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Denver Journal
OF INTERNATIONAL LAW AND POLICY

Taxing Boycotts and Bribes*

G.C. HUFBAUER**
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I. LEGISLATIVE HISTORY

A. *The Setting*

Between October 1973 and January 1974 the Mideast oil cartel raised the posted price of petroleum from $3.00 to $11.65 per barrel. In February 1975, Eli Black, President of United Brands, jumped to his death in mid-Manhattan. These seemingly unrelated events coalesced in the Tax Reform Act of 1976. Among other provisions, the Act contains severe tax penalties for U.S. persons who agree to participate in or cooperate with an international boycott or who bribe foreign officials.

The Arab boycott of Israel can be traced to 1946 when the Arab League declared that products of Palestinian Jews were to be considered undesirable in Arab countries. The year 1948 witnessed the creation of Israel, a de jure state of war between Israel and the Arab nations, and the Arab boycott office. All three still exist today. Until recently, however, the boycott was honored in the breach. With the quadrupling of oil prices and the multiplication of Arab economic power, boycott practices which previously existed mainly on paper were suddenly implemented and became a matter of concern—to Arab nations, to Israel, and to the United States Congress.[1]

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1. Wall St. J., June 25, 1976, at 1, col. 6.

Overseas bribery, like the boycott, has existed for many years. Boycott concern was triggered not by sensational new bribes, but by front page revelation of longstanding practices.[2]

Two bills were introduced during the second session of the 94th Congress to deal with these problems. On March 15, 1976, Senator Ribicoff and others introduced S. 3138, specifically aimed at the boycott of Israel. On March 16, 1976, Senator Harry Byrd, Jr., introduced S. 3150, aimed at the bribery of foreign officials. Over the serious misgivings of Senator Long, the two bills were melded together and included in the Senate Finance Committee version of H.R. 10612.[3] They passed the Senate essentially unchanged on August 6, 1976. Since the House had enacted no legislation on bribes or boycotts, the issues went to conference.

Bills were also introduced by Senators Stevenson and Williams,[4] and by Representatives Koch and Bingham[5] to address the boycott problem through tighter language in the Export Administration Act.[6] Among other features, these bills would have mandated disclosure of corporate boycott reports by the Commerce Department; prohibited U.S. firms from furnishing information pursuant to a boycott request on the firm's directors, officers, shareholders, or employees; and prohibited a refusal to deal with other U.S. firms pursuant to a boycott. There were differences between the House and Senate versions relating both to the scope of prohibited actions and to private dam-

2. *The Wall Street Journal* pursued the corporate expose with great diligence. *See, e.g.*, the following articles: Dec. 4, 1975, at 1, col. 6 (Lockheed Aircraft Corp.); Nov. 26, 1975, at 2, col. 1 (Castle & Cooke, Inc.); Nov. 17, 1975, at 1, col. 6 (Lockheed Aircraft Corp.); Nov. 14, 1975, at 1, col. 6 (Exxon Corp.); Oct. 20, 1975, at 20, col. 2 (American Home Prod. Corp.); July 14, 1975, at 10, col. 2 (Exxon Corp.); July 14, 1975, at 1, col. 6 (Del Monte Corp.); June 12, 1975, at 1, col. 6 (auditing procedures); May 21, 1975, at 5, col. 1 (Gulf Oil Corp.); May 21, 1975, at 4, col. 2 (United Brands Co., Del Monte Corp., Castle & Cooke, Inc.); May 19, 1975, at 2, col. 3 (Gulf Oil Corp.); May 19, 1975, at 1, col. 6 (U.S. oil company subsidiaries in Italy); May 15, 1975, at 3, col. 2 (Ashland Oil, Inc.); May 9, 1975, at 1, col. 1 (general practice of U.S. firms abroad); April 9, 1975, at 1, col. 6 (United Brands Co.).

3. S. REP. No. 938, 94th Cong., 1st Sess. 557-68 (1976).

4. S. 3084, 94th Cong., 2d Sess. (1976).

5. H.R. 5377, 94th Cong., 2d Sess. (1976).

6. 50 U.S.C. app. §§ 2401-13 (1970). Relevant committee reports include: HOUSE COMM. ON INT'L RELATIONS, EXTENDING THE EXPORT ADMINISTRATION ACT, H.R. REP. NO. 1469, 94th Cong., 2d Sess. (1976); SUBCOMM. ON OVERSIGHT AND INVESTIGATIONS OF THE HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 94th Cong., 2d Sess., THE ARAB BOYCOTT AND AMERICAN BUSINESS (1976).

age suits. While a Senate filibuster prevented the naming of conferees in the 94th Congress, a conference bill on amendments to the Export Administration Act was reported in the first session of the 95th Congress with the blessings of the Business Roundtable (170 officers of major U.S. corporations) and the Anti-Defamation League of B'nai B'rith and was enacted on June 22, 1977.[7]

B. *Administration Response*

The Ford Administration, and particularly the Treasury, applauded the goals of the 94th Congress but was unenthusiastic about new legislation in the context either of the Tax Reform Act or the Export Administration Act Amendments. Secretary Simon testified that existing U.S. anti-boycott measures were effective, that the Arab countries were liberalizing their boycott rules, and that new legislation might lead to confrontation and more rigid attitudes in the Middle East.[8]

The Treasury specifically objected to the tax measures contained in the Ribicoff Bill (S. 3138) for the following reasons:[9]

> (1) Existing legislation under the Export Administration Act, the Sherman Antitrust Act, and the Civil Rights Acts is more suited to dealing with the problem.
>
> (2) New legislation might have an adverse impact on trade and investment in the Arab League countries.
>
> (3) The possibility is at best small that the Arab countries would change their policies as a result of new legislation.
>
> (4) Tax legislation would impose a severe administrative burden on the Internal Revenue Service.

In connection with the Ford Administration's concerns, it may be noted that U.S. exports to Arab nations in 1976 were

7. Export Administration Amendments of 1977, Pub. L. No. 95-52, 91 Stat. 235, *amending* 50 U.S.C. app. §§ 2401-13 (1970).

8. Statement by Secretary of the Treasury William E. Simon before the House Committee on International Relations, in Department of the Treasury News Release No. 915 (June 9, 1976).

9. Letter from Secretary of the Treasury William E. Simon to Senate and House conferees on the Tax Reform Act of 1976, Aug. 26, 1976; Letter from Assistant Secretary for Tax Policy Charles Walker to Senator Russell Long, May 25, 1976.

approximately $8 billion. Total merchandise exports from all countries to the Arab nations amounted to some $60 billion for 1976; thus, U.S. sales already accounted for only 13 percent of the total. In addition, U.S. firms were carrying out Middle East construction contracts of approximately $20 billion, about one-half of the total outstanding contracts in the area. New contracts are vulnerable to competition from European and Japanese firms. On the other side of the ledger, U.S. imports of oil from the Arab countries amount to approximately 17 million barrels per day, some 30 percent of U.S. consumption. Meanwhile, the United States is a major depository for liquid funds from Arab countries, and the total of these funds could reach $40 billion by 1980.

At one time the Ford Administration might have had a choice between the Export Administration Act approach and the Tax Reform Act approach. However, instead of negotiating with Congress for one approach or the other, the Administration opposed both measures.[10] As a result, the 94th Congress enacted the tax legislation and the 95th Congress enacted the trade legislation.[11]

C. *Tax Reform Act of 1976*

The Conference Committee on the Tax Reform Act did not significantly alter the Senate language concerning foreign bribes.[12] Basically, the law provides that DISC (Domestic International Sales Corporation) and deferral benefits are lost with respect to the amount of any bribe paid directly or indirectly to an official, employee, or agent of any government. Further, the earnings and profits of a foreign corporation paying a bribe are not reduced by the amount of the bribe.

After prolonged and sometimes heated discussion, however, the Conference Committee did significantly narrow and

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10. President Gerald Ford endorsed the anti-boycott provisions of the Tax Reform Act of 1976 in his second televised debate with James Carter on Oct. 6, 1976, rather to the surprise of Administration officials who had been working the halls of Congress in an opposite direction.

11. The complexity and magnitude of the anti-boycott legislation, with its accompanying regulations and reporting requirements, sired the *Anti-Boycott Bulletin* published by the MIDDLE EAST MONTHLY, which deals exclusively with boycott issues.

12. The Senate bill treated the loss of tax benefits in terms of "bribe-produced income" while the Conference Committee related the loss of benefits to the amount of the bribe. Further, the Conference Committee deleted the Senate provision which would have denied foreign tax credit for bribe-produced income.

revise the Senate boycott provisions.[13] The Senate bill would have denied to all income from all boycotting countries the tax benefits associated with DISC, deferral, the foreign tax credit, and the exclusion from gross income of foreign earned income, even if a taxpayer had agreed to participate in the boycott at the behest of only one country. The Conference measure dropped the foreign earned income exclusion and set forth a proportional test for determining the extent to which tax benefits are denied. The Conference approach denies the various tax benefits in accordance with the ratio of sales, purchases, and payroll arising from boycott activity to total foreign sales, purchases, and payroll of the taxpayer. Alternatively, the taxpayer may specifically identify foreign taxes and income attributable to boycott activities and lose only the U.S. tax benefits associated with the specifically attributable taxes and income.

The Conference bill also carved out exceptions in the definition of an "international boycott" so as not to proscribe the kinds of trade restrictions which the United States itself has imposed from time to time, most recently on trade with Cuba and North Vietnam.

The definition of "participation in or cooperation with" an international boycott is fundamental to the anti-boycott provisions. The basic elements of the definition were first introduced by Senator Ribicoff. The Ribicoff bill[14] focused on the requirement that a taxpayer *agree* to participate in or cooperate with an international boycott before being subjected to tax sanctions. The requirement of an *agreement* remained intact throughout deliberation on the bill.[15] The seemingly simple concept of an agreement raises thorny factual issues which must ultimately be resolved on a case-by-case basis. These issues have long bedeviled the Sherman Antitrust Act and promise to be equally difficult in the boycott legislation.

Participation in or cooperation with an international boycott is also defined in terms of refraining from doing business with boycotted individuals, companies, or countries. Under the

13. H.R. REP. No. 1515, 94th Cong., 2d Sess. (1976). *See also* STAFF OF HOUSE COMM. ON WAYS AND MEANS, 94th Cong., 2d Sess., SUMMARY OF THE CONFERENCE AGREEMENT ON THE TAX REFORM ACT OF 1976 (Comm. Print 1976).

14. S. 3138, 94th Cong., 2d Sess. (1976).

15. INT. REV. CODE OF 1954, § 999(b)(3).

law, the benefits of DISC, deferral, and the foreign tax credit are lost to the extent a taxpayer agrees to refrain from doing business in furtherance of an international boycott.

D. *Export Administration Act Amendments of 1977*

While the boycott provisions of the Tax Reform Act[16] and the Export Administration Act[17] are parallel in many respects, there are significant differences, both as to triggering events and as to penalties. The tax provisions are triggered by a boycott *agreement*; boycott *actions* are relevant only insofar as they establish the existence of an agreement. By contrast, the trade provisions are triggered by boycott *actions*; and *agreement* is relevant only if it is carried out. Violation of the anti-boycott provisions of the Export Administration Act results in criminal penalties while violation of the anti-boycott provisions of the Tax Reform Act results in the denial of tax benefits. This difference of course implies a higher standard of proof (including proof of culpable intent) to obtain a conviction under the Export Administration Act than to impose penalties under the Tax Reform Act.[18] Middle level corporate executives are the likely target of the Export Administration Act, whereas corporate profits are the target of the Tax Reform Act. The Treasury Department is responsible for administering the Tax Reform Act, and the Commerce Department is responsible for administering the Export Administration Act. All these differences necessarily mean that the standards of behavior required under the Tax Reform Act are not precisely the same as the standards of behavior required under the Export Administration Act — much to the frustration of affected corporations and individuals.

Prohibited actions under the Export Administration Amendments are similar (but not identical) to those in the Tax Reform Act. The actions prohibited by the Export Administration Act include:[19]

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16. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1525, *amending* INT. REV. CODE OF 1954.

17. Export Administration Amendments of 1977, Pub. L. No. 95-52, 91 Stat. 235, *amending* 50 U.S.C. app. §§ 2401-13 (1970).

18. On the other hand, it may be inherently more difficult to prove the existence of an agreement than to prove the occurrence of particular actions.

19. Export Administration Amendments of 1977, § 201(a).

(1) Refusing, or requiring any other person to refuse, to do business with or in a boycotted country, with any business concern organized under the laws of the boycotted country, or with any national or resident of the boycotted country.
(2) Refusing, or requiring any other person to refuse, to employ or otherwise discriminate against any U.S. person on the basis of the race, religion, sex, or national origin of that person or of any owner, officer, director, or employee of that person.
(3) Furnishing information on the race, religion, sex, or national origin of any U.S. person or any owner, officer, director, or employee of a U.S. person.
(4) Furnishing information about whether any person has, has had, or proposes to have any business relationship with or in a boycotted country, with any business concern organized under the laws of the boycotted country, or with any national or resident of the boycotted country.
(5) Furnishing information about whether any person is a member of, has made contributions to, or is otherwise associated with or involved in the activities of a charitable or fraternal organization which supports the boycotted country.
(6) Paying, honoring, confirming, or otherwise implementing a letter of credit containing a prohibited boycott condition.

The Export Administration Amendments provide certain exceptions to the prohibited actions. These exceptions include:

(1) Compliance with requirements prohibiting the importation into the boycotting country of goods or services from the boycotted country or any business organized under the laws of the boycotted country, or compliance with requirements prohibiting the shipment of goods to the boycotting country on a carrier of the boycotted country, or by a route other than that prescribed by the boycotting country or its nationals.
(2) Compliance with certification requirements contained in import and shipping documents as to the country of origin, name and nationality of the

carrier, route of shipment, and the name of the supplier.
(3) Compliance with the unilateral and specific selection of goods and services by a boycotting country or its nationals.
(4) Compliance with export requirements relating to shipments or transshipments of exports.
(5) Compliance with immigration or passport requirements.
(6) Compliance by a U.S. person resident in a foreign country with local law with respect to that person's activities in that country.

The Commerce Department is now preparing rules and regulations to implement the Export Administration Amendments; preliminary rules must be issued within 90 days from enactment of the statute (June 22, 1977), and final rules must be issued within another 120 days.

E. *Treasury Guidelines and Other Procedures*

As the first step in administering the anti-boycott provisions of the Tax Reform Act of 1976,[20] the Secretary of the Treasury issued Guidelines consisting of questions and answers relating to the denial of certain tax benefits for participation in or cooperation with an international boycott. The first set of Guidelines was issued on November 4, 1976;[21] a supplementary set of Guidelines was issued on December 30, 1976.[22] In response to congressional criticism, primarily from Senator Ribicoff, the Carter Administration reviewed the Guidelines issued by the Ford Administration. This review culminated in a public hearing on April 29, 1977, chaired by Laurence N. Woodworth, Assistant Secretary for Tax Policy. Six witnesses made statements and numerous written comments were submitted.

The Carter Administration published a revised set of Guidelines on August 12, 1977, superseding all previous Guidelines.[23] These Guidelines will be followed by the Internal Reve-

20. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1525, *amending* INT. REV. CODE OF 1954.

21. Tax Reform Act of 1976 Guidelines; International Boycotts, 1976 INT. REV. BULL. No. 49, at 17 [hereinafter cited as Guidelines I].

22. Tax Reform Act of 1976 Guidelines; International Boycotts, 1977 INT. REV. BULL. No. 5, at 19 [hereinafter cited as Guidelines II].

23. Tax Reform Act of 1976 Guidelines; International Boycotts, 42 Fed. Reg. 41504

nue Service and the Treasury in requiring the filing of taxpayer reports, in making determinations as to participation in or cooperation with an international boycott, and in computing the loss of tax benefits associated with boycott participation or cooperation.[24]

As an additional step in administering the boycott provision, the Internal Revenue Service issued a revenue procedure setting forth the procedures for the issuance of "determinations" under section 999(d) relating to whether a particular activity constitutes participation in or cooperation with an international boycott.[25] Further steps in the administration of the law involved the publication of temporary and proposed regulations relating to the computation of the international boycott factor,[26] and the issuance of Form 5713, "International Boycott Report,"[27] to be used by taxpayers in fulfilling their reporting obligations under the anti-boycott provisions of the Tax Reform Act.

II. INTERNATIONAL BOYCOTTS

A. *Exception for Certain Boycotts*

Not all boycotts are bad. The United States itself has a history of boycotting foreign nations. Thus, the boycott legislation contains certain safe havens which permit the same kinds of trading restrictions which the United States itself has imposed in recent years under the authority of the Trading with

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(1977). These August 12, 1977 Guidelines contain new questions and answers and revisions to the first and second sets of Guidelines. To a large extent, however, the August 12, 1977 Guidelines carry over the questions and answers contained in the earlier Guidelines. Changes in the Guidelines which result in an increase in the reporting burden or tax liability of a person will be effective after August 22, 1977. The same numbering system is used in all three sets.

24. The Guidelines interpret the statute and the Conference Committee Report. While the Conference Committee was open to the public, and a transcript was maintained, little weight was given to that transcript in preparing the Guidelines. After the statute itself, Conference Committee Reports are regarded as the best indication of legislative intent. The appropriate weight to be given to a Conference Committee transcript is not well defined, particularly when the transcript amplifies or conflicts with the statute or the Committee Report. Public disclosure of Conference transcripts is a new occurrence , untested by the judicial system. However, for purposes of interpreting a statute, the courts may give substantial weight to contemporaneous statements made by a bill's sponsors.

25. 1977 INT. REV. BULL. No. 14, at 16 (proposed 26 C.F.R. 7.999-1).

26. Temporary Treas. Reg. § 7.999-1; Proposed Treas. Reg. § 1.999-1 (1977).

27. Department of the Treasury, Form 5713, *International Boycott Report,* May 1977.

the Enemy Act[28] and the Export Administration Act.[29] Thus, a taxpayer may agree to meet requirements imposed by a foreign country with respect to any manner of international boycott if United States law, regulations, or Executive Orders sanction that boycott.[30] In addition, whether or not there is a U.S. sanction, a taxpayer may agree to comply with either a prohibition on the importation of goods produced in whole or in part in any country which is the object of an international boycott[31] or a prohibition on the exportation of products to a country which is the object of an international boycott.[32]

B. *Boycott Agreements*

Tax benefits are denied under the boycott provision of the Tax Reform Act of 1976 only when a taxpayer *agrees* to participate in or cooperate with an international boycott.[33] The taxpayer is punished not for deeds, but for an agreement to commit those deeds. The mere fact that a taxpayer refrains from hiring Jews, refrains from doing business with a U.S. company on the Arab blacklist, or refrains from shipping on blacklisted vessels is not sufficient, in and of itself, to result in a loss of tax benefits. The taxpayer must *agree* to refrain from these activities to be affected by the anti-boycott sanctions contained in the Tax Reform Act of 1976. The Treasury Guidelines focus on the requirement of an explicit or implicit agreement, either written or oral.[34] When there is no explicit agreement, the existence of an agreement will not be inferred solely from the fact that a taxpayer has refrained from activities enumerated in the legislation.[35] However, a clear pattern of refraining from certain business arrangements could indicate that the taxpayer has agreed to refrain from these activities, and the burden would be on the taxpayer to establish otherwise. Thus,

28. 50 U.S.C. §§ 1-44 (1970).

29. 50 U.S.C. app. §§ 2401-13 (1970).

30. INT. REV. CODE OF 1954, § 999(b)(4)(A).

31. INT. REV. CODE OF 1954, § 999(b)(4)(B).

32. INT. REV. CODE OF 1954, § 999(b)(4)(C).

33. INT. REV. CODE OF 1954, § 999(b)(3).

34. Guidelines I, *supra* note 21, at 23 (Qs. H-1, H-2).

35. *Id.* at 24 (Q. H-5). The answer to H-5 was tightened in the revised Guidelines of August 12, 1977, to provide that a course of conduct "is evidence that, together with other evidence, could be sufficient to establish an implied agreement." A similar *in terrorem* caution was added to the prefatory material in the August 12, 1977 Guidelines in item (g).

an overall course of conduct could support an inference that an agreement exists, even though component parts of that conduct, by themselves, would not.[36]

The Guidelines draw a fine distinction between the permitted act of recognizing the application of a country's laws, regulations, requirements, or administrative practices[37] and the prohibited act of complying with those laws, regulations, requirements, or administrative practices.[38] The distinction is further developed in the hypothetical case of a subsidiary or a branch that acknowledges in its incorporation or registration documents that local laws apply to it, including local laws that implement a boycott. In this hypothetical case the acknowledgement of local law does not constitute a boycott agreement or support the inference that an agreement exists.[39]

Letters of credit and accompanying certificates are another area where fine lines have been drawn. Under the November 4, 1976 Guidelines, a bank could honor (with no loss of tax benefits) a letter of credit which required the bank to confirm that the payee has furnished a certificate of boycott compliance.[40] The reasoning of the November 4, 1976 Guidelines was that the bank had not itself refrained from the activities listed in section 999(b)(3). The August 12, 1977 Guidelines reverse this result. The bank, by confirming the certificate of boycott compliance contained in a letter of credit is now deemed to have entered into an agreement. By confirming the letter of credit with a boycott certificate, the bank is deemed to agree

36. Question H-14, for example, deals with the hypothetical example wherein a construction contract with a boycotting country specifies a list of permissible subcontractors. Such a contract indicates a pattern of exclusion; however, the general contractor might be able to show that the nonlisted companies were excluded for reasons unrelated to the boycott. Guidelines I, *supra* note 21, at 25.

37. Guidelines I, *supra* note 21, at 24 (Q. H-3). The August 12, 1977 Guidelines include a provision in the answer to H-3, noting that a course of conduct of complying with local boycott laws, regulations, requirements, or administrative practices may be evidence of an agreement to comply.

38. *Id.* at 24 (Q. H-4). This distinction parallels the language of the Conference Committee Report, S. REP. NO. 94-1236, 94th Cong., 2d Sess. 466-67 (1976). By contrast, the Export Administration Amendments provide an exception to the prohibited actions whereby a person can comply with or agree to comply with local law.

39. *Id.* at 24 (Q. H-7).

40. *Id.* at 27 (Q. H-29). The Export Administration Amendments specifically prohibit the paying, honoring, confirming, or otherwise implementing a letter of credit containing boycott conditions.

to refrain from doing business with any other U.S. persons that might not have been able to furnish a boycott certificate. The bank will therefore lose its tax benefits. Further, if a bank promises a boycotting country that it will not honor letters of credit relating to the export of goods to a boycotted country, the bank will lose its tax benefits.[41] Such a promise would amount to an agreement to refrain from doing business with the government, companies, or nationals of a boycotted country.

These distinctions and others mirror the fine lines that resulted from the legislative compromises underlying the statute and the Conference Report. Congress apparently intended to put some pressure on taxpayers with operations in boycotting countries without abruptly terminating all U.S. business activity in the Middle East.

C. *Related Boycotts and Related Persons*

If a taxpayer has agreed to an international boycott sponsored by one country, he is presumed to have agreed to cooperate with all countries associated in carrying out that international boycott.[42] Further, if a person controls or is controlled by[43] a corporation which participates in or cooperates with an international boycott, the controlling person or the controlled person is presumed to participate or cooperate in the boycott.[44] The taint of participation and cooperation thus spreads from one boycotting country to another and from one related corporation to another. If a person agrees to the Libyan boycott of Israel, that person will be presumed to have agreed to the Syrian boycott of Israel. Further, if corporation *A* agrees to boycott Israel, related corporation *B* will be presumed to have agreed to boycott Israel. However, these presumptions of taint may be rebutted if a taxpayer can clearly demonstrate that he or a

41. *Id.* at 27 (Q. H-30).

42. INT. REV. CODE OF 1954, § 999(b)(1).

43. INT. REV. CODE OF 1954, § 304(c) sets forth the relevant test of control as the ownership (actual or constructive) of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock.

44. INT. REV. CODE OF 1954, § 999(e)(1)-(2). Guidelines I, *supra* note 21, at 20 (Q. D-1). Note that under INT. REV. CODE OF 1954, § 7701(a)(1), a person includes an individual, trust, estate, partnership, association, company, or corporation.

member of a controlled group of corporations[45] of which he is a member, has separate and identifiable operations that were not involved with the international boycott.[46]

D. *Types of Boycott Activity*

An agreement to participate in or cooperate with an international boycott may involve any one of five different types of activity.

The first type of boycott activity involves refraining from doing business with or in a boycotted country.[47] A borderline example illustrates this case: A company owns a number of ships, some of which call at the boycotted country and some of which call at the boycotting country. The ships calling at the boycotting country refrain from calling at the boycotted country. This is not considered participation in or cooperation with an international boycott; the shipping company has not refrained from doing business with the boycotted country since some of its ships call there.[48]

The second type of boycott activity involves refraining from doing business with any U.S. person engaged in trade in a boycotted country.[49] Again borderline examples illustrate the rule. A U.S. company may agree to refrain from doing business with a foreign subsidiary of a U.S. company without refraining from doing business with a U.S. person.[50] Further, a bank which provides financial advice may agree to refrain from recommending for investment by a boycotting country the shares of U.S. companies engaged in trade in a boycotted country.[51] The rationale is that the bank itself has not agreed to refrain from doing business with the issuing companies. Finally, a bank managing an investment portfolio for a boycotting country may agree to refrain from purchasing stocks or bonds issued by certain companies on the theory that the concept of "doing

45. INT. REV. CODE OF 1954, § 993(a)(3) defines a controlled group of corporations.

46. Guidelines I, *supra* note 21, at 20 (Qs. D-1, D-2).

47. INT. REV. CODE OF 1954, § 999(b)(3)(A)(i).

48. Guidelines I, *supra* note 21, at 28 (Q. I-2).

49. INT. REV. CODE OF 1954, § 999(b)(3)(A)(ii). Section 7701(a)(30) defines the term "United States person" to mean: (A) a citizen or resident of the United States; (B) a domestic partnership; (C) a domestic corporation; and (D) any estate or trust (other than a foreign estate or foreign trust).

50. Guidelines I, *supra* note 21, at 28 (Q. J-4).

51. *Id.* at 29 (Q. J-5).

business" with a company does not encompass the purchase of that company's securities.[52]

The third type of boycott activity involves an agreement to refrain from doing business with any company whose ownership or management is made up, in whole or in part, of individuals of a particular nationality, race, or religion.[53] The fourth type involves an agreement to refrain from employing individuals of a particular nationality, race, or religion.[54] These last two anti-boycott provisions parallel the concerns of civil rights legislation. The basic standards established under that legislation are carried over in the Guidelines.[55]

The fifth and final type of boycott activity relates to conditional sales agreements which require refraining from shipping or insuring products on a carrier owned, leased, or operated by a person who does not participate in or cooperate with an international boycott.[56] The Guidelines provide a war risk safe haven rule: compliance with precautionary shipping measures designed to avoid the risk of confiscation of goods does not involve participation in or cooperation with an international boycott.[57]

E. *Tax Penalties*

Current U.S. taxation of the undistributed earnings of a foreign subsidiary, current taxation of DISC earnings, and denial of the foreign tax credit all occur if a firm agrees to an international boycott. The actual amount of benefits denied depends not only on the extent of participation and cooperation but also on the method used to compute the reduction of tax benefits.

There are two alternative methods for computing the loss of tax benefits. A taxpayer can use the international boycott factor, or the taxpayer can determine the taxes and income specifically attributable to his boycott activities.[58]

52. *Id.* at 29 (Q. J-6).
53. INT. REV. CODE OF 1954, § 999(b)(3)(A)(iii).
54. INT. REV. CODE OF 1954, § 999(b)(3)(A)(iv).
55. Guidelines I, *supra* note 21, at 29-30 (Qs. K,L).
56. INT. REV. CODE OF 1954, § 999(b)(3)(B). Guidelines I, *supra* note 21, at 30-32 (Part M).
57. Guidelines I, *supra* note 21, at 31 (Q. M-5). A similar exception is contained in the Export Administration Amendments.
58. INT. REV. CODE OF 1954, § 999(c).

The international boycott factor is intended for use primarily by taxpayers who cannot clearly separate boycott and nonboycott operations. The international boycott factor is a fraction. The numerator of the fraction reflects the operations of a person (or of the controlled group) which are related to all countries associated in carrying out a particular international boycott, and is determined by computing the *sum* of purchases made from, sales made to or from, and payroll paid or accrued for services performed in these countries *minus* the amount of purchases, sales, and payroll clearly demonstrated to be attributable to nonboycott operations in these countries.[59] The denominator of the fraction reflects the worldwide[60] operations of that person (or controlled group) and is determined by computing the sum of purchases made from, sales made to or from, and payroll paid or accrued for services performed in any country other than the United States.[61]

Using the international boycott factor method, the reduction in tax benefits resulting from a boycott agreement is determined by multiplying the otherwise allowable tax benefit by the taxpayer's boycott factor. In the case of DISC and deferral, the law operates by requiring a deemed distribution to the shareholders of the DISC[62] or to the shareholders of the controlled foreign corporation[63] of the amount found by multiplying undistributed earnings by the factor. Alternatively, under the specifically attributable method, the amount deemed distributed to the shareholders of the DISC or to the shareholders of the controlled foreign corporation is the amount of income specifically attributable to the boycott operations.[64]

The method of computing the reduction of the foreign tax credit differs depending on whether the international boycott factor or the specifically attributable taxes and income method is used. If the international boycott factor is used, the reduc-

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59. INT. REV. CODE OF 1954, § 999(c)(1). *See* Temporary Treas. Reg. § 7.999-1; Proposed Treas. Reg. § 1.999-1 (1977).

60. INT. REV. CODE OF 1954, § 999(c)(3) defines "worldwide" to mean operations in or related to countries other than the United States.

61. INT. REV. CODE OF 1954, § 999(c)(1). *See* Temporary Treas. Reg. § 7.999-1; Proposed Treas. Reg. § 1.999-1 (1977).

)2. INT. REV. CODE OF 1954, § 995(b)(1).

63. INT. REV. CODE OF 1954, § 952(a).

64. INT. REV. CODE OF 1954, § 999(c)(2).

tion in the foreign tax credit is determined by computing the foreign tax credit that would be allowed under section 901 for the taxable year as if section 908 (relating to boycotts) had not been enacted. The section 901 credit encompasses both the direct credit and the indirect credits allowable under sections 902 and 960. The section 901 credit is subject to the limitations of both section 904 (the overall limitation) and section 907 (the special limitation for oil related income). If a person participates in a boycott, the credit allowed under section 901 is reduced by the product resulting from multiplying the section 901 credit (before the application of the section 908 reduction) by the international boycott factor.[65]

If a taxpayer can clearly demonstrate the amount of foreign taxes and earnings which are allocable to his boycott operations, the international boycott factor need not be used.[66] Instead, the reduction in foreign tax credit is computed by reducing the amount of foreign taxes paid, before determination of the section 904 limitation, by all foreign taxes not specifically attributable to nonboycott operations.[67]

The taxes which are not creditable either by application of the international boycott factor method or the specifically attributable method are deductible, despite the general rule that a taxpayer cannot in a given taxable year claim both a credit and a deduction for foreign taxes.[68] Moreover, no recomputation of the section 901 credit nor the section 904 limitation is made after the deduction.[69]

F. *Reporting Requirements*

The boycott legislation imposes extensive reporting requirements both on individual taxpayers and on the Secretary of the Treasury. In some instances, the reporting burden may turn out to be the heaviest penalty of the statute. Generally, any U.S. person or any other person that either claims the benefit of the foreign tax credit under section 901 or owns stock in a DISC is required to report to the Internal Revenue Service

65. Guidelines II, *supra* note 22, at 22 (Q. N-1).

66. INT. REV. CODE OF 1954, § 999 (c)(2); Guidelines I, *supra* note 21, at 20 (Q. D-3).

67. Guidelines II, *supra* note 22, at 22 (Q. N-1).

68. INT. REV. CODE OF 1954, §§ 78, 275(a)(4), 908(b).

69. Guidelines II, *supra* note 22, at 22 (Q. N-2).

if it has operations in or related to a boycotting country.[70] Boycotting countries, for purposes of reporting under the statute, include two groups of countries: first, those countries on the Secretary's list of countries[71] which currently require or may require participation in or cooperation with an international boycott and, second, any other country in which the person required to file the report (or a member of a controlled group which includes that person) has operations and which the person knows or has reason to know requires *any* person to participate in or cooperate with an international boycott.[72]

A person required to file an international boycott report under section 999(a) will fulfill this requirement by filing a new Internal Revenue Service Form 5713, "International Boycott Report Form."[73] These reports will be submitted as part of the taxpayer's income tax return and, therefore, will be accorded the same degree of confidential treatment under section 6103 as any other information contained in an income tax return.[74]

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70. INT. REV. CODE OF 1954, § 999(a); Guidelines I, *supra* note 21, at 17 (Q. A-1), provides that a person is required to report if he: (a) has operations; or (b) is a member of a controlled group, a member of which has operations; or (c) is a U.S. shareholder (within the meaning of section 951(b)) of a foreign corporation that has operations, but only if a U.S. shareholder owns (within the meaning of section 958(a)) stock of that foreign corporation; or (d) is a partner of a partnership that has operations; or (e) is treated under section 671 as the owner of a trust that has operations in or related to a boycotting country. Additionally, if a person controls a corporation (within the meaning of section 304(c)) and either that person or the controlled corporation is required to report under section 999(e), that person must report whether the controlled corporation participated in or cooperated with the boycott. The controlled corporation must make the same report with respect to the operations and reports of the person controlling it. *See* text accompanying notes 75-77 *infra* for exceptions to the reporting requirements.

71. International boycotting countries included on the list published by the Secretary, effective Nov. 4, 1976, are as follows: Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Lybia, Oman, Qatar, Saudi Arabia, Syria, United Arab Emirates, Yemen Arab Republic, and the Peoples Democratic Republic of Yemen. 1976 INT. REV. BULL. No. 49, at 17. As of August 1977, the list has not been changed.

72. Boycotts sanctioned by INT. REV. CODE OF 1954 §§ 999(b)(4)(A), (B), or (C) are not included for purposes of this reporting requirement.

73. Guidelines I, *supra* note 21, at 18 (Q. A-5). The "International Boycott Report" will cover the same time period as the taxpayer's income tax return. In the case of a controlled group, all persons required to report under section 999(a) shall report for all members of the controlled group for the taxable years of those members which end with or within the taxable year of the controlled group's common parent that ends with or within the taxable year of the reporting person. In the event no common parent exists, the members of the controlled group shall elect the tax year of one of the members to serve as the common tax year for the group. *Id.* at 19 (Q. A-13).

74. *Id.* at 18 (Q. A-6). In this respect, the reports differ from those submitted to

Reports by taxpayers are waived in certain circumstances. Taxpayers are not required to report participation in or cooperation with an international boycott if the operations are sanctioned by section 999(b)(4), unless the boycotting country is on the list maintained by the Secretary of the Treasury.[75] A foreign corporation need not file an international boycott report for any taxable year unless it claims the benefits of the foreign tax credit under section 901 or owns stock in a DISC.[76] Other waivers are provided for special situations.[77]

The Secretary of the Treasury must report to Congress annually on the administration of the boycott provision.[78] The Secretary is also required to maintain and publish quarterly a current list of countries which require or may require participation in or cooperation with an international boycott.[79]

G. *Determinations*

In dealing with boycotts through the tax statutes, Congress realized that the burden of proof would be shifted to the taxpayer once the Internal Revenue Service asserted a deficiency. This was no doubt a welcome feature to Senator Ribicoff and other sponsors. By the same token, it was obviously a matter of concern to affected companies. In the tug and haul of legislative compromise, a novel procedure was devised. Upon request from a taxpayer, the Secretary of the Treasury is directed to issue a "determination" with respect to whether a particular operation of a taxpayer, or a member of a controlled group which includes that taxpayer, constitutes participation in or cooperation with an international boycott.[80] Assuming the

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the Commerce Department under the Export Administration Act (50 U.S.C. app. § 2406(c)). In October 1976, President Ford announced that reports submitted under the Export Administration Act would be made public.

75. *Id.* at 17 (Q. A-1).

76. *Id.* at 19 (Q. A-12).

77. *See, e.g.*, Guidelines II, *supra* note 22, at 20 (Qs. A-14, A-17, A-18).

78. Tax Reform Act of 1976, § 1067(a) requires the Secretary to set forth: (1) the number of international boycott reports filed; (2) the number of such reports indicating international boycott participation or cooperation; and (3) a detailed description of the administration of the boycott provision. The Conference Report invites the Secretary to provide additional information which would be helpful in evaluating the legislation.

79. INT. REV. CODE OF 1954, § 999(a)(3).

80. INT. REV. CODE OF 1954, § 999(d). While section 999(d) provides that a taxpayer may request a determination in advance of an operation, or before the end of a taxable year in which the operation is carried out, the Secretary may decline to issue such a determination before the close of the taxable year.

taxpayer's factual statements are correct, the determination will be binding for purposes of a subsequent audit. The determination and background documents relating to it will be subject to public inspection, unlike an international boycott report.[81]

H. *Effective Date Provisions*

Generally, the reporting requirements and tax sanctions apply to boycott agreements made after November 3, 1976, and to agreements made on or before November 3, 1976, that continue after that date.[82] However, operations on or before November 3, 1976, are also reportable if the taxpayer enters into a boycott agreement after the November 4, 1976, effective date.[83]

The Act contains a binding contract rule. Under this rule, the tax sanctions and reporting requirements apply only to boycott agreements made on or after September 2, 1976, and to agreements made before that date that continue after December 31, 1977.[84]

A person may renounce existing agreements to participate in or cooperate with an international boycott by communicating his renunciation to the government or person with whom the agreement was made.[85] A renunciation will avoid the tax penalties otherwise imposed.

III. FOREIGN BRIBES

The foreign bribe provision of the Tax Reform Act of 1976 denies the benefits of deferral and DISC for the amount of any illegal payment made by or on behalf of a controlled foreign corporation or a DISC to an official, employee, or agent of any government.[86] The benefits of deferral are denied by treating the amount of illegal bribes, kickbacks, or other payments as subpart F income, as defined in section 952(a). The benefits of

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81. Guidelines I, *supra* note 21, at 23 (Q. G-1). A determination will be treated as a "written determination" within the meaning of section 6110(b)(1) and will be subject to the rules set forth in section 6110(c).

82. Tax Reform Act of 1976, § 1066(a)(1); Guidelines I, *supra* note 21, at 21 (Q. E-1).

83. Guidelines I, *supra* note 21, at 20 (Q. E-1).

84. Tax Reform Act of 1976, § 1066(a)(2); Guidelines I, *supra* note 21, at 20 (Q. E-1). Special transition rules are set forth in Questions E-2 and E-3. *Id.* at 21.

85. Guidelines I, *supra* note 21, at 22 (Q. E-5).

86. INT. REV. CODE OF 1954, §§ 952(a)(4), 995(b)(1)(iii). These provisions apply to all illegal payments made after Nov. 3, 1976. Tax Reform Act of 1976, § 1066(b).

DISC are denied by treating the amount of illegal bribes, kickbacks, or other payments as distributions under section 995(b)(1). Further, the amount of illegal payments may not be used to reduce the earnings and profits (or to enlarge the deficit) of a foreign corporation.[87]

Illegal bribes, kickbacks, or other payments are defined under section 162(c). Such payments have long been disallowed as a deduction for U.S. tax purposes when they are considered unlawful under the laws of the United States or under any generally enforced law of a state.[88] Penalties are now provided for illegal payments made by foreign subsidiaries of U.S. corporations. The significance of the foreign bribe legislation is that foreign subsidiaries of U.S. corporations can no longer disregard the U.S. tax consequences of illegal payments.

In an attempt to uncover corporate tax evasion and avoidance schemes involving illegal bribes, kickbacks, and other payments, the Internal Revenue Service initiated an audit program characterized by the so-called "eleven questions" even before the Tax Reform Act was passed. Under this program, the auditors ask corporate officials, key employees, and accountants eleven specific questions concerning illegal bribes, kickbacks, and other payments.[89] Responses to the questions must be provided in writing and under oath. U.S. companies and their foreign subsidiaries that are engaged in bribing foreign officials now run the dual risk of additional U.S. tax liability and, if the illegal payments are concealed, U.S. perjury charges.

IV. SUMMARY OBSERVATIONS

A. *Novelty and Complexity*

The international boycott and foreign bribe provisions, like the Sherman Antitrust Act and the Trading with the Enemy Act, are extraterritorial in scope. Like the accumulated earnings tax and the personal holding company tax, the boycott and bribe provisions are used for penalty purposes. Finally, like the gambling and narcotics excise taxes, the purpose of the boycott and bribe penalty is not to collect revenue but

87. INT. REV. CODE OF 1954, § 964(a).

88. Treas. Reg. §§ 1.162-18(a)(4), 1.162-18(b)(2) (1977).

89. Department of the Treasury News Release, No. IR-1590 (Apr. 7, 1976).

to further public policy. What is novel in the new legislation is not the individual elements but the combination of extraterritoriality, penalty, and non-revenue considerations in a single provision. Whether this combination is viewed as a wise or improvident use of the tax law depends very much on the observer.

The sanctions imposed by these provisions may bear little relation to the offense. Moreover, benefits denied under the boycott provision depend as much on the method of computation as on the extent of participation and cooperation. For example, the taxpayer can select either the international boycott factor method or the specifically attributable method for computing tax benefits denied. Depending on the extent of their excess foreign tax credits, some taxpayers who use the specifically attributable method will incur no tax penalty, even though they cooperate fully with an international boycott. The same can be true of a U.S. corporation that bribes foreign officials using the earnings of a highly-taxed foreign subsidiary.

This paper testifies to the complexity of the tax statute. When a compromise law is drafted under severe time pressures, the result, as in this case, can easily resemble a lawyers' and accountants' relief act. The Export Administration Act Amendments, enacted after longer Congressional deliberation, seem simpler and clearer — in defining prohibited actions, in defining exceptions, and in stipulating penalties. Unfortunately, pride of legislative authorship may well preclude harmonization or merger of the Tax Reform Act provisions with the Export Administration Act Amendments.

B. *Tax Treaty Implications*

The Model U.S. Income Tax Convention, as well as some existing U.S. income tax treaties, guarantee a foreign tax credit for taxes paid to a treaty partner. Denial of the foreign tax credit for participation in or cooperation with an international boycott might be construed as a violation of these treaty provisions. The Treasury Department believes that the boycott legislation does not conflict with existing treaties, but merely amends U.S. law in a manner generally contemplated by the treaty language. For example, Article 23 (Relief from Double Taxation) of the U.S. Model Income Tax Convention, which has language similar to that of many existing treaties, provides that "subject to the limitations of the law of the United States

(as it may be amended from time to time without changing the general principle thereof), the United States shall allow . . . a credit against . . . United States tax."[90] This language specifically permits changes in U.S. law, provided the general principles of the foreign tax credit are not disturbed. The boycott provision is just such a change.

C. *Revenue Impact*

At best, it is difficult to estimate the revenue consequences of changes in taxation of international transactions. The revenue impact of a given change may depend on complex interactions between U.S. and foreign tax laws, the foreign tax credit limitation, and methods of organizing business enterprises. All these difficulties were inherent in the bribe and boycott provisions of the Tax Reform Act of 1976. To make matters worse, it is customary to express revenue estimates as point estimates rather than range estimates. Point estimates convey a false sense of precision, particularly for the boycott and bribe provisions.

With these caveats, the revenue estimates of the Senate and Conference Committee versions of the boycott and bribe provisions were estimated as follows, by fiscal year:

Millions of Dollars[91]

	1977	1978	1979	1980	1981
House	—	—	—	—	—
Senate	142	100	100	100	100
Conference	*	32	70	70	70

— nil

*Less than $5 million

90. Department of the Treasury, *Model Convention Between the Government of the United States of America and the Government of. . . for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital*, May 18, 1976.

91. Source: COMMITTEE ON CONFERENCE, TAX REFORM ACT OF 1976, H.R. REP. NO. 94-1515, 94th Cong., 2d Sess. 634 (1976).

At least 90 percent of the revenue projected in the Conference bill is related to boycotts and no more that 10 percent to bribes. A rough breakdown might be (in millions of dollars):

Boycott provision: denial of —	
Foreign tax credit	50
Deferral	10
DISC	5
Bribe provision	5
	—
Total, Conference bill, 1979	70

Revenue estimates are intended to show the impact of a change in law prior to any economic response. But a major reason for passing the bribe and boycott legislation was to persuade companies to change their business methods. There are a number of ways affected companies and countries can adjust their practices:

(1) They can stop participating in boycotts and they can stop paying bribes.
(2) Foreign countries can stop requiring participation in boycotts, and they can impose effective local sanctions against bribery.
(3) Companies with boycott and bribe activities can attempt to isolate those activities from other lines of business to avoid contamination.

While it is by no means certain that this legislation will have a significant revenue effect, the provisions are important. Senior officials of any prudent company will think twice before becoming mired in audit controversy and possible litigation over boycotts and bribes.