Law Offices of
DEKIEFFER & HORGAN

Washington D.C.
Saarbrücken, Germany
Monterrey, Mexico

A SUMMARY OF U.S. ANTIBOYCOTT LAW

deKieffer & Horgan, Washington, D.C.

Background

In 1954, the council of the League of Arab States approved a resolution calling for an economic boycott of Israel. Since that time, a boycott of varying effectiveness has been conducted by members of the League. To implement the boycott, the League formed a Central Boycott Office, headquartered in Damascus, Syria, for the purpose of facilitating communications among the boycott offices of the League members and to make recommendations regarding boycott enforcement.

The boycott is not confined to actual trade with Israel. It also applies to dealings with companies that have been blacklisted for activities deemed to be inconsistent with the "General Principles for the Boycott of Israel" (June 1972), published by the Central Boycott Office and the League of Arab States. Generally, a firm may be blacklisted if it trades with Israel or if it has a relationship with a firm that trades with Israel.

The Arab boycott of Israel occurs on three levels. The "primary boycott" involves a refusal by the government of the participating countries to deal, and a prohibition on their residents from dealing, directly with, or in the goods of, Israel or Israeli firms. The primary boycott is enforced by 16 Arab states. The "secondary boycott" involves a refusal by the governments of participating Arab states to deal, and a prohibition on their residents from dealing with persons or firms, or in the goods or services of persons or firms, which, although not Israeli, have been blacklisted by boycott officials of these Arab states. The "tertiary boycott" involves a requirement by participating governments that persons or firms not deal with blacklisted firms in certain circumstances. The secondary and tertiary aspects of the boycott are enforced in varying degrees in 11 Arab states.

Generally, decisions to blacklist a firm or person originate with local boycott authorities in one of the 11 Arab states participating in the secondary or tertiary aspects of the boycott, although they may originate with the Central Boycott Office. As a means of gathering boycott-related information, the local boycott office in an Arab state may send a questionnaire to a target seeking formal written responses as to the target's business affiliations, relationships with Israel, relationships with blacklisted persons or firms, and other matters. Failure by a target to respond to such a questionnaire within the prescribed time period makes it more likely than not that the target will be blacklisted by the country sending the questionnaire and that the target will be recommended for blacklisting to the Central Boycott Office. In the event a person or firm is blacklisted, the "General Principles" provide that its products and services will be denied entry into the boycotting states.

729 Fifteenth Street NW
Suite 800
Washington, DC 20005
USA

Tel: +1 202 783-6900
Fax: +1 202 783-6909
www.dhlaw.com

Beethovenstraße 13
Postfach 10 33 63
D-66033 Saarbrücken
Germany

Tel: +49 681 379 3220
Fax: +49 681 390 7219
www.dhlaw.de

Rio Mississippi 51 Pte.
Colonia del Valle
San Pedro, Nuevo León 66220
Mexico

Tel: +52 8 278 1990
Fax: +52 8 378 0420
www.dhlaw.com.mx

In the mid-1970's, Congress became concerned about Arab efforts to pressure U.S. companies into participating in the boycott against Israel and eventually enacted antiboycott legislation as amendments to the Export Administration Act and to the U.S. Internal Revenue Code. The essence of these provisions is to prohibit any U.S. person, firm, or related entity from participating in or furthering a boycott not sanctioned under U.S. law. Thus, the primary implementation of these provisions is with respect to the boycott of Israel, but they would apply to any other "unlawful" boycott.

Antiboycott Provisions
Under the Export Administration Regulations

The U.S. Export Administration Act makes it a criminal or civil violation for a U.S. company or its employees to take any one of a number of actions to participate in or cooperate with any foreign boycott not sanctioned by the United States Government (50 U.S.C. app. §2407). The provisions of the Export Administration Act are elaborated in substantial detail by regulations issued by the Commerce Department (15 C.F.R. §760).

A United States person under these provisions is defined as "any person who is a United States resident or national, including individuals, domestic concerns, and 'controlled in fact' foreign subsidiaries, affiliates, or other permanent foreign establishments of domestic concerns." A foreign subsidiary or affiliate is "controlled in fact" by a domestic concern when it has the ability to control general policies or daily operations. Several rebuttable presumptions of control are established in the regulations:

Where the domestic concern owns or controls more than 50% of the voting securities of the foreign subsidiary or affiliate;

Where the domestic concern owns or controls more than 25% of the voting securities of the foreign subsidiary or affiliate and no other person owns or controls an equal or larger percentage;

If the foreign subsidiary or affiliate is operated by the domestic concern pursuant to an exclusive management contract, or if a majority of the members of its board of directors are also members of the comparable governing body of the domestic concern;

If the domestic concern has the authority to appoint either a majority of the board of directors or the chief operating officer of the foreign subsidiary or affiliate.

It should be noted that, although the Act applies to a U.S. person who takes prohibited action with the <u>intent</u> to comply with, further, or support an unsanctioned boycott, <u>intent</u> in this context merely means the reason or purpose for behavior. Agreement with the boycott in question or desire to have the boycott succeed or that it be furthered or supported is not required in order to establish intent. Such reason or purpose can be established by circumstantial evidence.

The Export Administration Act requires U.S. companies to report any boycott requests they receive even though they refuse to participate in or cooperate with these requests. The term "request" under the Export Administration Act is broadly defined to include any request, whether written or oral and from either a boycotting or non-boycotting country entity, to take any action having the effect of furthering or supporting a restrictive trade practice or boycott against a country friendly to the U.S. A "request" may include a solicitation, directive, legend, or instruction that asks for information or asks that a U.S. person take or refrain from taking a particular action. A "request" also includes a situation in which a U.S. person is negotiating a transaction with a boycotting country, knows that he will be asked to supply certain reportable boycott information at the conclusion of negotiations, and, in an effort to forestall receipt of the request an thereby avoid having to file a report, supplies the information in advance.

Special attention should be paid to all transactions in or relating to the countries listed by the U.S. Treasury Department as boycotting countries. See Attachment I. The Treasury Department also defines as a boycotting country any country not on its list which a U.S. person knows or has reason to know requires any person to participate in or cooperate with an international boycott.

It is not unusual for letters of credit to contain conditions or terms which are boycott related. U.S. persons are prohibited from paying or otherwise implementing letters of credit that contain conditions or requirements, compliance with which is prohibited by the antiboycott provisions. Actions considered to be "implementing" such a letter of credit include paying, honoring, or confirming it, although a bank may take ministerial actions to dispose of such a letter of credit without implementing it and may also assist the beneficiary in seeking an amendment to the letter of credit to eliminate or nullify language which prevents the bank from implementing it.

The regulations provide certain exceptions to these prohibitions but, because the penalties for violation are substantial, as described below, it would be wise to obtain expert advice in connection with any activities in connection with a boycotting country prior to any contact with such a country.

Enforcement and Penalties

The regulations provide for both criminal and civil penalties. the criminal penalties are a maximum of a $25,000 fine and/or one year's imprisonment for a first violation, and up to a $50,000 fine and/or five years imprisonment for subsequent offenses. The civil penalties are a maximum of $10,000 per violation and/or denial of export privileges.

Of particular significance is how "violation" is interpreted. The Office of Antiboycott Compliance in the Department of Commerce has increased its enforcement activities within the past two years and a significant factor in the impact of these activities is its charging a violation of the antiboycott regulations for each and every separate answer or response to a prohibited question. For example, answering a single questionnaire relating to a single transaction could amount to hundreds of individual violations.

Guidelines For Compliance

The following is a list of guidelines for compliance with the antiboycott provisions. No officer, employee, representative, agent, or consultant, should take any action or make any agreement to:

- refuse, or require any person to refuse, to do business with anyone, including an entity of a boycotted country or a blacklisted person, pursuant to an agreement with, a requirement of, or a request from or on behalf of an entity of a boycotting country;
- discriminate against any individual or entity in employment or in commercial relationships on the basis of the race, religion, sex, national origin or nationality of such person or, where an entity, of its employees, officers, directors or owners;
- furnish information with respect to the race, religion, sex, or national origin of any U.S. individual or entity or, where an entity, of any owner, officer, director, or employee of

such entity;

- furnish information about past, current, or prospective business relationships of anyone with a boycotted country, an entity of a boycotted country, or firms known or believed to be on a boycott list; and
- furnish information about the affiliation or other relationship of any person with an organization which supports a boycotted country.

Any officer, employee, agent or consultant of a U.S. company or its subsidiary who receives a request, whether in relation to a sanctioned or unsanctioned boycott, either in writing or orally, which is, or might be construed as, a request to take or agree to take any of the prohibited actions set forth above should not respond to the request without specific guidance.

Warning Signals

The following is a list of some warning signals which may suggest the presence of boycott concerns in international business dealings:

- requests not to do business with a boycotted country, with companies, nationals or residents of such country, with other entities doing business with such country, with so-called "blacklisted" firms or persons, or with any person or company if you suspect the request is related to the boycott of such country (for example, Arab boycott of Israel);
- requests to do business only with approved firms or persons (for example, those on a so-called "whitelist");
- requests to do business with specified firms or persons, such as potential contractors or subcontractors, which you have reason to believe have been selected by boycotting countries or entities in such countries for boycotting reasons;
- requests to discriminate against U.S. persons on the basis of race, religion, sex, or national origin;
- requests in which the words "Israel", "Hebrew", "Jewish", or other words indicative of ancestry, nationality, or national origin are used, as well as questions about parentage;
- requests to furnish information regarding race, religion, sex, or national origin;
- requests to furnish information about anyone's past, present or future business relationships with a boycotted country, with companies, nationals, or residents of such country, or with blacklisted persons, as well as requests to furnish information about anyone's association with charitable or fraternal organizations supporting a boycotted country;
- insistence upon contract clauses making applicable, or requiring compliance with, local laws or regulations; and
- requests to supply a negative certificate or origin of goods (for example, "not produced in Israel").

While some of the examples described above may not constitute a violation of federal law or regulation, the examples, which are not exhaustive, do reflect warning signals which should trigger concern. All personnel should be alert for <u>any</u> statements or requests (written or oral) which could indicate the presence of boycott issues. If any such warning signal is encountered, the company personnel involved should refrain from responding to or discussing the matter either with the source of the signal or others and should promptly seek advice and guidance from the appropriate supervisory personnel or company counsel.

As noted above, the regulations require companies to report requests to comply with an unsanctioned boycott, whether such requests are acted upon or not. Furthermore, companies doing business in and with boycotting countries are subject to income tax reporting requirements as well. It is recommended that all records relating to reportable boycott requests, including copies of any document in which the request appeared, be maintained by the company for three years after receipt of the request.

Tax Aspects of U.S. Antiboycott Law

This is a brief analysis of the provisions of section 999 of the Internal Revenue Code of 1954, as amended ("Code", 26 USC § 1 ET SEQ.) and the Treasury Department's Boycott Guidelines ("Guidelines", 43 Fed. Reg. 3454, Jan. 25, 1978, 44 Fed. Reg. 66272, Nov. 19, 1979) which interpret this provision. This is to provide an overview of what section 999 penalizes and the scope and manner of its application. It also analyzes the key differences between code section 999 and its Guidelines and the antiboycott provisions of the Export Administration Act.

Overview of Code Section 999

Code section 999 imposes certain tax penalties, namely loss of deferral, foreign tax credits and foreign sales corporation ("FSC") benefits with respect to, agreements made as a condition of doing business with or in a boycotting country:

(1) to refrain from doing business with a boycotted country, or with its government, companies or nationals;

(2) to refrain from doing business with a blacklisted United States person;

(3) to refrain from doing business with companies whose owners or managers are of a particular nationality, race, or religion; or

(4) to refrain from employing individuals on the basis of their race, nationality or religion.

The Code also penalizes agreements, made as a condition of the sale of goods to a boycotting country, its companies, or nationals, to refrain from shipping or insuring with blacklisted carriers.

The Code's tax sanctions for a penalized agreement apply to a "person or a member of his controlled group (within the meaning of section 993(a)(3) which includes the person) ..." *See* Code section 999(b)(1). A "controlled group", in general, is a group of companies connected through stock ownership with a common parent in which more than 50% of the voting stock or of the total value of the shares in each of the corporations in the group, except the common parent, is owned directly or indirectly by one or more of the other corporations. Section 999(b)(1) also provides that if any member of a controlled group engages in acts of boycott compliance, all members of the controlled group with operations in boycotting countries are presumed to have complied with the boycott.

Under Code section 999(b)(1), if a person engages in an act of boycott compliance, all of that person's operations in any boycotting country (including specifically all of the countries set forth in a list of boycotting countries published quarterly by the Treasury Department) are presumed to be boycott-tainted. The presumption of boycott participation does not arise automatically because a person does business in a boycotting country; it is triggered by an initial act of actual boycott participation.

If a taxpayer or other members of the taxpayer's controlled group are engaged in "separate and identifiable" operations in boycotting countries, the taxpayer (or group) may avoid loss of tax benefits as to those operations in which there is no boycott compliance. In order to benefit from this rule, it must be demonstrated that the operations in boycotting countries were separate and identifiable, and that there was no boycott compliance in such operations. The income and taxes attributable must also be identified.

Among the tests applied under the Guidelines in determining whether operations are clearly separate and identifiable are whether the operations were conducted by different corporations or other entities, were supervised by different management personnel, whether they involved different products or services, or were undertaken pursuant to separate contracts. A taxpayer must demonstrate that different operations within the same country are separate and identifiable in order to avoid having a penalized agreement in one operation taint other operations.

"Boycotting countries" for purposes of the above rules are both the countries periodically listed by Treasury and other, unlisted countries, if the taxpayer "knows or has reason to know" that country requires boycott participation as a condition of doing business. Countries appearing on the most recent Treasury list are listed in Attachment I.

Key Differences Between the EAA and Code Section 999

There are many areas in which the EAA and Code section 999 overlap. Both laws penalize agreements to refrain from doing business with boycotted countries and with blacklisted U.S. persons (the EAA is broader in that it prohibits refusals to do business with **ANY** blacklisted persons, rather than solely U.S. persons). Both penalize certain types of discrimination although there are important differences in scope. The most important differences between the two sets of laws (and their interpretative regulations and guidelines) are the following:

1. Code section 999 penalizes only <u>agreements</u> do certain things, for example, refraining from doing business with a boycotted country or blacklisted U.S. persons. Such agreements must be made as a condition of doing business with a boycotting country. Unlike the EAA, the Code does not, by its terms, penalize:

   (a) the taking of actions not pursuant to a proscribed agreement;

   (b) the furnishing of information *per se*. *See* Guideline H-17 (but beware of agreements to furnish information or certifications at a future date because such agreements may be penalized; *See* Guidelines H-17 and H-35).

2. The EAA applies only to transactions in the interstate or foreign commerce of the United States, whereas Code section 999 is not limited in this way.

3. The EAA applies only to "U.S. persons" (defined to include controlled-in-fact foreign affiliates) and prohibited certain actions only if they are taken with "intent to comply with, further or support" a foreign boycott against a country friendly to the United States which is not the object of any form of boycott under U.S. law. In contrast, Code section

999 applies to all U.S. taxpayers and members of their "controlled group" as defined above. "Intent" is not required under the Code.

4. Code section 999 penalizes discrimination in employment on the basis of <u>nationality</u>, whereas EAA prohibits it on the basis of <u>national origin</u>.

5. Both the EAA and Code section 999 make some provision for compliance with primary boycott requirements:

   (a) EAA section 2407(a)(2)(A) permits a U.S. person to comply with boycotting country's prohibition on imports of goods <u>or services</u> from the boycotted country, or produced or provided by boycotted country companies, nationals, or residents.

   (b) In contrast, Code section 999(b)(4)(B) permits agreements to comply with a prohibition on the import of goods, <u>but not services</u>, produced in whole or in part in a country which is the object of boycott.

6. Not surprisingly, there are also a number of key differences and inconsistencies between the EAA's antiboycott Regulations and Treasury's Guidelines interpreting Code section 999:

   (a) The most dangerous difference is the Treasury's apply/comply distinction. Under this distinction, an agreement that the laws of a boycotting country "shall apply" to the performance of a contract is not penalized. In contrast, an agreement "to comply" generally with a boycotting country's laws is penalized, even though boycott laws are not specifically mentioned. *See* Guidelines H-3, H-4. In Guideline H-39, Treasury has further elaborated on this distinction. An agreement that a boycotting country's laws "shall govern" performance of a contract or that the company would be "subject to" the laws, regulations, requirements or administrative practices of the boycotting country is not penalized under the Code.

   This distinction does not exist under the EAR. Under EAR section 15 CFR §760.2(a)(5), an agreement "to comply" generally with the laws of a boycotting country or an agreement that the laws of the boycotting country "shall apply" or "govern" is not prohibited.

   (b) Unlike the EAA and EAR, the Guidelines make no provision for an in-country exception: compliance by U.S. firms resident in boycotting countries with local law with respect to their activities exclusively within that country, for example, entering contracts providing that the parties will comply with local laws and compliance with local import laws in importing goods, materials, or components into the boycotting country.

7. Unlike the EAR, which basically makes all boycott-related requests reportable (regardless of whether they are prohibited or permissible, unless they are exempted from reporting by 15 CFR §760.5(a)(4)), the Code requires that all "operations"[(1)] in or related to boycotting countries must be reported on Form 5713 (International Boycott Report) filed each year with the taxpayer's federal income tax return (with a duplicate copy filed with the Internal Revenue Service Center in Philadelphia).

   (a) Form 5713 must be filed regardless of whether any boycott "requests" are received. Any such "requests" to participate in or cooperate with an unsanctioned international boycott within the meaning of Code section 999(b)(3) must also be reported.

(b) Unlike the EAR, a taxpayer must report the "operations" of his or its entire "controlled group" (including foreign affiliates in which more than 50% of the voting stock or total value of shares in each of the corporations, except the common parent, is owned directly or indirectly by one or more of the other corporations), regardless of whether their activities involve U.S. interstate or foreign commerce.

(c) It should be remembered that while the Treasury Department, unlike Commerce, lists certain "boycotting countries", operations in other, unlisted countries are also reportable if the taxpayer knows or has reason to know that country requires participation in or cooperation with an unsanctioned international boycott. Special scrutiny should be given to the member countries of the Islamic Conference Organization which has declared an Islamic Boycott of Israel. These countries are listed in Attachment II.

Attachment I

LIST OF BOYCOTTING COUNTRIES

The U.S. Treasury Department currently lists the following as boycotting countries, that is, countries "which may require participation in or cooperation with an international boycott":

Bahrain

Iraq

Kuwait

Lebanon

Libya

Oman

Qatar

Saudi Arabia

Syria

United Arab Emirates (U.A.E.)

Yemen, Republic of

Attachment II

MEMBERSHIP IN THE ISLAMIC CONFERENCE ORGANIZATION (ICO)

NON-ARAB MEMBERS OF THE ICO: Afghanistan (currently suspended from the ICO), Bangladesh, Cameroon, Chad, Comoros Is., Djibouti, Gabon, Gambia, Guinea, Guinea-Bissau, Indonesia, Iran, Malaysia, Maldives, Mali, Niger, Pakistan, Senegal, Turkey, Uganda, Burkina Faso

ARAB MEMBERS OF THE ICO: Algeria, Bahrain, Egypt (currently suspended from the ICO), Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates, Yemen, Arab Republic, Palestine Liberation Organization

COUNTRIES/ORGANIZATIONS HAVING OFFICIAL OBSERVER STATUS IN THE ICO: Moslem World Congress, Nigeria, Turkish Federated State of Kibris (the Turkish part of Cyprus), League of Arab States, Moslem World League

---

Endnote:

1. The term "operations" is broadly defined under Guideline B-1 to include all forms of business or commercial activity, regardless of whether productive of income.

Reportable "operations" include selling, leasing, purchasing, performing services, producing, and performing ancillary activities such as contract negotiating, advertising, site selection, etc