U.S. antiboycott laws: overview and compliance strategies

U.S. and non-U.S. companies falling foul of complex and often-overlooked U.S. antiboycott regulations may face civil and criminal penalties and the loss of certain U.S. tax benefits. Kim Strosnider and Christine Minarich examine these controls and provide practical guidance on appropriate compliance measures.

Recent efforts to overhaul U.S. export controls have received widespread attention. However, a related area of U.S. regulation has been little changed in more than 40 years and appears unlikely to be revamped any time soon: U.S. antiboycott laws and regulations, which target compliance with the Arab League boycott of Israel.

Despite the lack of attention these laws and regulations receive, they can substantially impact both U.S. and non-U.S. companies. Moreover, as tensions in the Middle East continue, U.S. officials have reported receiving increased reports of boycott requests from that region and North Africa.

The United States actually has two separate and distinct antiboycott regimes, one administered by the U.S. Department of Commerce, the other by the U.S. Department of the Treasury. These regimes are complex and sometimes inconsistent. Further, the problematic boycott language targeted by these two schemes can be buried in the fine print of purchase orders or letters of credit and can be difficult to spot, making compliance a challenge.

This article provides background and an overview on these laws and regulations, and discusses compliance strategies.

Background

U.S. antiboycott laws and regulations are designed to prohibit or penalize cooperation with international economic boycotts in which the United States does not participate.

U.S. antiboycott legislation adopted in 1965 required persons exporting from the United States to report to the Commerce Department the receipt of any request to take action or provide information supportive of an international boycott directed against a country friendly to the United States. The law was amended in the 1970s to extend these reporting requirements to all entities controlled by U.S. firms and, for the first time, prohibited certain boycott-related conduct. In addition, a 1976 law created a separate tax return reporting requirement and imposed tax burdens on U.S. taxpayers if they or members of their controlled groups participate in certain international economic boycotts.

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The primary (but not the only) target of U.S. antiboycott programmes is the Arab League boycott of Israel. This boycott has a primary aspect, which bars the import of Israeli goods and services into the boycotting countries and bars the export of goods and services from those countries to Israel. However, U.S. antiboycott laws generally do not target such prohibitions. Rather, they are directed against the secondary and tertiary aspects of the boycott. The secondary boycott precludes dealings with companies and individuals that do business with Israel. The tertiary boycott bans entities from doing business with companies or individuals who have been 'blacklisted' because of their relationships with Israel.

Currently, the U.S. government has listed eight countries as supporting the boycott of Israel: Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, the United Arab Emirates, and Yemen. While Iraq currently is not included on the list, its status remains under review, meaning that it could be added back onto the list in the future.

U.S. Commerce Department antiboycott program

The U.S. Commerce Department's antiboycott regulations are found in the Export Administration Regulations ('EAR'), 15 C.F.R. Part 760. These regulations apply to the conduct of 'domestic concerns' and non-U.S. entities that are 'controlled in fact' by a 'domestic concern' if the conduct is in 'U.S. commerce'. Domestic concerns include (1) any partnership, corporation, company, association, or other entity of, or organized under the laws of, any U.S. jurisdiction and (2) any permanent U.S. establishment of a non-U.S. concern. A non-U.S. entity is 'controlled in fact' by a domestic concern if the domestic concern has the authority to establish the general policies or to control the day-to-day operations of the non-U.S. entity. Certain factors – *e.g.*, direct or indirect beneficial ownership or control of a certain percentage of outstanding voting securities; the existence of an exclusive management contract; the authority to appoint members of the board of directors or chief operating officer; etc. – give rise to a rebuttable presumption of control in fact.

Below, we discuss the jurisdictional requirement that a transaction be in 'U.S. commerce' for these regulations to apply. Then, we describe the type of conduct these regulations prohibit.

U.S. commerce connection

In order to trigger the Commerce Department's antiboycott regulations, the individual transaction in which the boycott request was made must be in 'U.S. commerce'.

As a threshold matter, any transaction between a controlled in fact foreign affiliate of a domestic concern and a person located in the United States is an activity in U.S. commerce. For example, if a wholly owned foreign affiliate of a domestic concern purchases goods or services from the United States in order to fill an order for a customer, that transaction will be in U.S. commerce and the Commerce Department antiboycott provisions would apply if the transaction involves a prohibited boycott request.

Determining when the *non-U.S.* sales activities of non-U.S. affiliates of a U.S. company are in U.S. commerce requires a careful transaction-by-transaction inquiry. Generally, non-U.S. sales activities are considered to be in U.S. commerce if they involve:

- Goods or services (including information and ingredients or component parts) specifically acquired from the United States in order to engage in the transaction; or
- Transactional services provided to or for the benefit of the customer by a person in the United States (*e.g.*, U.S. guarantees of performance or technical services provided to the non-U.S. affiliate's customer). However, this does not include U.S. accounting, legal, or other support to the foreign affiliate itself.

Penalties for non-compliance with U.S. antiboycott laws and regulations and recent enforcement actions by the U.S. Department of Commerce

Companies ignore U.S. antiboycott laws and regulations at their peril. Maximum penalties for violations of the Commerce antiboycott regulations include civil penalties per violation of $250,000 or twice the value of the transaction, whichever is greater, and criminal penalties of $1 million per violation or 20 years' imprisonment.

Companies and operations outside the United States are not beyond the reach of these regulations. In fact, one-quarter of the settlement agreements entered into by the Commerce Department's Office of Antiboycott Compliance in 2010 and 2011 involved non-U.S. branches or affiliates of U.S. companies or the U.S. branches of non-U.S. companies.

While the Treasury Department's antiboycott measures do not carry civil or criminal penalties for non-compliance, they can result in adverse U.S. tax consequences, such as a loss of foreign tax credits and the inability to defer foreign-source income. The manner and degree to which U.S. taxes are affected by boycott participation are complex and depend upon the circumstances of the particular taxpayer. In addition, willful failure to file a required boycott report with the Treasury Department may result in a $25,000 fine and/or imprisonment for up to one year.

Following are summaries of several recent antiboycott enforcement actions pursued by the Commerce Department.

- Rexnord Industries LLC, a U.S. company dealing in engineered mechanical components and other products used in water management, paid a civil penalty for, among other things, allegedly providing a commercial invoice containing the following statement: 'We certify that the goods are neither of Israeli origin nor do they contain any Israeli materials.'
- Weiss-Rohlig USA, a logistics provider and freight forwarder, paid a civil penalty for allegedly providing a certification from an agent stating: 'The carrying vessel is allowed to enter Kuwaiti ports' and for failing to report the receipt of a request for a similar certification.
- Smith International Inc., a major supplier of drilling tools and services doing business in Texas, paid a civil penalty for, among other things, allegedly agreeing to a condition in a UAE subcontract which provided:

  '[S]ubcontractor acknowledges that the laws of Abu Dhabi and the U.A.E. include, *inter alia*, laws regarding the boycott of "Israel" especially those related to blacklisted companies, ships and persons.'

  The company also allegedly provided a freight forwarder with a commercial invoice addressed to an entity in Libya that contained the following statement: 'We further certify that no materials charged herein are of Israeli origin, nor do they have Israeli content.'

Boycott requests – six categories of prohibited conduct

The Commerce Department defines the term 'boycott request' broadly to include virtually any requirement to participate in or cooperate with a boycott. In some countries, registrations or renewals of trademarks and other intellectual property rights may give rise to boycott requests. In addition, boycott requests may appear in questionnaires, purchase orders, tender invitations, contracts, and letters of credit. Boycott requests also may be received from customs or consular officials in the course of clearing goods for import.

There are six categories of prohibited boycott-related conduct under the EAR:

- Refusing or agreeing to refuse to do business with or in a boycotted country (*e.g.*, Israel) or with a national of a boycotted country (*e.g.*, an Israeli company) or a boycotted person (*e.g.*, a 'blacklisted' party). This includes, among other things, agreeing to comply with a country's boycott laws; ship goods on a carrier that is eligible to enter the ports of a boycotting country (other than Saudi Arabia); or provide a certificate stating that products are not of Israeli origin (a 'negative certification');
- Refusing to employ or otherwise discriminating against a U.S. person, in deference to a boycott request, on the basis of race, religion, sex, or national origin;
- Furnishing information, in response to a boycott request, about the race, religion, sex, or national origin of a U.S. person or any owner, officer, director, or employee of a domestic concern or controlled in fact non-U.S. affiliate;
- Furnishing information about any person's past, ongoing, or proposed future relationships (or the absence of relationships) with other parties, if that information is sought for boycott-related reasons;
- Furnishing information about any

person's association with or support for any charitable or fraternal organization supporting a boycotted country; and
- Paying, honouring, confirming or otherwise implementing a letter of credit that contains any prohibited boycott requirement or request.

There are several narrowly drawn exceptions to these prohibitions. For example, it is permissible to agree not to ship goods to a boycotting country on Israeli vessels or airlines or on a ship or aircraft that will call at an Israeli port en route to a boycotting country. These requirements are treated as reasonable security measures of a boycotting country rather than prohibited boycott requests.

Commerce Department statistics indicate that traditional boycotting countries propagate most prohibited boycott requests, with the UAE, Libya, and Syria among the leading propagators of boycott requests in recent years. However, companies also must be alert for requests that may come from other countries, such as Bahrain, Bangladesh, Malaysia, Oman, Pakistan, and Tunisia. In addition, companies may receive boycott requests from distributors or other intermediaries working for customers in boycotting countries. For example, a distributor in the European Union with a Lebanese customer may propagate a boycott request in order to satisfy the requirements of its customer. On some occasions, though rare, boycott requests may relate to boycotts other than the boycott of Israel.

U.S. Treasury Department antiboycott program

The U.S. Treasury Department's antiboycott measures are codified in the Internal Revenue Code ('IRC'). These measures penalize U.S. taxpayers if they or members of their controlled groups agree to participate in or cooperate with a boycott that is not sanctioned by the United States. Such agreements are not *prohibited* and do not carry civil or criminal penalties but rather can result in adverse U.S. tax consequences for the taxpayer.

Boycott participation under the IRC

The definition of 'boycott participation' under the IRC does not align exactly with prohibited boycott activities under the EAR. Under the IRC, the term includes any agreement – as a condition of doing business within a boycotting country or with the government, a company, or a national of a boycotting country – to *refrain* from any of the following:

- Doing business with or in a boycotted country (*e.g.*, Israel) or with the government, companies, or nationals of a boycotted country;
- Doing business with a boycotted or blacklisted person or undertaking, as a condition of sale, not to ship goods on a blacklisted carrier or insure goods with a blacklisted insurer;
- Doing business with a company by reason of the nationality, race, or religion of its owners or individuals in its management, or removing corporate directors or individuals from management for such reasons; or
- Employing individuals of a particular nationality, race, or religion.

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Some of the most common types of boycott participation agreements are undertakings to comply generally with the laws of a boycotting country (deemed to include that country's boycott laws). In addition, Treasury considers an agreement to provide certain information in the future, such as a commitment to provide a certification of non-blacklist status, to be boycott participation.

Perhaps most importantly, unlike the EAR provisions, the IRC provisions reach the conduct of non-U.S. affiliates who are members of a U.S. taxpayer's controlled group under the IRC, even if that conduct is not associated with an activity in U.S. commerce.

COMPLIANCE STRATEGIES

Responding to boycott requests

Receiving a boycott request in the course of a proposed transaction does not necessarily require companies to walk away from the business. Rather, companies can negotiate amendments and changes to problematic boycott language so as to ensure that such language is not prohibited or penalized by U.S. antiboycott laws. Often, small changes that may appear subtle to business partners can successfully neutralize problematic boycott requests. The likelihood of successfully negotiating the necessary changes will depend on the customer, country, and goods involved in each transaction. However, many customers in boycotting countries are aware of U.S. antiboycott laws and accept that U.S. companies and their affiliates must comply with these laws or risk penalties or the loss of tax benefits.

Recommended compliance measures

Given the complex and nuanced nature of these regulations, implementing practical and effective compliance strategies can be a challenge. At a minimum, companies that are subject to U.S. antiboycott regulations should consider the following compliance strategies:

Review

Train responsible employees to carefully review all oral and written communications including, but not limited to, e-mails, contracts, purchase orders, letters of credit, import documents, invoices, and requests for information, to determine whether any boycott language is present. Special attention should be paid to documents emanating from the traditional boycotting countries. All transaction documents should be reviewed, even if the company does not intend to pursue the business. Problematic boycott language might include:

- References to 'Israel' or 'Israeli' when the transaction does not otherwise involve any apparent connection to Israel;
- References to a vessel or aircraft being eligible to enter the ports or airports of a boycotting country;
- References to 'negative' certificates of product origin (*e.g.*, goods are 'not of Israeli origin');

- References to an insurance company having a qualified agent or representative in a boycotting country;
- Requests to comply with the laws or regulations of a boycotting country generally or boycott laws specifically; or
- Boycott questionnaires seeking information about relationships with Israel, including data about the company's ownership, management, subsidiaries, licensees, or affiliated firms.

This list is *not* exhaustive. Whether a boycott request is problematic from a U.S. legal standpoint will depend on jurisdictional factors and how the request is framed.

Refer

If any problematic boycott language is identified, place the transaction on hold and promptly forward a copy of the exact language received to the export compliance or legal department for further evaluation. Given the complexities involved in applying this area of the law, companies frequently elect a centralized review rather than training employees extensively on the nuances of this area.

Respond/report

The export compliance or legal department should provide instructions on how to proceed. This may involve amending or striking the problematic language. It also could involve collecting information necessary to ensure proper and timely reporting of any boycott requests to the Commerce and/or Treasury Departments. Commerce Department reports are filed within 30 days after the end of the calendar quarter in which a reportable boycott request is received (or 60 days if the request is received outside of the United States). Treasury Department boycott reports are filed annually with the U.S. taxpayer's tax returns. Boycott requests must be reported (unless an exception applies), even if the prohibited or penalized action was not taken.

Conclusion

The complex and sometimes inconsistent nature of U.S. antiboycott programmes can substantially impact both U.S. and non-U.S. companies and, in some situations, lead to civil or criminal penalties or the loss of tax benefits. As a result, companies should ensure that compliance staff are adequately trained on this often-overlooked area of U.S. law. In addition, compliance policies for U.S. and covered non-U.S. entities should include procedures for reviewing transaction materials, referring problematic boycott-related language for appropriate review, and reporting boycott requests as required.

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