Internet Service Provider and the Dependent Agent

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Abstract. The article analyses the role of Internet services providers (ISP) when an enterprise performs e-commerce abroad and uses ISP services. One of the premises for the appearance of the institute of a permanent establishment is the acknowledgement of ISP as a dependent agent of a foreign company. Activities performed by ISP sometimes may raise doubts if they really do not take over a part of business functions of the foreign company. With regard to how much ISP act in the name of the foreign company a possibility may be discussed to acknowledge ISP as a dependent agent.

Also the role of an intelligent software agent is discussed in the article together with functions it receives in the transactions of purchase-sale or services provision. Requirements for a dependent agent and the question if an intelligent software agent corresponds to them are analysed.

Index Terms: internet service provider, intelligent software agent, electronic commerce, dependent agent, permanent establishment, double taxation, electronic commerce taxation, independent agent.

JEL Classification: K33, K34, H21.

I. INTRODUCTION

Companies often perform their activities abroad using services of natural or legal persons (further referred to as agents). When countries sign international agreements on double taxation avoidance it is important to foresee the criteria for determining which country has the right to tax a company’s profit or profit part. Such international agreements are often drawn up based on recommendations given by The Organisation for Economic Co-operation and Development (OECD). If income is taxed in two countries that have signed a double taxation avoidance agreement, the right of taxation is given to one of the countries: the country of residence (residence-based taxation) or the country of income source (source-based taxation). With regard to the received income this convention foresees two rules for avoiding double taxation. According to the first rule the exclusive right to taxation is given to the country of residence. According to the second rule the source country has a complete or partial right to tax income; then the residence country, seeking to avoid double taxation, must grant a tax exemption1.

The spread of e-commerce has strongly influenced the traditional international concept of taxation, based on the taxation right given to the income source country. In essence income source is attributed to the place where business is run directly. It becomes very difficult and sometimes even impossible to determine the place of economic activity in e-commerce due to buyers’ anonymity and possibilities to have transactions in real time with any company selling in cyberspace disregarding geographical distances and different jurisdictions of various countries.

With regard to new possibilities in international trade provided by e-commerce a too narrow approach towards a permanent establishment would be favourable for companies that want to pay taxes in the country of residence. On the other hand a too wide perception of the concept of a permanent establishment for companies of economically developed countries could be unfavourable when seeking to expand their business into other countries. The emerging arguments on the interpretation of a permanent establishment reflect well the reaction of the state2 to the new realities of international trade in cyberspace. Some countries seek to keep the basis to tax foreign companies that do not reside in that country but have a possibility to trade in the country’s market by electronic means; other countries tend to think that the most important aspect that needs to be kept in mind when deciding on a company’s tax obligations is residence. With regard to how a server will be interpreted some authors see a threat that in practice a monopoly of some countries (Trester, 2012-2013) may form in the area of e-commerce taxation. One of such countries could be the USA. Also sellers adapting to the existing tax regulation can manipulate the system easily (Pastukhov, 2009) and thus avoid taxes or choose tax regimes that are favourable for them that could be totally unrelated to their business. The use of tax havens or low-tax jurisdictions creates a threat to countries to loose big revenues to their budgets (Crocket, 2013). Companies that are involved in e-commerce can easily use such zones that exist in any place in the world.

Also another approach exists according to which a special model of double taxation avoidance should be applied to e-commerce. The two above mentioned traditional rules should be renounced. Tax collection and administration of the whole system should be delegated to one supranational institution the Global Tax Fund (Azam, 2011-2012). Of course this would not solve all problems that arise seeking for efficient tax collection, correct attribution to one or another country, operative reaction to


various changes, and the creation of a suitable argument resolution and their performance mechanism. Such exceptional approach towards the taxation of e-commerce is based on the seek to apply a more suitable and more efficient regulation to new commercial and tax relations with regard to the fact that gaps have existed in the area of an imperfect taxation system of double taxation avoidance (Doernberg, Hinnenkens, Hellerstein and Li, 2001) become more evident in the case of cyberspace business.

The OECD Model Tax Convention on Income and on Capital (Model Convention) foresees a possibility to acknowledge the existence of a permanent establishment of a foreign company in the country where another subject acts in the name of the company1. A question often arises in e-commerce – can ISP be acknowledged as a dependent agent? It is from them that companies often borrow servers when performing their activities in foreign countries. But in order to have a permanent establishment in another country when using services of an agent the latter must be dependent on the company to which it provides its services. Thus the dependency of ISP on a foreign company becomes the object of discussions. Also an intelligent software agent is often mentioned together with ISP as a new and exceptional concept of a dependent agent forming in the 21st century.

II. AGENT STATUS AND INTERNET SERVICE PROVIDERS

From the historical point of view a dependent agent has not always been understood as defined today. The main aim of the appearance of a dependent agent was to ensure the conformance of the requirement of a fixed place of business. Companies in the jurisdiction of another country do not need to have a fixed place of business and can link their business in that country with the activities of agents. Such agents must have the right to draw up contracts in the name of the company. Even one of the first versions of the Model Convention in 1927 foresaw that an agent could not be independent if a company wanted to have an institute of a permanent establishment in that country2:

“The fact that an undertaking has business dealings with a foreign country through a bona fide agent of independent status (broker, commission agent, etc.), shall not be held to mean that the undertaking in question has a permanent establishment in that country.”

The agent must be dependent on the company legally as well as economically. After 2 years this legal dependency of an agent was defined as one of the four criteria3:

“The first is a criterion of a legal nature, it being considered that the only agents dependent on an enterprise are those having sufficient contracts binding upon that enterprise. The Committee considered that this criterion was admissible, but was not applicable to every case.”

Up till 1930 it was considered that the establishment of a dependent agent is one of the necessary conditions to be fulfilled seeking for the agent’s activity to be acknowledged as the basis for the appearance of the institute of a permanent establishment. After 1930 this requirement was renounced. But later the definitions of an agent changed (the most significant changes were made in 1958, 1963, 1992, and 1994), and as a result two approaches to agent interpretation seeking to assess the appearance of the institute of a permanent establishment developed: “scope of authority” and “dependent agent”.

After the review of the Model Convention of 2003 the priority was given to the approach of the “dependent agent”. OECD comments on the assessment of a dependent agent do not describe how widely or narrowly its dependency must be assessed when drawing up contracts in the name of the company.

At present OECD’s position is that decisions made by an agent must factually bind the company. Also OECD’s comments soothed the position on the independency of an agent’s actions from the company by introducing the expression “routinely approves”4, i.e. the company can routinely approve the decisions made by the agent:

“For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign

6 (b) According to the second system there is no „permanent establishment”, unless the agent has a fixed depot. There are cases, however, in which the presence of an agent of an enterprise may connote, for the enterprise, the existence of a permanent establishment, although the enterprise undoubtedly has no fixed depot; this is particularly the case with insurance companies and certain buying agencies.
(c) The third system takes into account the relations between the agent and the enterprise, the only agents regarded as not autonomous being those in receipt of fixed emolument. This may be a determining but it is not an indispensable factor in deciding whether there is a non-autonomous agent, i.e. a permanent establishment.
(d) The fourth criterion is that of the continuity of the relations between the agent and the enterprise.
This criterion is not absolute and requires closer definition.
5 Model Tax Convention …. 2012
6 Double Taxation and Tax Evasion Report. League of Nations. 1927
enterprise routinely approves the transactions."

But it must be noted that such wider explanation of the norm does not decrease an agent’s dependency on the company. In e-commerce this usually is an automated approval (it is usually done by software not belonging to the agent) for implementation of a certain business stage, for example, approval to download information or to ship a product from a warehouse.

Also the authors note that it is important to identify such activities as outsourcing the making of contracts to a dependent agent (Sprague and Hersey, 2003-2004). This would be more of a formal imitation of business activities than the possession of real powers of a dependent agent during this business. A dependent agent will not be able to make decisions that are not foreseen in advance independently. Such activities resemble more the work of software which is based on the performance of pre-programmed decisions. The right to decide and not only to make a contract is a very important criterion of consolidating the constant agent status. The decision right should most likely be related with such decisions that could have certain influence on business development in that country where the activities of a dependent agent are analysed. In practice there is no strict line separating what influence it should be, how significant for company development it should be, etc.

Based on current OECD recommendations and practice of many countries it is acknowledged that a fixed place of business having a physical expression is defined by these three criteria (Schaffner, 2013):

1) it has to be permanent (not temporary),
2) it has to be fixed (geographic or territorial link to the ground),
3) it has to be at the disposal of the business undertaking which uses it to carry out its activities.

Often it is not possible to apply all these requirements to e-commerce companies. Criteria of a legal institute created more than one hundred years ago cannot be applied in the same way to traditional trade and to e-commerce. In e-commerce companies performing activities in a foreign country and receiving profit from the country’s citizens should pay income tax to the income source country based on the principle of double taxation avoidance. But at the same time it could be that such a company does not correspond to some of the above mentioned criteria at all. Such incompatibility between the main provisions based on which the country receives the right to tax a company’s profit and existing criteria that a company does not correspond to creates a situation of discomfort for the company itself. Unsolved cross-border questions of double taxation avoidance in e-commerce and double taxation avoidance agreements signed before the spreading of e-commerce do not create a clear tax environment for sellers. Sellers are left to themselves to decide where they must pay their income tax and how to assess certain criteria. Some existing cases show that opinions of companies and state tax institutions when interpreting double taxation agreements differ. Different opinions exist also between countries.

In such an environment of legal uncertainty companies search for a solution that would be most acceptable for them. The business of e-commerce, characterized by flexibility and mobility, would allow adapting to different requirements in different countries, but clarity when assessing them is nevertheless needed.

Following the legal norms regulating the status of an agent as a subject dependent on the company the following requirements that the mentioned agent needs to correspond to may be distinguished:

1) a dependent agent must be a person, a natural as well as a legal one;
2) a dependent agent cannot be a self-employed person and perform similar activities for more than one business entity;
3) a dependent agent must act in the name of the company and for its benefit;
4) activities of a dependent agent should not be limited by a one-off activity.

One of the dependent agents in e-commerce mentioned in the literature the most often is ISP. It must be noted that not all companies may use services provided by ISP. The big companies most often use not one but several servers in different countries of the world for e-commerce, also companies use patent software or hardware that help them to manage data flows more efficiently. ISP personnel is not specialised to perform such commercial operations. Their activities first of all are based on ensuring a technical base for proper functioning of a server. Also companies do not entrust patent software or hardware to other subjects. In such cases companies usually own servers in foreign countries by the right of property, and a company’s personnel ensures the functioning of hardware or even the making of commercial transactions.

But most companies use ISP services. E-commerce models which are the most widely spread are when foreign companies rent a server or a certain part of a server’s memory where they place their Internet website, and ISP ensures the functioning of this equipment. In this case ISP activities correspond to the activities of supportive nature foreseen in Part 4 of Article 5 of the OECD Model Convention. Other activities characteristic of e-commerce, not necessarily performed by ISP, may also be attributed to such activities: providing a communications link between suppliers and customers, advertising of goods or services, relaying information through a mirror server for security and efficiency purposes, gathering market data for the enterprise, supplying information.

Also the already described aspect of making contracts and the role of ISP must be mentioned. Foreign companies usually do not give authorisations to Internet service providers to make contracts with buyers. Some authors state that the institute of a permanent establishment cannot

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9 Model Tax Convention …. 2012
appear if "...person’s role was to accept customer’s orders on terms and conditions pre-set by a foreign principal" (Sprague and Hersey, 2003-2004). The activities of telesales centres are given as an example. The authors state that in most cases such agents will be acknowledged as being dependent on the company and will create the institute of a permanent establishment in a foreign country. Of course activities performed by agents may determine business development or direction of that company in a foreign country but it is very important if agents may make decisions when choosing such activities or their ways of performance. In most cases agents do not receive such rights. They act strictly according to instructions given to them.

It must be noted that in e-commerce a company also does not make these contracts directly. These actions are made independently by automated software. But as in the case mentioned before the main influence on the action of the software, the scope of its operation and independency are made by the company’s decisions. ISP and automated software may have different authorisations given by the foreign company or programmed actions but the main decision-making function remains at the responsibility of the foreign company. Most often the automated software will make decisions more important for business than ISP. Based on provided authorisations ISP may make decisions without a separate consent of the company, but such decisions do not have essential influence on business (e.g. an Internet website or database may temporarily be moved to other servers when supervising server performance due to technical reasons). In such cases ISP must ensure that their performed activities will not temporarily interrupt a company’s business and will not influence its development. Therefore all these activities may be assessed only as preparatory and auxiliary services.

ISP, when performing their activities, may provide services not to one but to several foreign companies. Often several companies at once place their Internet websites on one server, and the same Internet service provider looks after their maintenance. When managing various companies’ Internet websites on their server, ISP develops its business and does not seek for benefit for the foreign company. Also it acts on its interests and is completely independent from the foreign company.

Since an Internet service provider does not correspond to these requirements and has no authorisations related to the making of contracts it does not perform the functions of a dependent agent and may be treated only as an independent agent.

But a possibility should remain that ISP under certain circumstances could be treated as a dependent agent. In such a case based on the above mentioned requirements for a dependent agent ISP must act in the name of the foreign company and for its benefit, have an authorisation to make contracts, and to depend on the foreign company.

III. INTELLIGENT SOFTWARE AGENT

Next to the traditional perception of an agent being a natural or a legal person some authors analyse the possibility to attribute the software used in e-commerce to the category of an agent (Mehra and Jariwal, 2000). Presumptions for such a discussion are created by the assessment of an intelligent software agent as a sufficiently independent object with functions which are very similar to a dependent agent. In the case of the reservation of trip tickets such software may provide lists of prices, choose a suitable time, route, compare the existing information with the information provided by the client, choose the best solution based on the presented information, and make a contract. Also an automated argument solution procedure based on the activities of an intelligent software agent may be installed in the seller’s website. All mentioned functions are performed without the interference of a human being into the process. But intelligent software has to be pre-programmed in advance for performing these operations and for making possible decisions.

Suggestions to apply the principle of source-based taxation in e-commerce business-to-consumer contracts relating it with the activities of an intelligent software agent are first of all directed towards the aim for countries not to lose income received from taxation of profits of such companies (Schaefer, 2000). Also the existing similarities between the already mentioned activity of telesales centres and functions performed by an intelligent software agent allow making assumptions that also in the latter case the appearance of the institute of a permanent establishment may be discussed. Actions of human personnel of telesales centres cannot deviate from given instructions in the same way as an intelligent software agent cannot deviate from programmed commands (Sprague and Hersey, 2003-2004). The difference is only that in the first case a human is participating. But human participation is not an essential premise without which discussions about the acknowledgement of an intelligent software agent as a dependent agent would stop. The last comments of OECD on Article 5 of Model Convention also demonstrate this – Article 5 states that the presence of personnel in the place of a permanent establishment is not necessary, and the explication of the OECD Committee on Fiscal Affairs on human intervention into various stages of e-business states: "...that human intervention is not a requirement for the existence of a permanent establishment."10

Part 5 of Article 5 of the OECD Model Convention foresees that a person may be a dependent agent. This means natural as well as legal persons. Software may not be equated to a person. The independency of software when making decisions is very limited and cannot adapt to a changing environment. It does not matter how many

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10 Clarification on the application of the permanent establishment definition in e-commerce: changes to the commentary on the model tax convention on article 5 / OECD Committee on Fiscal Affairs. 22 December 2000
functions software may perform but always the help of an external subject will be necessary to ensure its functioning.

Also the authors emphasize other important aspects due to which it would be difficult to equate an intelligent software agent to a dependent agent. It is important to draw attention to the fact that an intelligent software agent is simple software that is placed on a website therefore a question arises on the determination of the company’s fixed place of business. A website may be related to the source, resident or a third country. The link between a fixed place of business and a website may have nothing in common with the company’s business in a certain country, and that means that also the fixing of the place of business of an intelligent software agent would be very complicated seeking to show a relation with a concrete country.

It needs to be mentioned that software may be assessed as satisfying the second, the third and the fourth requirements of a permanent agent. Software belongs totally to the company that manages it and there are no possibilities for intelligent software to perform independently not pre-programmed activities with other companies. Also software is programmed to act only on behalf of the company, and its activities are expressed by repetitive operations.

A parallel may be drawn between the limitation of operations performed by software that is ensured by technical means and the limitation of actions of traditional agents ensured by legal means (by signing contracts). But a natural or legal person participates in a contract as one party of the contract, having some rights and corresponding obligations and the institute of legal liability may be applied here; whereas software cannot be the subject of legal relations. It may be treated only as owned assets of a company.

IV. CONCLUSIONS

ISP does not acquire exceptional properties in e-commerce due to which it would not be possible to apply traditional legal norms to it when identifying the status of a dependent agent not changing the existing interpretation.

Whereas the range of actions performed by software is quite wide and a client can end the making of a contract, but the non-independency of software and the lack of legal status do not allow to treat it as a dependent agent which would create the institute of a permanent establishment in a foreign country.

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