COMMENTS

PAYMENTS TO FOREIGN OFFICIALS BY MULTINATIONAL CORPORATIONS: BRIBERY OR BUSINESS EXPENSE AND THE EFFECTS OF UNITED STATES POLICY

The successful transaction of business in the international community by a corporation necessitates compliance with certain accepted international trade customs and practices. Throughout the global business market, payment of funds to consultants, agents, middlemen or foreign officials is a prerequisite to successful transaction of business.[1] Multinational corporations (MNC's)[2] expend a substantial amount of corporate funds in such

1. *Hearings on Political Contributions to Foreign Governments Before the Subcommittee on Multinational Corporations of the Senate Committee on Foreign Relations*, 94th Cong., 1st Sess., at 167 (1975) (testimony of Thomas V. Jones, President and Chairman of the Board of Northrop Corp.) [hereinafter cited as *Hearings*]. A portion of the testimony appears below:

> Senator PERCY. Had you had a frustration in not being able prior to the 15 years overseas experience you had in not being able to really land overseas contracts and, this was impairing your business, and that you as a management, wondered why and began to study the arrangements of some of those who had been more successful? [sic]
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> Mr. JONES. Precisely.

Id. See also S. Res. 265, 94th Cong., 1st Sess., 121 CONG. REC. 16,735 (daily ed. Sept. 25, 1975) (co-authored and submitted by Senator Ribicoff and based on facts revealed in the investigation being conducted by the Senate Subcommittee on Multinational Corporations). In his remarks Senator Ribicoff stated that:

> [P]olicies and practices in foreign nations necessitate the use of special and unusual payments through middlemen, and the use of direct and indirect payments to foreign government officials, to reasonably and effectively compete in those markets. . . .

Id. See generally Polk, *Slush*, THE NEW REPUBLIC, May 17, 1975, at 21; TIME, June 23, 1975, at 52; Wall Street Journal, May 9, 1975, at 1, col. 1.

2. A multinational corporation is defined as a related group of companies operating simultaneously in different countries and therefore subject to different national jurisdictions, but under the corporate control of one parent company. Litvak & Maule, *The Multinational Corporation: Some Economic and Political-Legal Implications*, 5 J.W.T.L. 631, 632 (1971) [hereinafter cited at Litvak & Maule]. To explain further the context of this definition, the authors state:

> Thus, this firm has its base in one country, but operates and resides under the laws and customs of other countries as well. To be multinational in the operational sense, it is not necessary for local nationals to own shares in the subsidiary operations, although they may. The par-

a manner to compete in international commerce.[3] This payment of "transaction fees" is a standard practice in many multinational business transactions.[4]

Many of the MNC's which engage in this practice are subject to United States policy.[5] Contrary to attitudes in foreign countries,

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ent company is one with worldwide business interests. Its foreign affiliates may be branch plants, wholly-or partially-owned subsidiaries or joint-ventures, sometimes involving licensing agreements and management contract arrangements.

Id. at 632. The primary objective of a multinational corporation is to integrate the activities of its foreign subsidiaries with those of the parent to form a single entity operating to maximize profits by serving the international market. Behrman, *The Multinational Enterprise: Its Initiatives and Governmental Reactions*, 6 J. INT'L L. & ECON. 215, 217 (1972) [hereinafter cited as Behrman].

3. In the course of its investigation of clandestine expenditures made by multinational corporations, the United States Senate Subcommittee on Multinational Corporations has revealed the payment of an estimated $50 million by Exxon Corporation to Italian officials. *Hearings, supra* note 1, at 75 (testimony of Archie L. Monroe, Controller, Exxon Corp). $5 million was paid by Gulf Oil Corp. to other foreign officials. *Id.* at 8-9 (testimony of B.R. Dorsey, Chairman of the Board of Directors, Gulf Oil Corp). Also under investigation, Northrop Corp. disclosed to the subcommittee that it distributed $450,000 to two Saudi Arabian generals, $15,000 to an Indonesian politician, and $4,400 to an Iranian tax official. *Id.* at 120-23 (testimony of Richard W. Miller, Chairman of the Executive Committee of the Northrop Board of Directors). In addition, Northrop allegedly has established a $30 million slush fund for payments to foreign officials. 33 CONG. Q. 1211 (June 14, 1975). Lockheed Corp. also admitted the payment of $100 million in commissions into Saudi Arabia. *Hearings, supra* note 1, at 353 (testimony of D.J. Haughton, Chairman of the Board, Lockheed Corp).

4. *See Hearings, supra* note 1, at 380 (testimony of Ned Ridings, Sales Representative, Lockheed Corp). A portion of his testimony appears below:

> Senator BIDEN. . . . [W]ere any of you aware of the fact that any of your foreign competitors . . . were competing in the same manner in which you were? That is, were they offering kickbacks, or whatever term you want to use, for money on top?
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> Mr. RIDINGS. I do not know the details of their arrangements but most major manufacturers . . . are represented overseas by consultants or agents.

Id. See also Hearings, supra note 1, at 381 (testimony of D. J. Haughton, Chairman of the Board, Lockheed Corp). A portion of his testimony appears below:

> Senator BIDEN. . . . You say the reason for engaging in these practices is to stay competitive. You needed to do it in order to be competitive, is that correct? That is your basic premise?
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> Mr. HAUGHTON. You have to do it to be competitive not only with foreigners but with—
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> Senator BIDEN. With anybody.
>
> Mr. HAUGHTON. With anybody.

Id. Payments are made in a myriad of ways. Most commonly, they appear as entertainment expenses, consultants' or agents' fees, or in most instances are simply incorporated into the basis of the contractual bargaining process itself. *See* Wall Street Journal, May 9, 1975, at 1, col. 1.

5. Litvak & Maule, *supra* note 2, at 632. The authors point out that "in

such payments are vociferously condemned in the United States where the distribution of funds in this manner is characterized as illegal bribery.[6] However, the payment of bribes to consultants, agents, middlemen or foreign officials is not expressly made illegal by present federal statutes.[7] Nevertheless, in an effort to implement domestic policy, indirect attempts to curtail these payments are being made by the Securities and Exchange Commission (SEC)[8] and the Internal Revenue Service (IRS).[9] MNC's usually distribute these payments in a clandestine manner and deduct them from taxable income as a business expense.[10] Such undisclosed payments are not legally deductible expenses, however, and an MNC which secretly disburses funds in this manner while deducting them as expenses may be in violation of both securities and tax regulations.[11]

International and United States attitudes pertaining to the use of such transaction fees conflict. This comment will examine the international and American policies concerning the regulation of such payments. In doing so, the activities of the SEC, IRS and United Nations will be explored. In turn, the detrimental effects

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1965 . . . 70 percent of [these corporations] had their headquarters in the United States." *Id.*

6. *See, e.g., Hearings, supra* note 1, at 2 (opening statement of Senator Church). Senator Church states:

> In short, we cannot close our eyes to this problem. It is no longer sufficient to simply sigh and say that is the way business is done. It is time to treat the issue for what it is: a serious foreign policy problem.

Id. See also 121 CONG. REC. 7530 (daily ed. May 6, 1975) (Remarks of Senator Clark based on facts revealed in the Senate Subcommittee on Multinational Corporations' investigation). In his remarks Senator Clark stated that:

> The United States Government cannot condone these practices. When they come to light—as they do eventually—they seriously tarnish not only the reputation of the company involved, but that of United States corporations generally and the United States itself.

Id.

7. *See, e.g.*, remarks of Congressman Solarz before the House of Representatives, 121 CONG. REC. 5043 (daily ed. Sept. 26, 1975), in which he states:

> One of the very discouraging aspects of this whole situation is the fact that the Federal Government does *not* have the authority to monitor overseas business activities. . . .

Id. (emphasis added).

8. *Id.* In further remarks to the House, Congressman Solarz noted that although there is no Federal authority to monitor the overseas business activities of MNC's, "[c]ertain IRS and SEC regulations indirectly prohibit secret and/or illegal payments but these are somewhat limited in their applicability."

9. *Id. See also* 121 CONG. REC. 11,342 (daily ed. June 23, 1975) (remarks of Senator Haskell).

10. *See* note 54, *infra*, and accompanying text.

11. *See* notes 41 and 59, *infra*, and accompanying text.

upon MNC's and the United States resulting from unilateral application of United States policy will be discussed. Finally, this comment will conclude that the use of transaction fees is necessary if MNC's are to compete in the international market, and that the United States should not unilaterally pursue curtailment of this practice.

I. THE USE OF BRIBERY AS AN INTERNATIONAL CUSTOM

The use of "bribery" or transaction fees to obtain favorable trade policies is an historically accepted international business custom. Incidents of this nature are recorded as having occurred as early as the 1600's.[12] One such incident involved the British East India Company which exchanged "rare treasures," including paintings, carvings and costly objects of copper, brass and stone with Mogul rulers to obtain duty-free treatment for its exports.[13] The effect of such incidents was to establish the use of transaction fees as a bargaining tool employed both by businesses wishing to export their technology and by underdeveloped nations desiring to import such technology.

The development of this practice is largely a result of the history and economic structures of countries in which MNC's transact business.[14] Absent the existence of price or quality competition similar to that which exists in the United States, the business markets of less industrialized nations promote the use of social connections and family relations.[15] In West Africa, such practices represent a form of institutionalized welfare under which any individual acquiring a government position must, by tradition, care for his relatives and close friends.[16] In cases of this nature, transaction fees are actually a component of the political systems of many underdeveloped countries.[17] The use of transac-

12. Gwirtzman & Novak, *Reform of Bribery Abroad Involves U.S. Policy*, L.A. Times, Oct. 5, 1975, § 4, at 1, col. 8 [hereinafter cited as Gwirtzman & Novak]. Milton Gwirtzman is an international attorney who maintains offices in Washington, D.C. and Paris. Alan Novak is an attorney and businessman and was formerly executive assistant to the Undersecretary of State.

13. *Id.*

14. *See* notes 27 and 29, *infra*, and accompanying text.

15. *Id.*

16. L.A. Times, Nov. 13, 1975, at 22, col. 4. This article is based on reports from correspondents situated in Africa, Latin America, Paris, the Middle East, Tokyo, Mexico City, West Germany, Moscow, London, Rome, Washington, D.C., and Los Angeles.

17. *See* Curry, *The Multinational Corruption*, THE NATION, May 24, 1975, at

tion fees is not found exclusively in low-level government positions, but prevails in high-level government positions as well.

In politically volatile nations, deliberately low compensation coupled with the high risk of short tenure for key government officials necessitates solicitation and acceptance of transaction fees to supplement income.[18] MNC's are often targets of those seeking transaction fees because it is considered a more acceptable policy to extract money from these wealthy firms rather than from the country which the official represents.[19] Since many MNC's have sales greater than the gross national products of many nations, they are viewed as being better equipped financially to bear such expenses.[20] Compliance with the practice of paying transaction fees in nations where an MNC operates is essential to insure the smooth transaction of business.[21]

Fierce competition among Japanese, Western European and United States MNC's motivates corporations to engage in the use of transaction fees,[22] because contracts for new business are frequently awarded to the MNC tendering the most appealing offer to key officials of the host government.[23] Eventually, this process evolves into a bidding competition wherein acceptance is based upon the offer which channels the most money to the appropriate officials.[24] For this reason, successful competition on an international scale without the use of transaction fees is virtually impossible.

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621. In this article, the author expresses his opinion that the disclosure of payments in this manner by MNC's is evidence that "bribery is built into the political systems of underdeveloped countries, where the multinational corporations acquire most of their raw materials. . . ."

18. For example in 1973, in the Brazilian Army's quartermaster corps, an investigation by the Brazilian Government revealed that a dozen high Army officers had received payments from civilian contractors for supplying them with food and equipment. 121 CONG. REC. 7531 (daily ed. May 6, 1975).

19. Gwirtzman & Novak, *supra* note 12, at 4, col. 2.

20. Litvak & Maule, *supra* note 2, at 632. The authors point out, for example, that "in 1965 . . . 87 corporations in the world . . . had sales greater than the gross national product of 57 nation states. . . ."

21. *See* note 1, *supra.*

22. Wall Street Journal, May 9, 1975, at 1, col. 1.

23. Vaitsos, *Foreign Investment Policies and Economic Development in Latin America,* 7 J.W.T.L. 619, 629 (1973) [hereinafter cited as Vaitsos]. The host government is the sovereign country in which a subsidiary of an MNC operates.

24. Wall Street Journal, May 9, 1975, at 1, col. 1. For example, in one case of bidding competition, one American firm even outbribed another American firm for a mining concession.

Transaction fees, however, are not paid exclusively for the acquisition of new business. To a large extent, funds are distributed to insure the continued existence of markets or to preserve favorable relations with local officials in the nation where an MNC transacts business.[25] Such payments usually originate either as a *willing fee*, solicited by the representative of an MNC, or as an *unwilling fee*,[26] extorted from an MNC by local officials who threaten economic retaliation for failure to cooperate. Regardless of the nature of the fee, its payment is essential for business and therefore is widely used.

Many instances exist in which transaction fees are used by MNC's and foreign officials to facilitate the efficient transaction of business.[27] In many Latin American countries, for example, union officials and labor inspectors are regularly paid such fees as part of a standard practice which is essential to maintain peaceful labor relations.[28] MNC's also pay transaction fees in many of these same Latin American nations to exert pressure on local governments to modify laws or policies unfavorable to the foreign firms.[29]

Recognizing the need for extensive use of transaction fees on an international scale, many MNC's employ agents or middlemen to effect payment or to serve as business advisors or consultants.[30] Employment of such personnel is required in many instances because certain foreign officials will accept fees only from a trusted, native countryman acting as intermediary.[31] Syrian law, for example, requires that a local agent be retained before business negotiations may even be initiated.[32] Under similar circumstances, when

25. *Id.*

26. Not all payments to foreign officials are voluntary. In the most blatant case of extortion, a threat was made by the ruling party leader that Gulf Oil operations in South Korea would be closed down unless a $4 million donation was made to his presidential election campaign. *Hearings*, *supra* note 1, at 8-9 (testimony of B.R. Dorsey, Chairman of the Board of Directors, Gulf Oil Corp).

27. 121 CONG. REC. 7531 (daily ed. May 6, 1975). In African countries such as Nigeria and Zaire, bribes must be paid to get anything done. They are part of the price of visas, getting customs clearance on items, and in Nigeria, they are even necessary for travelers to get their suitcases.

28. Dehner, *Multinational Enterprise and Racial Non-Discrimination: United States Enforcement of an International Human Right*, 15 HARV. INT'L L.J. 71, 75 n.20 (1974).

29. Vaitsos, *supra* note 23, at 629-630.

30. *See* 33 CONG. Q. 1211 (June 14, 1975).

31. Wall Street Journal, May 9, 1975, at 10, col. 3-4.

32. Dow & El-Batal, *The Commercial Laws of Syria*, THE DIGEST OF

Northrop Corporation attempted to sell military aircraft to Saudia Arabia, the Saudi Arabian Defense Minister directed Northrop's international consultant to retain a particular agent who had been employed in previous dealings with the Lockheed and Raytheon Corporations.[33] Agents and middlemen may also be employed for their governmental connections and familiarity with local laws and customs.[34] Such agents or middlemen frequently serve in *bona fide* consulting capacities, and the advice they offer significantly contributes to the success of an MNC in the host country.[35] Regardless of the capacity in which they serve, the use of agents or middlemen is often a concomitant of success.

The attitude of approval toward payment of transaction fees is not shared by legislators and agencies within the United States who advocate immediate curtailment of this practice. As a result, American based MNC's are placed in the untenable position of jeopardizing their business interests abroad or facing legal sanctions at home for failure to comply with United States policy.

II. BRIBERY UNDER UNITED STATES LAW

Bribery under the law of the United States has been defined as the corrupt payment or receipt of a private price for official action.[36] In accord with this concept, many United States legislators

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COMMERCIAL LAWS OF THE WORLD, 41, 43 (1972). The pertinent sections pertaining to the transaction of business in Syria are set forth below:

> (g) *Foreign Companies and Branches of Foreign Companies*
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> Companies and firms formed outside Syrian territory . . . cannot form a branch or agency in Syria to work in their name . . . unless they register in the ministry of economy. . . . Non-Syrian governmental enterprises . . . in which a foreign government is associated, which seek to form a branch in Syria, must also register in the ministry after getting a special authorization from the council of state . . . .
>
> To this application must be attached:
>
> . . . .
>
> (4) A notarized document of representation showing the name of the agent representing the company in Syria and that this agent is in effect dwelling in Syria. This representative may be an individual of Syrian nationality or a commercial company instituted in Syria and conforming to Syrian law.

33. 33 CONG. Q. 1211 (June 14, 1975).

34. 121 CONG. REC. 16,735 (daily ed. Sept. 25, 1975) (Remarks by Senator Ribicoff). In his remarks, Senator Ribicoff acknowledges the argument asserted by American companies that due to their unfamiliarity with local customs, the hiring of agents was necessary to compete in these countries.

35. Gwirtzman & Novak, *supra* note 12, at 4, col. 4. *See also* 33 CONG. Q. 1211 (June 14, 1975).

36. 18 U.S.C. § 209 (1970). This section punishes employees of the United States who receive outside compensation for any services rendered in any manner

and governmental agencies view the undisclosed payment of corporate funds by MNC's to consultants, agents, middlemen or foreign officials as bribery, and, therefore, a violation of United States law.[37] Out of this position, an attempt is being made by these legislators and agencies to regulate unilaterally the international business activities of MNC's. The Senate Foreign Relations Committee has formed a subcommittee to make a factual investigation of the activities of MNC's abroad in an attempt to discover if any violations have occurred, and if so, what sanctions are appropriate.[38]

Despite this attitude, no present federal statutes provide the necessary authority to regulate or impose sanctions for payments abroad by American-based MNC's.[39] This lack of existing law, however, has not thwarted the determination of some legislators and agencies to curtail the practice.[40] In an effort to pursue this policy, both the SEC and IRS are attempting to discourage the use of such payments.

A. The SEC: Requirement of Disclosure

SEC regulations provide one means of indirectly enforcing the policy favoring curtailment of bribery abroad. Their aim is to protect shareholders from undisclosed use of corporate funds. MNC's registered with the SEC which secretly disburse these payments have been charged with violating sections 13(a) and 14(a) of the Securities Exchange Act of 1934[41] for failure to

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before a federal department or agency in which the United States is a party. 18 U.S.C. § 201 (1970) includes "an officer or employee or person acting for or on behalf of the United States, or any department, agency or branch of Government thereof . . . in any official function. . . ."

37. *See* notes 47 and 59, *infra*, and accompanying text.

38. Letter to author from Senator Frank Church, Chairman of the Senate Subcommittee on Multinational Corporations, United States Senate [on file at CALIF. W. INT'L L.J.].

39. *See* note 7, *supra*, and accompanying text.

40. *See* note 6, *supra*, and accompanying text.

41. SECURITIES EXCHANGE ACT OF 1934, ch. 404, §§ 13(a), 14(a), 48 Stat. 894 (1934), 15 U.S.C. §§ 78m(a), 78n(a) (1970). These sections provide:

§ 78m. Periodical and other reports.

(a) Every issuer of a security registered pursuant to . . . this title shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security—

(1) such information and documents . . . as the Commission shall require to keep reasonably current the information and documents required to be included in or filed with an application or registration statement . . . .

report such payments as material financial information.[42] Thus, the involvement of the SEC arises solely from the undisclosed disbursement of corporate funds rather than actual bribery.[43]

The SEC regulations require disclosure to shareholders, describing the purposes of such payments.[44] However, because they fear unfavorable publicity, MNC's are reluctant to comply.[45] Consequently, they have persistently neglected to disclose the existence or purposes of such payments to their auditors.[46] By filing complaints against MNC's suspected of having violated sections 13(a) and 14(a), the SEC is attempting to enjoin further nondisclosure violations, and, in effect, to deter the distribution of bribes or similar payments abroad.[47]

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(2) such annual reports . . . certified if required by the rules and regulations of the Commission by independent public accountants, and such quarterly reports . . . as the Commission may prescribe.

Every issuer of a security registered on a national securities exchange shall also file a duplicate original of such information . . . with the exchange.

§ 78n. Proxies.

(a) It shall be unlawful for any person by the use of the mails or by any means or instrumentality . . . or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary and appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security . . . registered pursuant to . . . this title.

42. *Id.* The payments made are characterized as material expenditures because of the substantially large size of the amounts expended without the knowledge of the shareholders.

43. Letter to author from S. James Rosenfeld, Director, Office of Public Information, Securities and Exchange Commission [hereinafter cited as Letter] [on file at CALIF. W. INT'L L.J.].

44. *Id.*; 17 C.F.R. §§ 240.12(b)-20, 240.13(1)-1, 240.14(a)-9 (1975).

45. TIME, Jan. 26, 1976, at 61.

46. TIME, June 23, 1975, at 52. In light of all that has transpired, it may be that accounting firms should have a duty to inquire about such payments.

47. For example, the SEC has filed a complaint in the United States District Court for the District of Columbia against Gulf Oil Corporation. A portion of the complaint is set forth below:

9. Since about 1960 and continuing to the date hereof defendants GULF, WILD and others, singly and in concert, directly and indirectly, and aiding and abetting each other, filed and caused to be filed with the Commission certain reports including Annual Reports as required by Section 13(a) of the Exchange Act, 15 U.S.C. 78m(a), and Rules 17 C.F.R. 240.12(b)-20 and 17 C.F.R. 240.13(a)-1, which reports were false and misleading and omitted to state material facts necessary to make the statements made not misleading as more fully alleged in subsequent paragraphs of this Count I.

Excerpt from complaint filed by SEC [on file at CALIF. W. INT'L L.J.]. Complaints have also been filed in the United States District Court for the District of Columbia against Ashland Oil Corporation and the American Ship Building

An MNC alleged to have violated SEC regulations may escape the imposition of sanctions. At any time after a complaint has been filed, but prior to a hearing, the SEC, in its discretion, may allow an MNC to consent to an order against it.[48] The effect of such an order is to allow an MNC, by promising to refrain from further violations, to obtain a settlement without an admission of guilt.[49] On the other hand, if an MNC persists in further violations, the SEC or shareholders may prosecute the MNC in a new action for failure to disclose.[50] Thus, the consent agreement is a very desirable alternative for an MNC confronted for the first time with this type of SEC action.

Proper disclosure by an MNC to shareholders and the SEC concerning distribution of corporate funds to foreign officials would preclude a violation of securities regulations. Under SEC regulations it is irrelevant whether the funds expended are considered bribes in the United States; the concern of the SEC is only with the *non-disclosure* of such payments.[51] Proper disclosure could be accomplished, therefore, by publishing in the financial statement given to the shareholders and the SEC the amounts paid as consultants' fees for each respective business transaction. Since the SEC requires only that shareholders be informed of the amounts and purposes for expenditures of corporate funds, this method would be satisfactory.[52]

Company [copies on file at CALIF. W. INT'L L.J.]. The SEC has the burden of making the proper showing of a violation in these cases. The relevant portion of the statute provides as follows: "upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond." 15 U.S.C. § 78u(e) (1970).

48. 17 C.F.R. § 0.54(b) (1975). This section states:

> (b) *Consent order.* At any time after the issuance of the complaint and prior to the hearing in any proceeding, the Commission, in its discretion, may allow the respondent to consent to an order. In so consenting, the respondent must submit, for filing in the record, a stipulation or statement in which he admits at least those facts necessary to the Commission's jurisdiction and agrees that an order may be entered against him. Upon a record composed of the complaint and the stipulation or agreement consenting to the order, the Commission may enter the order consented to by the respondent, which shall have the same force and effect as an order made after oral hearing.

49. *Id.*

50. In the event of a successful prosecution an MNC would be subject to the imposition of penalties. *See* 15 U.S.C. § 78ff (1970). The penalties which may be imposed include imprisonment or a fine of not more than $10,000. An injunction may also be obtained against a firm violating securities regulations.

51. *See* Letter, note 43, *supra.*

52. The SECURITIES EXCHANGE ACT OF 1934, §§ 13(a) and 14(a) and the alleged violations in the complaints filed require only disclosure of "reasonably current" information which is not "false" or "misleading."

While SEC regulations may be effective to require disclosure, they are not effective in preventing the continued practice of making such payments. Through proper disclosure, an MNC could preclude SEC violations and unfavorable publicity, and could continue to make such expenditures. Only the IRS scrutinizes the nature of such payments, to determine whether they qualify as legitimate business deductions.

B. *The IRS: Deductibility Of the Payment*

MNC's subject to United States taxation[53] which engage in distribution of transaction fees or similar payments commonly deduct these expenses from taxable income. Section 162(a) of the Internal Revenue Code of 1954 authorizes deduction of all ordinary and necessary expenses paid or incurred during the taxable year in conjunction with carrying on any trade or business.[54] Deductions are allowed, for example, for reasonable salaries or other compensation paid for personal services.[55] To qualify for such deductions, MNC's must establish that payments to foreign consultants or advisors are compensation and not gifts or other non-deductible distributions.[56] If the compensation is determined to be reasonable,[57] it satisfies the requirement of being a legitimate

53. The United States exercises jurisdiction to tax an MNC if it is: (1) operating in the United States; (2) organized under United States law; or (3) a foreign corporation controlled by United States shareholders. INT. REV. CODE OF 1954, § 864(b), (c); Reg. §§ 1.864-2 - 1864-7; *see also* Norr, *Jurisdiction to Tax and International Income*, 17 TAX L. REV. 431 (1962). "Controlled Foreign Corporation" refers to a foreign corporation in which more than 50% of the voting stock is owned by, or is treated as being owned by United States shareholders. INT. REV. CODE OF 1954, § 957(a). A United States shareholder is any United States person who owns or is treated as owning 10% or more of the voting power of a foreign corporation. INT. REV. CODE OF 1954, § 951(b). A United States person is any United States citizen or resident, domestic partnership or corporation or any trust or estate (except a foreign trust or estate). INT. REV. CODE OF 1954, §§ 957(d), 7701(a)(30).

54. INT. REV. CODE OF 1954, § 162(a)(1).

55. *Id.*

56. *See, e.g.*, Palmetto Pump & Irrigation Co. v. Tomlinson, 9 Am. Fed. Tax R.2d 1136 (S.D. Fla., 1962), *aff'd*, 313 F.2d 220 (5th Cir. 1963). In this case the court determined that if amounts paid to stockholders were paid to them because of their ownership in the business, then the amounts were not compensation. On the other hand, if the amounts paid were for personal services rendered to the corporation as employees, then these amounts are to be considered compensation.

57. *See, e.g.*, Robert Rogers Inc. v. United States, 93 F. Supp. 1014 (Ct. Cl. 1950) in which the court held that compensation awarded under a contract which provided for a small salary with the balance to be paid as a bonus equal to 50% of the net profits of the business and pursuant to a reasonable bargain made before

business expense, and an MNC may then deduct it from taxable income.[58] The IRS has invoked section 162(c)(1) to disallow those deductions which it characterizes as illegal bribes as defined by the policy advocated in the United States.[59]

Under section 162(c)(1) of the Code, no deduction is allowed for payments to foreign officials or their employees if such payments would be unlawful in the United States.[60] Present domestic statutes characterize payments to American officials or their employees for official action as illegal bribes.[61] Consequently, the IRS interprets similar payments to foreign officials as being illegal bribes as well.[62] "Officials", in this context, refers to any individual officially connected with a government, agency or instrumentality of a foreign nation.[63] Such individuals may be serving in any capacity on a permanent or temporary basis.[64] Whether the indi-

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the services were rendered was a fully deductible expense even if the amounts when paid far exceeded the usual norms.

58. *Id.*

59. INT. REV. CODE OF 1954, § 162(c)(1). This section states in pertinent part:

> Illegal payments to government officials or employees
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> No deduction shall be allowed . . . for any payment made, directly or indirectly, to an official or employee of any government, . . . if the payment constitutes an illegal bribe or kickback or, if the payment is to an official or employee of a foreign government, the payment would be unlawful under the laws of the United States if such laws were applicable to such payment and to such official or employee.

For a discussion of regulation with respect to domestic bribery, see Note, *Federal Income Taxation—Public Policy and the Deductibility of Kickbacks Under § 162(c)(2)*, 32 OHIO ST. L.J. 686 (1974).

60. *See id.*

61. *See, e.g.*, Opper v. United States, 348 U.S. 84 (1954), in which the defendant was convicted of violating 18 U.S.C. § 2 and § 281 (superceded in 1962 by § 209) on charges that he conspired with and induced a federal employee to accept outside compensation for services in a matter before a Federal agency in which the United States had an interest.

62. *See* note 59, *supra* and accompanying text.

63. INT. REV. CODE OF 1954, Reg. § 1.162-18(a)(3). This section provides in pertinent part:

> *Official or employee of a government.* Any individual officially connected with . . .
>
> (ii) The government of a foreign country, or
>
> (iii) A political subdivision of, or a corporation or other entity serving as an agency or instrumentality of, any of the above, . . .
>
> in whatever capacity, whether on a permanent or temporary basis, and whether or not serving for compensation, shall be included within the term "official or employee of a government", regardless of the place of residence or post of duty of such individual. An independent contractor would not ordinarily be considered to be an official or employee.

64. *Id.*

vidual receives compensation from his government is not decisive in determining if the individual is a government official.[65]

Within the meaning of section 162(c)(1), the IRS considers a payment to an agent or middleman employed by a foreign official as merely an indirect means to the same illegal bribe.[66] For example, a payment to an agent or relative of a foreign official may be treated as payment to that official if it inures or will inure to his benefit, or will promote his financial or other interests.[67] Similarly, a payment by an MNC to an agent acting on its behalf in the transaction of business and who is also representing a foreign official in the official's country may be characterized as an indirect bribe to the official or employee of that nation.[68] For this reason, such payments are not legally deductible expenses, and a business which attempts to deduct them from taxable income is in violation of tax regulations. However, an individual employed exclusively by an MNC is not ordinarily considered by the IRS to be an "official" or agent of a foreign government.[69] Any compensation paid to him may be a deductible expense. In this instance the legitimacy of the deduction hinges on a semantic distinction.

The characterization of an MNC employee as an independent consultant, as an agent of a foreign official, or as a middleman in a dual capacity representing both the corporation and a foreign official, determines whether the individual's compensation is considered to be a deductible business expense.[70] If an individual is retained as an agent or middleman for the purpose of compensating a foreign official, then the IRS will characterize the individual as an agent of the foreign official, and the entire amount paid by the MNC will be an illegal bribe, and therefore, non-deductible.[71]

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65. *Id.*

66. *See* INT. REV. CODE OF 1954, § 162(c)(1), note 59, *supra.*

67. INT. REV. CODE OF 1954, Reg. § 1.162-18(a)(2). This section provides in pertinent part:

> *Indirect payment.* For purposes of this paragraph, an indirect payment to an individual shall include any payment which inures to his benefit or promotes his interests, regardless of the medium in which the payment is made and regardless of the identity of the immediate recipient or payor. . . . A payment made by an agent or independent contractor of the taxpayer which benefits the taxpayer shall be treated as an indirect payment by the taxpayer to the official or employee.

For an analogous case, see Opper v. United States, 348 U.S. 84 (1954).

68. *See id.*

69. *See* INT. REV. CODE OF 1954, Reg. § 1.162-18(a)(3), note 63, *supra.*

70. *Id.*

71. *See* INT. REV. CODE OF 1954, § 162(c)(1), note 59, *supra.*

Conversely, if an independent individual is retained as a consultant to advise and counsel an MNC on foreign business matters and not merely to compensate a foreign official, then any reasonable funds disbursed to the consultant will be an allowable deduction.[72]

Seemingly, this distinction is based on whether the individual retained is a known agent of a foreign official. To date, disclosure before the Senate Subcommittee on Multinational Corporations by representatives of some MNC's concerning the identity of agents employed to compensate foreign officials has provided the only means by which the IRS can determine that an illegal bribe has been paid.[73] Absent such disclosures, there appears to be no other way that the legality of a deduction for consultants' fees may be determined. The realization that such deductions have only recently come under IRS scrutiny, and then only because of the subcommittee disclosures, is evidence of the difficulty involved in making this determination.

The investigation of MNC's by the IRS raises important questions which require more explicit regulations clearly delineating IRS standards. If an MNC retains a foreign independent consultant or advisor without intending that he compensate foreign officials from his fee, is it required to trace the path of disbursed funds? If it employs an independent foreign consultant and compensates this individual, should it be forced to inquire as to the source of the consultant's information? The criteria for making these determinations have not been made clear by the IRS. Furthermore, must an MNC require as a condition of retaining a foreign independent consultant that all funds paid to the consultant not be distributed to any foreign officials? How could such a condition be enforced? A requirement that an MNC discover and disclose the identity of the ultimate recipient of its payments would place an unreasonable burden on the ability of an MNC to compete effectively in international commerce. MNC's which adhere to current IRS policy might not be able to compete effectively under acceptable international standards because foreign independent consultants or agents might be disinclined to transact business within the confines of United States law.[74] International custom

72. *See* INT. REV. CODE OF 1954, Reg. 1.162-18(a)(3), note 63, *supra.*

73. *See* 121 CONG. REC. 11,342 (daily ed. June 23, 1975) (remarks of Senator Haskell). The IRS is not authorized to conduct investigations outside the United States.

74. *See* note 32, *supra.*

and local policy of the host country, as in the case of Syrian law[75] which requires the use of agents, may dictate a policy contrary to that of the IRS. As a result, an MNC adhering to IRS policy would be at a competitive disadvantage in transacting business. Some MNC's, however, may determine that the long term benefits to be gained outweigh the expenses, and in this case might simply decide not to deduct the payments from taxable income at all.

Clearer and more definitive standards pertaining to the deductibility of foreign independent consultants' fees are necessary. The present IRS policy disallowing deductions for payments to foreign officials poses some major difficulties for effective regulations of illegal bribes. Clear guidelines must be established to define whether a fee paid to a foreign consultant represents legal compensation or an illegal bribe. These guidelines must not unreasonably restrict the ability of MNC's to compete in international commerce. Answers to these questions are necessary to clarify the nature and extent of an MNC's duty to discover the ultimate recipient of funds paid and the source of the consultants' advice, and to formulate conditions to be placed on fees paid to foreign consultants.

Even though current policy is at variance with international custom, Congress is considering even more restrictive measures in an effort to curtail the practice of international corporate bribery.[76] One such measure would impose criminal sanctions for bribery of a foreign official.[77] This would necessitate the exercise of extraterritorial jurisdiction, an extention of sovereignty frowned upon under international law.[78] International law supports the view that each

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75. *Id.*

76. Two bills have been introduced in the House of Representatives. One would give authority to the State Department to monitor the activities of American based MNC's abroad, and the other would amend Title 18 of the United States Code specifically to prohibit bribery of any foreign official. 121 CONG. REC. 2946 (daily ed. June 6, 1975) (H.R. 7563 and 7539, respectively, were introduced by Congressman Solarz). Another proposed bill would terminate the investment insurance issued by the Overseas Private Investment Corporation in any case where an insured investor is found to have bribed a foreign official. 121 CONG. REC. 5044 (daily ed. Sept. 26, 1975) (H.R. 9860 was introduced by Congressman Solarz).

77. *See* H.R. 7539, note 76, *supra.*

78. There are five basic theories of jurisdiction which are recognized to varying degrees in international law and which might be the basis for the exercise of extraterritorial jurisdiction by the United States. They are: (1) the *territorial principle,* which is the most generally accepted, and bases jurisdiction on the place where the act occurred; (2) the *nationality principle* of criminal jurisdiction under

nation has the right to maintain exclusive jurisdiction to regulate the activities and investments of MNC's within its territorial boundaries.[79] The substance of this position is evident in the efforts of the United Nations.

III. REGULATION OF MULTINATIONAL CORPORATIONS UNDER INTERNATIONAL LAW

A. The United Nations: Charter of Economic Rights and Duties of States

The United Nations has adopted the Charter of Economic Rights and Duties of States[80] which outlines the rights and duties of nations in regulating activities of MNC's within each state's territorial boundaries. The Charter defines the scope of authority and sets out the regulatory procedures to be implemented by each nation. It states that each nation has the exclusive authority to determine what conduct it considers proper within its sovereign territory.[81] This authority includes the power to decide economic and social policies and customs.[82] The Charter offers no definitive guidelines or standards to aid in the determination of what acts constitute bribery. Furthermore, no provision even refers to the use of bribery or transaction fees.[83] The only standard available is

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which a sovereign may claim jurisdiction over a citizen of that nation although acts are committed in another State; (3) the *protective principle* of jurisdiction which may be claimed when some national interest is harmed by an act; (4) the *passive personality principle* which bases jurisdiction upon the nationality of the injured person; and (5) the *universal principle* which follows the individual who commits a crime of an international nature wherever he is found so that jurisdiction is determined by the country which has custody regardless of where the act occurred. *See* Bassiouni, *Theories of Jurisdiction and Their Application in Extradition Law and Practice*, 5 CALIF. W. INT'L L.J. 1 (1974).

79. *See* note 80 and text accompanying note 89, *infra*.

80. Charter of Economic Rights and Duties of States, G.A. Res. 3281, 24 U.N. GAOR Supp. 31, at 50, U.N. Doc. A/9631 (1974) (reproduced in 14 INT'L LEGAL MATERIALS 251 (1975)) [hereinafter cited as Charter]. This resolution was unanimously passed on December 12, 1974. The significant portion of the resolution appears below:

> 2. Each State has the right:
>
> (a) To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities.

Id. at 255.

81. *Id.*

82. *Id.*

83. The only document of a multinational nature which makes reference to the use of bribery is the Organization of American States: Permanent Council

that of international custom which recognizes the use of transaction fees in business dealings. Consequently, a conflict in interpretation exists between international business custom and the policy of the United States.

Article 2, paragraph 2(a) of the Charter provides exclusive jurisdiction to nations to ensure that MNC's within their territory comply with their sovereign law. As in the case of Syrian law,[84] which requires that an agent be retained before business may be transacted, the use of agents is not precluded. Although the provisions establishing the jurisdictional rights of each nation as outlined in article 2, paragraph 2(a), do not specifically state that such jurisdiction is exclusive, this inference, nevertheless, finds support under international law. Both the United Nations recommendation[85] and the territorial principle of jurisdiction[86] in international law dictate that the right of each nation to control the activities within its borders is a mutually exclusive element of sovereignty. From the enactment of this article, it is apparent that the desire of the international sector is to allow each nation exclusively to determine which business practices are deemed proper within its borders.

The Charter of Economic Rights and Duties of States reaffirms the international policy that each nation has the exclusive right to monitor the actitivies of MNC's within its own borders. It is also in accord with international custom which recognizes the use of agents or consultants in business transactions. Further distinctions between United States and international policy are evident in the United Nations recommendation pertaining to the activities of MNC's abroad.

Resolution of the Behavior of Transnational Enterprises, O.A.S. Doc. OEA/Ser. G, CP/RES. 154 (167/75) of July 10, 1975 [reproduced in 14 INT'L LEGAL MATERIALS 1326 (1975)]. This resolution was approved unanimously by the Permanent Council of the O.A.S. The relevant sections appear below:

> I. To condemn in the most emphatic terms any act of bribery, illegal payment or offer of payment by any transnational enterprise; any demand for or acceptance of improper payments by any public or private person, as well as any act contrary to ethics and legal procedures; and
>
> II. To urge the governments of the member states, insofar as necessary, to clarify their national laws with regard to the aforementioned improper or illegal acts.

Id. at 1328.

84. *See* note 32, *supra.*

85. *See* note 87, *infra.*

86. *See* note 93, *infra,* and accompanying text.

B. The United Nations: A Recommendation

In 1974, the United Nations appointed a group of eminent persons to study the effects of MNC's on the international community. From this study,[87] a recommendation was presented to the United Nations which adopted it as a guideline for international regulation of MNC's.[88] The study determined that intergovernmental confrontations and serious economic consequences would result unless the entire international community complies with a uniform policy.[89] The United Nations recommended that the domestic policy, law and jurisdiction of the country in which the parent company resides apply only until an MNC enters the jurisdiction of a foreign state.[90] Once established in a foreign nation, the MNC subsidary would be subject to the policy, law and jurisdiction of the host government only.[91] The United Nations further recommended that all States refrain from extraterritorial application of domestic policy unless contrary agreement could be reached.[92]

The effect of this recommendation on the use of foreign consultants or agents is consistent with international custom and the Charter of Economic Rights and Duties of States. In accord with international policy, the United Nations recommendation does not preclude the use of foreign consultants or agents in nations which require their employment to transact business.

This United Nations recommendation reflects the consensus of global opinion and is in accord with the territorial principle, the most widely recognized basis of jurisdiction in international law.[93] This principle states that each sovereign nation has the exclusive right to determine what is proper conduct within its borders.[94] The

87. The Impact of Multinational Corporations on the Development Process and on International Relations, U.N. Doc. E/5500/Add. 1 (Part I) (1974) (reproduced in 13 INT'L LEGAL MATERIALS 800, 826 (1974)) [hereinafter cited as U.N. Study of MNC's].

88. *Id.*

89. *Id.* at 828. *See also* Reich, *Global Social Responsibility for the Multinationals*, 8 TEX. INT'L L.J. 187 (1973) [hereinafter cited as Reich].

90. U.N. Study of MNC's, *supra* note 87, at 828.

91. *Id.* at 829.

92. *Id.*

93. 1 L. OPPENHEIM, INTERNATIONAL LAW 327-28 (8th ed. 1955); *see* RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 17 (1965). Under this theory, a state's right to prescribe and enforce conduct within its own physical boundaries is an inseverable component of sovereignty.

94. *See* authority cited in note 93, *supra.*

United States, however, does not adhere to this concept and is unilaterally attempting to enforce abroad its domestic policy concerning MNC's. In doing so, the United States must exercise extraterritorial jurisdiction, which conflicts with the territorial principle of jurisdiction.

IV. UNILATERAL APPLICATION OF UNITED STATES POLICY: ITS EFFECTS ON MULTINATIONAL CORPORATIONS

American policy is not in accord with that of the United Nations. The United States views MNC's as instruments of American foreign policy in nations where MNC subsidiaries operate,[95] and as potential conduits for extraterritorial application of United States law.[96] American economic dominance and the fact that the majority of MNC's are American controlled contributes significantly to the "alter ego" impact on such foreign nations.[97] As a result, the United States is experiencing increased resentment from countries subjected to this new form of "imperialism."[98]

In order to succeed, MNC's must adapt to the country in which business is transacted, and for this reason, a commitment must be made to local policies.[99] Businesses are not committed to national, social or political goals and objectives, except insofar as those factors affect business.[100] An American-based MNC operating under the laws of a foreign country is influenced to a greater

95. *See* Rubin, *Multinational Enterprise and National Sovereignty: A Skeptic's Analysis*, 3 LAW & POL. INT'L BUS. 1, 10 (1971).

96. *Id.*

97. *See* note 5, *supra*, and accompanying text.

98. Litvak & Maule, *The Multi-national Firm and Conflicting National Interests*, 3 J.W.T.L. 309 (1969) [hereinafter cited as *Conflicting Interests*]; Note, *Canada's Changing Posture Toward Multinational Corporations: An Attempt to Harmonize Nationalism With Continued Industrial Growth*, 7 N.Y.U.J. INT'L LAW & POL. 271, 277 (1974). United States Foreign Assets Control law applied to subsidiaries of American MNC's in Canadian territory is considered by Canada to be a perfect example of United States extraterritorial violation under international law. The problem involves two aspects: (1) the legal implications which arise from the imposition of United States law on firms incorporated in Canada, and; (2) a conflict of national policies. For example, the policy of the United States has been not to trade with communist countries, while Canada has encouraged such trade. Litvak & Maule, *supra* note 2, at 637. For an example of such a United States Foreign Asset Control law, *see* Trading With the Enemy Act of 1917, 50 U.S.C. App. §§ 1-44 (1970).

99. Miller, *The Global Corporation and American Constitutionalism: Some Political Consequences of Economic Power*, 6 J. Int'L L. & ECON. 235, 245 (1972) [hereinafter cited as Miller].

100. *Id.*

degree by that country's policies than by United States policies.[101] Similarly, an MNC would be committed to American policy only to the extent such policy affected its business interests in the United States. As a result, significance is no longer attached to the distinction between domestic and international markets.[102] MNC's which operate at this stage of development have attained multinational orientation, and, therefore, business transactions performed must be in harmony with international policy.[103] Unilateral application of American policy exposes MNC's to conflicting policies which could have detrimental effects for the United States and MNC's based there.

An MNC experiencing the pressure of such a conflict could relocate its international parent headquarters or the registered legal domicile of its controlling shareholders to escape United States jurisdiction.[104] By relocating outside the United States, an MNC would no longer be subject to domestic policy, except to the extent that it or its subsidiary transacted business in the United States. The prospects of relocation are not remote. For example, when the United States attempted to restrict the capital outflow of International Nickel, the company moved its parent headquarters to Canada,[105] which does not impose such restrictions. The move was made in order to prevent valuable business from being lost as a result of United States policy.

Other MNC's may also find relocation simple and desireable if corporate assets become greater abroad than in the United States.[106] Furthermore, with the advent of European management centers,[107] such a shift becomes a relatively simple matter.[108] If MNC's relocate, the United States may suffer a loss of economic influence, substantial tax revenues and spendable income.[109] Ad-

101. *Conflicting Interests, supra* note 98, at 315.

102. Miller, *supra* note 99, at 245.

103. *Id.*

104. *See* Reich, *supra* note 89, at 207 in which he states that, "if the parent government were to place uncomfortable limits upon multinational activity, the multinational corporation would quickly move to find a new parent government and a new home."

105. Behrman, *supra* note 2, at 228.

106. *Id.*

107. European management centers are the local headquarters of MNC's which handle operations in the entire European area rather than from the location of the international parent headquarters.

108. Behrman, *supra* note 2, at 228.

109. Although the entire amount would not be lost; for purposes of an

ditionally, it may mean a loss of numerous jobs.[110] Avoidance of such relocation dictates that the United States subscribe to international business policy and not attempt to apply domestic policy extraterritorially.

Another probable repercussion of unilateral application of United States policy might be to render United States controlled MNC's uncompetitive in the international market.[111] If an MNC adheres to United States policy abroad, it would be precluded from transacting business in nations which require the use of agents.[112] MNC's would also be uncompetitive in countries which recognize the use of transaction fees. Ultimately, this inability to compete would affect not only MNC's, but would cause numerous economic repercussions in the United States as well.

V. CONCLUSION

The use of "bribery" or transaction fees, under certain circumstances, is recognized as a customary method of transacting business in international commerce. United States legislators and agencies have determined that the use of such payments is an illegal and undesirable practice. The resources of the SEC and the IRS are simultaneously being utilized to deter the use of such payments, and Congress is considering even more stringent action. While the SEC requirement of disclosure to shareholders would seem perfectly proper, the IRS should allow transaction fees as a deductible expense, without resort to questionable semantic distinctions, especially where such payments are essential to transacting business in foreign nations.

The United States must recognize that the use of transaction fees is a fact of life beyond its control and is endemic to the systems

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example of the size of the amount involved, the fiscal 1977 United States corporation income taxes are estimated at approximately $49 million. MANAGEMENT BUDGET OFFICE, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 1976 312 (1975).

110. In 1973, in a report to the Senate Finance Committee, the Tariff Commission (now the International Trade Commission) reviewed competing claims concerning the effect of foreign investment on domestic jobs and found that the question cannot be answered conclusively. Under assumptions that the study determined to be the most realistic of those considered, it found an overall gain of half a million U.S. jobs. Patrick, *U.S. Tax Policy and Foreign Investments—Legislative and Treaty Issues*, 5 DEN. J. INT'L LAW & POL. 1, 4 (1975).

111. *See* note 1, *supra*, and accompanying text.

112. *See* note 32, *supra*, and accompanying text.

of many nations. It is highly questionable whether the United States has the power to terminate unilaterally this practice. Moreover, an unsuccessful attempt to do so might jeopardize diplomatic relations with many foreign nations and precipitate irreversible damage to United States business interests abroad. At the very least, a careful re-examination of United States policy by the executive and legislative branches is mandatory. The economic, social and legal ramifications of any proposed regulatory action must be carefully balanced with the ethical considerations.

In concluding this comment, a statement by A. Gerstacker, Chairman of the Dow Chemical Company poses a final provocative thought:

> The anational company may be the major hope in the world today for economic cooperation among people, for prosperity among nations, for peace in our world. I have long dreamed of buying an island owned by no nation, and of establishing the world headquarters of the Dow company on the truly neutral ground of such an island, beholden to no nation or society.[113]

Michael S. Sinkeldam

113. Reich, *supra* note 89, at 187.