from a neutral country. The arbitration process usually involves travel for all parties and it may also involve translators. Discovery costs in arbitration can be lower but this cost savings may be offset by the lack of other judicial procedures, like motions to dismiss, that can expedite resolution of the dispute and limit attorney preparation and fees.

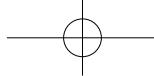
If a company has assets in the United States and your agreement involves IP rights, I would try to get an agreement to jurisdiction and venue in the US courts. You will want the power of the courts to protect your IP and enforce any judgment. Injunctions are important remedies in many types of IP cases. Additionally, if you win in court and the foreign company won't pay the damages award, a US court may have the power to seize the assets of the foreign corporation in the US for payment.

In any event, it pays to consider potential costs of a dispute with a foreign company when estimating the costs and benefits of a potential deal. It may be far more costly to do business with a foreign company than you anticipated.

EXERCISES

▲ Reading Comprehension

1. According to the passage, startups should watch out for the contract governed by foreign laws, because _____.
 - A. it may not mean what you think it means and your rights may be radically different from what you've come to expect under US laws
 - B. your rights cannot be protected by foreign laws
 - C. foreign laws might cost you much more than US laws



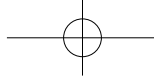
- D. it is difficult to find a proper foreign lawyer
2. According to the passage, it is common to specify international arbitration in _____.
- A. a location in Asia
 - B. a location in the United States
 - C. a location that is neutral and mid-way between the companies
 - D. a location in Europe
3. According to the passage, which of the following statements is NOT true?
- A. International arbitration and judgment enforcement may be very expensive.
 - B. The court cannot decline to exercise their power to hear the case based on the arbitration term in the agreement.
 - C. Foreign laws may be radically different from the laws in the United States.
 - D. Jurisdiction has to do with the rights and power of the courts to apply the law.

▲ Pair Work

You and your partner will respectively act as a representative from a US firm and a French firm. The two firms are going to sign a contract. Your task is to persuade the other party to agree to sign the contract governed by your country's law. Please list all the arguments of each party.

Internet Exercises

1. The World Intellectual Property Organization (WIPO) was established in 1967. Its aim is to establish a balanced and accessible international intellectual property system, to reward creativity, and to stimulate innovation. Please refer to the WIPO website at <http://www.wipo.int>, and try to finish the following tasks:
 - 1) Find out its member countries.
 - 2) Choose one member country in which the protection of IP is still weak.
 - 3) Describe and illustrate the weak protection of IP, and then analyze its influence on one of its industries.
 - 4) Write a report based on your research.
2. The Koran condemns interest (*Riba* in Arabic) as exploitative and unjust, so a banking system operates without interest under Islamic law system. By 2005, about 176 Islamic financial institutions had been established worldwide. Islamic banks make a profit in a different method from conventional banks. Please refer to the following



websites at http://en.wikipedia.org/wiki/Islamic_banking, <http://www.islamic-bank.com>, <http://www.dib.ae>, or other relevant websites, and finish the following assignments:

- 1) Find out the principles and banking methods of Islamic banks.
- 2) Analyze how these principles and methods would influence an international business.
- 3) Write a short essay based on your research.

Closing Case Study

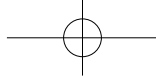
Inventive Warfare

Battles over patents are becoming fiercer and more expensive

This deal is all about patents. That was the near universal view of Google's announcement this week that it was taking over Motorola Mobility, a maker of handsets and other devices, for a colossal \$12.5 billion. Indeed, the purchase will provide Google with an awful lot of patents: around 17,000 of them issued and another 7,500 pending. They should help Google in its efforts to get more smartphones and other mobile devices running on its Android operating system. But it could also make the battles over patents nastier and more costly.

A scramble for patents had already begun. In December four companies, including Microsoft and Apple, paid \$450 million for around 880 patents and applications owned by Novell, an ailing software firm. In July those two and four others, including Research in Motion, maker of the BlackBerry, spent \$4.5 billion on 6,000 patents owned by Nortel, a bankrupt Canadian telecoms-equipment maker. Before its latest deal, Google bought 1,000 patents from IBM. Firms are also suing each other. Apple claims its technology has been copied by SAMSUNG and Motorola in their Android phones. Oracle is suing Google for up to \$6 billion, claiming that Android infringes its patents. Microsoft is suing Motorola over Android, too. Nokia recently settled a similar quarrel with Apple.

What is going on? Some say companies are attaching more value to intellectual property. Indeed, the Google deal seems to have been priced on a cost-per-patent basis, causing the share prices of other firms with lots of patents to rise. Others, however, think the battles reflect



deficiencies in the patent system forcing firms to pay vast sums to protect technologies they have developed. The answer is a bit of both.

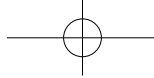
Kent Walker, one of Google's senior lawyers, grouses at being forced to spend a lot of money defending the company against frivolous lawsuits by rivals. Others counter that as computing goes mobile, it favours information-technology firms that have invested in research for years and that Google was naive—or idealistic—to broaden its IT business without having a stack of patents. There is a retort to that, too: that incumbents can use patents as barriers to entry, which is why America's antitrust regulators are showing interest in them. In April the Department of Justice demanded changes to Novell's patent sale to protect open-source software.

Nowadays, innovations in IT usually rely on many small improvements involving numerous technologies, which means it is not always clear precisely which inventions a patent covers. The open secret is that everyone infringes everyone else's patents in some way. This creates an incentive for firms to build up their patent portfolios to strengthen their position in negotiations, leading to what some liken to an arms race. The legal tussles usually end in cross-licensing deals, in which small sums of money change hands. This is considered preferable to a mutually destructive exchange of endless lawsuits.

The patent battle has become more contentious than ever. One reason is the mobile phone has provided a new platform of computing that firms want to dominate. Also, such a backlog of applications built up at America's patent office (now more than one million, with a waiting time of around three years) that standards slipped. Dubious patents were granted, helped in part by court rulings that allowed patents to stand on some software and "business methods" that many thought no one could lay claim to. In Europe and Japan, where patentability standards are higher, this is less of a problem.

Making things even more troublesome is that as lawsuits became particularly lucrative some companies entered the fray to feed off them. Non-practicing entities (NPEs), which have intellectual property but no actual products, include such august bodies as the Harvard Medical School. But some NPEs are derided as "trolls" because their sole purpose seems to be to exploit the legal system by demanding licensing fees from companies, sometimes for questionable patents. Over the past 15 years, the median award to NPEs of damages for patent infringement has doubled while that for other firms has declined.

Court rulings in America have begun to clip the trolls' beards by making it harder to win injunctions and by strengthening the criteria for whether an invention is truly "non-obvious". Microsoft has seen the number of suits filed in the famously plaintiff-friendly district court of Eastern Texas fall from 17 in 2007 to just two so far this year, says Brad Smith, Microsoft's



general counsel. However, as big companies have improved their defenses, the trolls have changed their tactics and are now going after start-ups.

New legislation could change things. David Kappos, director of America's patent office, says the America Invents Act could amount to "the most sweeping reforms to the US patent system in 175 years". It is expected to be passed this autumn, Barack Obama has indicated that he will sign it, and big IT and drug companies support it. But many entrepreneurs and venture capitalists do not, arguing that it does not fix any of the system's big problems and risks creating new ones.

The most contentious point is a change to determine who is the rightful inventor. Instead of being the "first to invent", the successful applicant would be the "first to file", the standard used worldwide. Harmonizing America's rules with those in other countries would be a step towards greater co-operation and efficiency in patent examinations globally. Big companies like the proposal because it gives them more legal certainty that someone will not appear claiming they came up with the idea first. But inventors like Steve Perlman, the founder of WebTV and other firms, argue that it forces companies to file for patents before their inventions are fully developed. That, says Mr. Perlman, would lead to yet more incremental improvements rather than big innovative steps and put a toll on America's competitiveness.

For the moment, though, companies are amassing ever larger arsenals of patents. Google, for one, was hit by eight lawsuits in April alone—more than in the first five years of its 13-year existence, says Mr. Walker. "See how far we have strayed from the notion of innovation, that we need to acquire patents to fend off potential suits," he says of the firm's overall strategy. "That money could have been spent on engineers, to much more productive use."

▲ Questions

1. What do you think are the core values of patents?
2. Why have the MNCs including Microsoft, Apple, IBM and Google been suing each other over patents?
3. How will the new legislation change things in the United States?