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Comments on the New Treasury Antiboycott Regulations

by
Gillis L. Heller†

INTRODUCTION

Recently the U.S. Treasury Department promulgated additional guidelines (hereinafter the New Guidelines) under section 999 of the Internal Revenue Code (hereinafter the Code),¹ relating to the determination of whether and the extent to which a taxpayer will be deemed to have agreed to participate in or cooperate with an international boycott.² On the whole, the New Guidelines represent an improvement over the existing Guidelines in terms of clarity and certainty. Unfortunately, they also raise novel and even disturbing issues which call into question the wisdom of such guidelines.

Section 999 is the anchor section of the international boycott provisions added to the Code by the Tax Reform Act of 1976.³ The primary purpose of the international boycott provisions is to provide a disincentive to certain restrictive boycott practices:

Congress is concerned that U.S. businesses have been prevented from freely operating in international markets by the threat of economic sanctions by certain foreign countries or their nationals or companies. Unless the U.S. businesses agree to participate in or cooperate with certain foreign countries in an international boycott, they are denied the opportunity to conduct business with a country. Congress believes that it is particularly unfair to those taxpayers who refuse to participate in the boycott, when the taxpayer who does participate in the boycott is a recipient of tax benefits by reason of the participation. Congress believes that many taxpayers would not participate in an international boycott if the taxpayer and the foreign countries were made aware that tax benefits were not available to a taxpayer who participates in a boycott.⁴

The international boycott provisions provide in general that if a

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1. Internal Revenue Code of 1954, as amended by the Tax Reform Act of 1984 [hereinafter cited as I.R.C.]. All further references are to the 1984 version of the Code.

2. Notice of Additional Guidelines, 49 Fed. Reg. 18,061 (Apr. 26, 1984); proposed in 48 Fed. Reg. 53,003 (Nov. 23, 1983).

3. Pub. L. No. 94-455, § 1064, 90 Stat. 1650 (1976) (prior to 1978 amendment).

4. JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, 94th Cong., 2d Sess. 282 (1976).

person, or a member of a controlled group⁵ which includes such person, participates in or cooperates with an international boycott in a taxable year, then an allocable portion of certain tax benefits shall be denied. To help enforce these provisions, certain tiered reporting requirements are imposed.⁶ At the lowest level, if any person, or a member of a controlled group which includes that person, has operations in or related to a country (or with the government, a company, or a national of that country) which is on the list of countries maintained by the Secretary of the Treasury which require or may require participation in or cooperation with an international boycott, then that person must file a report on Internal Revenue Service Form 5713.⁷ Filing is also required with respect to operations during the taxable year in or related to any other country (or with the government, a company, or a national of that country) if such person⁸ knows or has reason to know that participation in or cooperation with an international boycott is required as a condition of doing business within such country or with such government, company, or national.⁹

Requests to participate in or cooperate with such a boycott, if any, entail a second tier of reporting.¹⁰ Finally, actual participation or cooperation must also be reported.¹¹

In the international context, there are three identifiable levels of boycotts. A "primary boycott" occurs when Country A refuses to trade with Country B. Under a "secondary boycott", Country A refuses to trade with anyone who does business with Country B and, in furtherance of such boycott, Country A may develop a blacklist of companies trading with Country B. Finally, a "tertiary boycott" is said to take place when Country A refuses to trade with anyone who does business with those on Country A's blacklist.

Presently the boycott with the most pervasive international effect is the Arab boycott of Israel.¹² Operating at all three levels, the Arab boycott mainly seeks to isolate Israel economically through a primary boycott. It also seeks to prevent those companies that it deems to contribute to Israel's economic or military development from doing business in the Arab world (through the use of a blacklist) and prohibits those companies doing business in the Arab world from dealing with firms on the blacklist.

Other international boycotts include the black African boycott of the Republic of South Africa, India and Pakistan's mutual boycott, Taiwan and

5. Within the meaning of I.R.C. § 1563(a) except that "more than 50 percent" is substituted for "at least 80 percent" and I.R.C. § 1563(b) does not apply. See I.R.C. § 993(a)(3).

6. See generally I.R.C. § 999(a)-(b).

7. I.R.C. § 999(a)(1)(A).

8. If such person is a foreign corporation, then the reporting requirements apply as to any United States shareholder of that corporation. I.R.C. § 999(a)(1)(B).

9. I.R.C. § 999(a)(1)(B).

10. I.R.C. § 999(a)(2).

11. *Id.*

12. See LOWENFELD, TRADE CONTROLS FOR POLITICAL ENDS 99-113 (1977).

the People's Republic of China's mutual boycott, and the eastern European countries' boycott of various other nations such as Israel, South Africa, Namibia (South-West Africa), South Korea, and Chile. These boycotts are generally primary in nature, and are often not in force.¹³

The United States' response to international boycotts has been in direct proportion to their impact on U.S. interests. Congress's first response to international boycotts came in 1965, when it required the Secretary of Commerce to promulgate boycott reporting requirements.¹⁴ In 1976, the Department of Justice filed suit against Bechtel Corporation under the Sherman Antitrust Act for its participation in the Arab boycott of Israel.¹⁵ Reflecting frustration at the ineffectiveness of the Commerce Department's antiboycott regulations, the so-called Ribicoff Amendment to the Tax Reform Act of 1976 added the antiboycott provisions to the Internal Revenue Code, denying certain tax benefits to U.S. taxpayers participating in or cooperating with an international boycott.¹⁶

The tax benefits subject to the international boycott provisions include an allocable portion of the credit for foreign taxes paid or deemed paid,¹⁷ deferral of tax with respect to unrepatriated earnings of controlled foreign corporations,¹⁸ deferral of tax with respect to income earned by domestic international sales corporations (DISCs),¹⁹ and the exempt foreign trade income of foreign sales corporations (FSCs).²⁰ The allocable portion of the tax benefits subject to sanction for participation in or cooperation with an

13. See generally Rubinfeld, *Legal and Tax Implications of Participation in International Boycotts*, 32 TAX L. REV. 613, 613-615 (1977).

14. Act of June 30, 1965, Pub. L. No. 89-63, § 4(a)-(e), 79 Stat. 209-10 (1965).

15. *United States v. Bechtel*, No. 76-99 (N.D. Cal. filed Jan. 16, 1976). The *Bechtel* case did not come to trial. On January 10, 1977, plaintiff and defendants stipulated for the entry of final judgment. For the text of the stipulated judgment, see 16 I.L.M. 97 (1977). For a detailed discussion of the *Bechtel* case, see Jones, *Extraterritoriality in U.S. Antitrust; An International "Hot Potato"*, 11 INT'L LAW. 415 (1977).

16. In 1977, Congress amended the Export Administration Act (EAA) to prohibit certain forms of compliance with international boycotts. 50 U.S.C.A. §§ 2401-2420 (West 1983). The 1976 version of the EAA had been defeated when Congress adjourned without final approval, due to a Senate filibuster. Antiboycott legislation became an issue during the 1976 presidential campaign, with Jimmy Carter taking a strong position in favor of the law. In early 1977, the issue again came before Congress, and again was highly controversial. In private negotiations, the representatives of the Business Roundtable and major Jewish service organizations reached agreement on a "Statement of Principles", which became the basis for the EAA provisions signed into law in June 1977. (For legislative history, see 1977 U.S. CODE CONG. & AD. NEWS 362). In 1979 the provisions were re-enacted without change, effective through September 1983. (For legislative history, see 1979 U.S. CODE CONG. & AD. NEWS 1147). Because the controversy regarding certain EAA export control provisions has apparently prevented Congress from extending the EAA in general, the Commerce Department's antiboycott regulations are currently in force only through Executive Order No. 12,214, 3 C.F.R. 256 (1981).

17. See I.R.C. § 908(a).

18. See I.R.C. § 952(a)(3). In effect, non-subpart F income of a controlled foreign corporation subsidiary is converted into subpart F income, thus ending the deferral of taxation on that part of the subsidiary's income.

19. See I.R.C. § 995(b)(1)(F)(ii).

20. See I.R.C. § 927(c)(2).

international boycott is the "international boycott factor".²¹ The international boycott factor is a fraction determined according to the regulations under section 999. The numerator of the international boycott factor reflects the world-wide operations of a person (or, in the case of a controlled group which includes such person, the group) which constitute operations in or related to a group of countries associated in carrying out an international boycott in or with which that person or a member of that controlled group has participated or cooperated in the taxable year. The denominator of the international boycott factor reflects the world-wide operations of that person or group outside the United States.

The calculation of the international boycott factor is based on the presumption that if the person (or a member of a controlled group which includes such person) participates in or cooperates with an international boycott in the taxable year, then all operations of the taxpayer (or such group) in that country, and in any other country which requires participation in or cooperation with the boycott, shall be deemed a part of such participation or cooperation, except to the extent that the person can demonstrate that a particular operation is a "clearly separate and identifiable operation" in connection with which there was no such participation or cooperation.²² In other words, if a taxpayer or a member of the same controlled group participates in, or cooperates with, an international boycott, then the taxpayer will lose a part of its foreign tax credit, non-subpart F income deferral, DISC deferral, and FSC income exemption, with all operations in the boycotting countries considered tainted. Obviously, for taxpayers with operations in the boycotting countries, every contract must be monitored closely in order to prevent a highly infectious loss of tax benefits, particularly since, as a practical matter, the tax benefits subject to the sanction are highly relevant to such operations.

For purposes of section 999, a person participates in or cooperates with an international boycott if he agrees to any of the following: first, if, as a condition of doing business directly or indirectly within a country or with the government, a company, or a national of a country, he agrees to (i) refrain from doing business with or in a country which is the object of the boycott or with the government, companies, or nationals of that country, (ii) refrain from doing business with any U.S. person engaged in trade in a country which is the object of the boycott or with the government, companies, or nationals of that country, (iii) refrain from doing business with any company whose ownership or management is made up, in whole or in part, of individuals of a particular nationality, race, or religion, or to remove (or refrain from selecting) corporate directors who are individuals of a particular nationality, race, or religion, or, (iv) refrain from employing individuals of a particular nationality, race, or religion; second, if, as a condition of the

21. See I.R.C. § 999(c).

22. See I.R.C. § 999(b)(1).

sale of a product to the government, a company, or a national of a country, he agrees to refrain from shipping or insuring that product on a carrier owned, leased, or operated by a party who does not participate in or cooperate with an international boycott.

Section 999, of course, does not apply to an agreement to meet requirements imposed by a foreign country with respect to an international boycott if U.S. law or regulations, or an Executive Order, sanctions participation in or cooperation with that international boycott.²³ Section 999 also does not apply to an agreement to participate in or cooperate with an international boycott aimed directly at the country which is the object of the boycott, that is, a primary boycott.²⁴ Such agreements (collectively, "condoned agreements" or "condoned prohibitions") include an agreement to comply with a prohibition on the importation of goods produced in whole or in part in any country which is the object of an international boycott, or to comply with a prohibition imposed by a country on the exportation of products obtained in such country to any country which is the object of an international boycott.²⁵

The current regulations under section 999 do not elucidate the definition of participation in or cooperation with an international boycott. A taxpayer may obtain a determination from the Internal Revenue Service with respect to whether a particular operation constitutes participation in or cooperation with an international boycott.²⁶ The Internal Revenue Service's current policy, however, is that, pending the issuance of final regulations, determinations will be made by the National Office of the Internal Revenue Service only with respect to those issues which are specifically addressed in the published Guidelines.²⁷ Otherwise, the National Office will not make a determination until it has brought the issue to the attention of the Assistant Secretaries of the Treasury for International Affairs and for Tax Policy and a new or modified Guideline that specifically addresses the issue is published.²⁸ Thus, given the built-in additional delay, the published Guidelines are the only practical source of assurance.

The New Guidelines consist of four clarifications of the existing Guidelines and seven additional Guidelines.

I GUIDELINE CLARIFICATIONS

A. Condoned Agreements Not Reportable

The first clarification concerns Guideline A-9, and confirms that an

23. I.R.C. § 999(b)(4)(A).

24. See I.R.C. § 999(b)(4)(B)-(C).

25. *Id.*

26. I.R.C. § 999(d).

27. Rev. Proc. 77-9, 1977-1 C.B. 542.

28. *Id.*

agreement to a condoned prohibition is itself not reportable.²⁹ Under Guideline A-9, a person agrees, in the course of its operations in or related to a boycotting country, to comply with a condoned prohibition. Guideline A-9 currently provides that such a person is required to report its operations in the boycotting country on Form 5713, even though that person has not violated the antiboycott rules. The clarification provides that requests to enter into condoned agreements need not themselves be reported on the form. Rather, it would appear that only requests to enter into agreements which are not condoned must themselves be reported.

*B. Indirect Business with Country X;
Extraterritorial Import Restrictions Condoned*

The second clarification concerns Guideline J-3, and confirms that an agreement to comply with a "condoned" prohibition will not result in a violation of section 999 even where business is done with the boycotting country only indirectly.³⁰ While it is reasonable that the reach of the antiboycott sanctions should extend to indirect business dealings, it is questionable, however, whether the exception regarding direct import restrictions should be equally far-reaching. In Guideline J-3, Company C competes for an industrial plant construction contract for which Company P of Country W is inviting international tenders.³¹ The contract is to be financed by Country X, which maintains a blacklist of companies. Country X requires contracts for projects which it finances to state that the contractor is required to refrain from making any purchase for the project from any blacklisted company. Country W does not boycott those companies. Company C wins the tender and signs the contract with Company P with the blacklist provision.

Guideline J-3 currently provides that Company C's action constitutes participation in or cooperation with an international boycott, despite the fact that the boycott is not implemented by Country W but rather by Country X and the project is being carried out in Country W. The rationale is that Company C has agreed not to do business with blacklisted U.S. companies as a condition of doing business with Country X indirectly. The clarification provides that, on the other hand, if the contract precluded the use of goods produced in Country Y (the boycotted country)³² in connection with the project in Country W, it would constitute a condoned

29. 49 Fed. Reg. 18,061 (1984).

30. *Id.*

31. The Guidelines are in question-and-answer format, using hypotheticals. "Company C" is a company organized under the laws of any country (including the U.S.), whose actions presumably may have consequences under the antiboycott laws.

32. "Country Y" is a country boycotted by "Country X", a boycotting country. By contrast, the Department of Commerce regulations, also in question-and-answer format, define "Country Y" as the country boycotting "Country X". See, e.g., 15 C.F.R. § 369.2(a) (1984).

agreement, and thus would not result in a violation under the antiboycott provisions.

The clarification appears to extend the rationale of condoning a primary boycott well beyond compliance with laws banning the importation of boycotted-country goods. Under New Guideline J-3, it appears that goods which are "imported" may now include goods which will be used outside the boycotting country. This would apply in circumstances where the boycotting country is not actually purchasing the goods, but is merely bearing the initial expense of carrying such goods until someone else can pay for them.

At first glance, the rationale of the clarification appears to be one of simple symmetry. Because there would be a violation under section 999 if Company C had agreed not to purchase any goods from blacklisted companies, it should not be in violation if it agrees to an otherwise condoned prohibition. However, the legislative rationale behind the rule that an agreement to comply with a prohibition on the importation of goods produced in whole or in part in a boycotted country is that, under general international law, every country has the sovereign right to control what goods enter its territory.³³ On the other hand, the fact that Company C does business only indirectly with Country X is irrelevant to whether it has agreed, as a condition of doing business with Country X, not to do business with blacklisted U.S. companies. Symmetry is thus inappropriate. Arguably the condoned boycott posited in the clarification is still "primary", in that the boycotted country is the entity primarily affected. Nonetheless, the clarification goes well beyond the legislative rationale and expands the ways in which the boycotting countries can use their economic might to influence the purchasing conduct of third parties (in this case, Country W), indicating that the clarification perhaps should be reconsidered.

C. "War Risk" Exception: Narrowed or Just Explained?

The third clarification concerns Guideline M-5 and, rather enigmatically, elaborates on the so-called "war risk" exception. Under the example given in the pre-existing Guideline M-5, Company C enters into a contract to export goods to or from Country X which requires Company C not to ship the goods on a Country Y flag vessel or on a vessel owned, controlled, operated, or chartered by Country Y or by companies or nationals of Country Y, or on a ship which during the voyage calls at Country Y en route to or from Country X. Guideline M-5 currently provides that Company C's

33. See generally LAUTERPACHT, *INTERNATIONAL LAW*, at 286-88 (8th ed. 1955). See also S. REP. NO. 1236, 94th Cong., 2d Sess. 465-70, reprinted in 1976 U.S. CODE CONG. & AD. NEWS 2897; JOINT COMM. ON TAXATION, *GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976*, 94th Cong., 2d Sess. 282 (1976).

action does not constitute participation in or cooperation with an international boycott. Rather, the provision is "presumed" to arise from the need to protect the goods from damage or loss.

The "clarified" Guideline stresses that the above presumption arises in every case where such clauses are used in connection with countries which are hostile to each other. This raises more questions than it answers. How does a taxpayer determine whether countries are "hostile" to each other? What is the effect of a prohibition promulgated by a country which is on the list of boycotting countries maintained by the Treasury Secretary against the shipment of imported goods through another such country? It is understood that certain Iraqi government agencies are requesting that import shipments not be made through Syria, presumably because Syria is backing Iran in the war against Iraq. Iraq also does not have diplomatic relations with Syria.³⁴ May Iraq and Syria safely be considered to be "hostile" to each other for purposes of the presumption of Guideline M-5?

More fundamentally, is the addition of that phrase meant to limit the scope of the Guideline, or merely to provide a rationale for its rule? Or is it meant to expand the scope of the Guideline beyond cases of the state of actual war to some lesser state of being "hostile"? If it is meant to restrict the Guideline's scope, it does so in an ironic way. Because they are explicitly "listed" as being arrayed only towards Israel, it is clear which countries are "hostile" toward Israel. The pro-taxpayer aspect of Guideline M-5 can then come into play, and taxpayers' goods carriers may safely avoid Israel without fear of adverse consequences under the antiboycott provisions. In contrast, when a taxpayer is requested not to ship imported goods through some other country, he will be inclined to resist such request, not knowing whether the "hostilities" presumption will be applicable. In some cases the taxpayer will succeed in having the "war risk" clause deleted, and will ship the goods through such other country. In this regard, other countries may be better off than Israel, since they will not be boycotted.

D. Clarification of the Reach of the Antiboycott Guideline on Shipping

The final clarification simply confirms that the antiboycott provisions will be violated if any U.S. corporation whose actions may have antiboycott law consequences agrees that goods being exported to Country X may not be shipped on a vessel that has been blacklisted by Country X because it has called at Country Y in the past.³⁵ The original Guideline M-7 posited, inadvertently it would appear, that the corporation involved had to be a U.S. corporation (Company A) rather than a company incorporated under the laws of any country (Country C).

34. Telephone interview with office of Kamal Issa, Press Counselor, Iraqi Interests Section, Embassy of India, Washington, D.C. (Apr. 27, 1984).

35. 49 Fed. Reg. 18,061 (1984).

II ADDITIONAL GUIDELINES

A. *"War Risk" Request Not Evidence of Country Joining Boycott*

The first New Guideline expands on the "war risk" exception of Guideline M-5, and raises the same problematic issues as above. New Guideline C-2 applies to situations in which Company C is engaged in the sale of machinery to Country W, a country not on the Treasury Secretary's list of boycotting countries, and Company C has no knowledge or reason to know that Country W requires participation in or cooperation with an international boycott as a condition of doing business within Country W or with its government, companies, or nationals. Thus, Company C (or, if Company C is a foreign corporation, Company C's U.S. shareholders) need not report its operations in Country W to the Internal Revenue Service. Issues arise, however, if Company C is asked to sign a contract with Country W requiring Company C not to ship goods on a Country Y flag vessel or on a vessel owned, controlled, operated, or chartered by Country Y or by companies or nationals of Country Y, or on a ship which during the voyage calls at Country Y en route to or from Country W.

New Guideline C-2 provides that Company C is not deemed to have knowledge that Country W is a boycotting country such that its operations with Country W are reportable. The rationale is that where the only Country W requirements of which Company C knows or has reason to know involve requests which, if agreed to, are not defined to constitute participation in or cooperation with an international boycott, Company C has no reason to treat Country W as a boycotting country.³⁶

Ostensibly, New Guideline C-2 is meant to simplify and lessen the burden of reporting. However, as discussed above, it appears that Country W must be "hostile" to Country Y in order for the "presumption" to arise that the contract clause has a "war risk" purpose and not a boycott purpose.³⁷ In such cases, the New Guideline achieves little practical simplification. Since by hypothesis Country W is not a listed country, the taxpayer must make an independent determination of hostility in order to feel comfortable that the presumption does in fact arise such that it need not report its operations in Country W.

B. *Further Considerations Concerning "Shall Apply" vs. "Shall Comply" Clauses*

New Guidelines H-37 and H-39 expand upon the "shall apply" versus "shall comply" distinction set forth in Guidelines H-3 and H-4 and provide useful guidance regarding where particular language falls on either side of the "shall apply—shall comply" line. New Guideline H-37 applies in

36. *Id.* at 18,062.

37. *See supra* section II.C.

situations where Company C signs a contract which provides that, in connection with its performance, it acknowledges that the import and customs laws and regulations of Country X "shall apply" to the furnishing and shipment of any products or components thereof to Country X, and that Company C "acknowledges" that such import and customs laws and regulations prohibit, among other things, the importation into Country X of products or components originating in Country Y, manufactured, produced, or furnished by companies organized under the laws of Country Y, and manufactured, produced, or furnished by nationals or residents of Country Y.

New Guideline H-37 provides that, under such circumstances, Company C's contract does not constitute an agreement to participate in or cooperate with an international boycott. Rather, Company C has merely acknowledged that such import and customs laws "shall apply" to the furnishing of goods under the contract. On the other hand, an agreement by Company C "to comply with" Country X's restriction on the importation of goods furnished either by companies organized under Country Y's laws or by nationals of Country Y would constitute such an agreement.

New Guideline H-39 hypothesizes that Company C signs a contract to construct an industrial plant in Country X. The contract states that the laws, regulations, requirements, or administrative practices of Country X "shall govern" Company C's performance of the contract in Country X. The laws, regulations, requirements, or administrative practices of Country X prohibit the importation into Country X of goods manufactured by any company engaged in trade in Country Y or with the government, companies, or nationals of Country Y. New Guideline H-39 provides that Company C's action does not constitute an agreement to participate in or cooperate with an international boycott. Moreover, the result would be the same if the contract had instead stated that Company C would be "subject to" the laws, regulations, requirements, or administrative practices of Country X.

Thus, contracts in which a company agrees that it "shall comply with" local boycott laws constitute agreements to participate in or cooperate with an international boycott. On the other hand, contracts in which the company agrees that such laws "shall govern" or "shall apply to" the company's performance thereunder, or in which the company agrees that it shall be "subject to" such laws, do not constitute such agreements. The rationale appears to be that there is no violation where the company remains essentially passive with respect to the boycotting country's boycott laws, and does not otherwise "participate in" or "cooperate with" such boycott.³⁸ Thus, other formulations in contracts which leave implementation and enforcement of local boycott laws completely in the hands of the host country

38. Compare Guideline H-9 with Guidelines H-10 & H-11, 43 Fed. Reg. 3454, at 3463 (1978). See also *Abrams v. Baylor College of Medicine*, Civ. Action No. H-81-1433 (S.D. Texas filed Feb. 22, 1982) (private action under EAA).

should not result in a finding of an agreement to participate in or cooperate with an international boycott.

C. Disclaimers

New Guideline H-38 concerns disclaimer clauses, and provides useful guidance on the effectiveness of boycott compliance disclaimers in contracts. It nevertheless leaves open problematic issues with respect to cases in which it is unclear what clauses are contained in the contract.

New Guideline H-38 would apply if Company C signed a contract in which it agreed to comply with the laws, rules, and regulations of Country X, with the added qualification: "except to the extent such compliance is penalized under laws of the United States." Under such circumstances, the New Guideline rules that Company C's contract would not constitute an agreement to participate in or cooperate with an international boycott because the commitment to comply with Country X's boycott laws is qualified by the exception of compliance penalized by U.S. law.

Moreover, New Guideline H-38 provides that any phrase which "effectively excludes" the agreements penalized under the antiboycott provisions from the requirements of a contract with Country X would support the same result. For example, a compliance clause qualified by the disclaimer "except to the extent inconsistent with U.S. law" would also suffice to take the contract out of the coverage of section 999. By contrast, New Guideline H-38 concludes that the disclaimer "except to the extent prohibited by U.S. law" would not defeat the presumption that the contractual provision requires an agreement penalized under section 999, since section 999 does not *prohibit* anything, but merely penalizes certain agreements.

There are three further observations concerning New Guideline H-38. First, the disclaimer "except to the extent prohibited by U.S. law" arguably should suffice to take the contract out of the coverage of section 999 if the contract otherwise provided only for actions which are prohibited under the antiboycott regulations promulgated by the Department of Commerce, or otherwise prohibited under U.S. law. For example, such regulations prohibit a U.S. person from agreeing to refuse to do business with any national or resident of a boycotted country when such refusal is pursuant to an agreement with a boycotting country.³⁹ If the contract provided for no more than this disclaimer, and the agreement were between a U.S. person and a boycotting country covering a transaction in "U.S. commerce", then such a disclaimer should "effectively exclude" any agreement to such a clause and the U.S. person should therefore not be penalized under section 999.

Second, New Guideline H-38 appears to override any conflicting principles of substantive contract law as to whether a disclaimer "effectively"

39. See 15 C.F.R. § 369.2(a)(1) (1984).

excludes a commitment to comply with the boycott provisions in a contract. Suppose, for example, that Company C's contract with Country X contains a boycott compliance term qualified by an "effective" disclaimer. Suppose further, however, that under the laws of Country X a disclaimer regarding boycott compliance is prohibited and therefore unenforceable. Thus, according to the laws of Country X, the boycott compliance terms remain completely in force and, if Company C does not abide by them, it may be sued in a Country X court for damages or even specific performance. Nonetheless, New Guideline H-38 appears to imply that, so long as the disclaimer "effectively" excludes compliance on a purely literal basis, Company C will not be considered to have agreed to participate in or cooperate with an international boycott under section 999.

Finally, New Guideline H-38 raises an issue concerning the sufficiency of a literally effective disclaimer which is not in any final "contract", but rather is in a "form of acceptance" or "counter-offer". For example, suppose that Country X sends Company C an offer to purchase goods for import into Country X. The offer requires Company C to certify on the invoices that the ship on which the goods will be delivered is eligible to enter the ports of Country X. The laws and regulations of Country X prohibit, *inter alia*, blacklisted vessels from calling at its ports. In the absence of additional circumstances, Company C's agreement to provide such a certificate would constitute an agreement to participate in or cooperate with an international boycott.⁴⁰ Company C replies with its standard "form of acceptance" letter, providing that Company C accepts Country X's offer but that Company C will not provide the requested certification in its invoices. Country X does not reply. Company C ships the goods to Country X, which accepts and makes use of the goods. Company C's invoices do not contain the requested certification.⁴¹

Assuming that the rule is that a disclaimer which "literally" excludes compliance with boycott terms is sufficient to take a contract out of the coverage of section 999, the issue is whether the disclaimer is technically even in the "contract". Whether and to what extent disclaimers and other terms form part of the "contract" between two parties is generally governed by the substantive law of "offer and acceptance". This could potentially raise conflict-of-laws issues, if the laws of the United States differ from those of the jurisdiction under which Company C is organized and from the laws of Country X.

For example, under the U.S. Uniform Commercial Code a definite and seasonable expression of acceptance which is sent within a reasonable time

40. See Guideline M-10, 44 Fed. Reg. 66,272, at 66,274 (1979).

41. If Company C is deemed to have agreed to participate in or cooperate with an international boycott, its failure to provide such a certificate after shipment will not forestall the consequences under the antiboycott provisions. See Guideline H-18, 43 Fed. Reg. 3454, 3464 (1978).

operates as an acceptance even though it states terms additional to or different from those offered, unless acceptance is expressly made conditional on assent to the additional or different terms.⁴² In the example above, Company C did not expressly condition its acceptance upon the assent of Country X to the disclaimer. Company C and Country X would be considered to have entered into a contract but, under some cases, such contract would contain the boycott-related clauses and not the disclaimer.⁴³ Technically, New Guideline H-38 would then be of little comfort, although Company C expressly disclaimed agreement to the boycott terms and although a court in equity would likely find that Company C did not in fact agree to provide the requested certificate.

By contrast, if traditional common law principles were applied, the disclaimer of the boycott clause in the "form of acceptance" letter would constitute a rejection of Country X's offer coupled with a counter-offer.⁴⁴ Country X's acceptance of delivery of the goods and use thereof would constitute an acceptance of Company C's counter-offer and thus the "contract" between Country X and Company C would not contain the boycott compliance clause. Company C would accordingly not be in violation of section 999 and would not have to rely on New Guideline H-38.

Notwithstanding the ambiguities of substantive contract law, in the above example Company C unambiguously disclaimed any commitment to comply with the boycott terms of the contract. As noted above in the second comment, New Guideline H-38 may reasonably be interpreted to override any conflicting principles of substantive contract law concerning whether a disclaimer "effectively" excludes commitment to comply with boycott terms, for purposes of section 999. Under similar reasoning, then, it should be interpreted to stand for the proposition that any "effective" disclaimer contained in written or oral communication which, in good faith, evidences an intention not to comply with a request to participate in or cooperate with an international boycott suffices to take the transaction out of the coverage of section 999, without regard to the substantive law of contracts on offer and acceptance.

Unofficially, Treasury Department counsel have stated that it is highly unlikely that the Internal Revenue Service would attempt to penalize Company C under circumstances such as those stated above.⁴⁵ In practice, of course, it would take an extremely determined Internal Revenue agent to raise such an issue, since it would involve knowledge and interpretation of

42. U.C.C. § 2-207(1) (1972).

43. Compare *American Parts Co. v. American Arbitration Ass'n*, 8 Mich. App. 156, 154 N.W.2d 5 (1967) with *Boese-Hilburn Co. v. Dean Mach. Co.*, 616 S.W.2d 520, 527 (Mo. App. 1981) and *Steiner v. Mobil Oil Corp.*, 20 Cal. 3d 90, 102 & n.5, 569 P.2d 751, 141 Cal. Rptr. 157 (1977).

44. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 59 (1979).

45. Telephone interview with David D. Joy, Office of General Counsel, U.S. Department of Treasury (May 25, 1984).

the law of offer and acceptance and conflicts of law, and possibly foreign law. Nevertheless, oral opinions of Treasury Department counsel are not binding on the Service, and it would thus appear helpful if the Guideline provided that the "exclusion" of the boycott compliance terms need only be literally effective to take the *transaction* out of the coverage of section 999.

D. Letter of Credit Bank Also Subject to Antiboycott Laws

New Guideline H-40 appears to expand upon Guideline M-10, providing helpful guidance on the reach of the antiboycott provisions. New Guideline H-40 posits that Company A (a U.S. corporation) signs a contract to export goods to Country X which provides that payment will be made by means of a letter of credit confirmed by Bank C, a banking corporation organized under the laws of any country but whose actions may have consequences under U.S. antiboycott laws. The letter of credit requires Company A to provide Bank C with a certificate stating that the ship on which the goods are to be shipped is eligible to enter the ports of Country X in conformity with its laws and regulations, and that the insurer of the goods has a duly qualified and appointed agent or representative in Country X. Bank C confirms the letter of credit requiring the shipping and insurance certificates.

New Guideline H-40 provides that *Bank C's* action constitutes an agreement to participate in or cooperate with an international boycott, unless Country X has offered the kind of explanation described in Guidelines M-12⁴⁶ and M-13,⁴⁷ that is, nonboycott reasons for such laws and regulations. The rationale behind this rule is that Bank C's confirmation of the letter of credit constitutes an agreement to refrain from doing business with a U.S. person. The result would be the same if the beneficiary of the letter of credit were organized under the laws of Country Y, or if Bank C had reason to know that it would not be able to obtain the required certificate because of the nationality, race, or religion of the beneficiary's ownership, management, or directors.

New Guideline H-40 concludes with a citation to Guideline H-29A. Thus, presumably, Bank C's action would not constitute participation in or cooperation with an international boycott if the beneficiary were neither a Country Y person nor a U.S. person, if Bank C had no reason to know that it would not be able to obtain the required certification because of the nationality, race, or religion of the beneficiary's ownership, management, or directors. However, if Bank C had reason to know that a person has been

46. In Guideline M-12, Country X states that eligibility relates to maritime matters such as the age and condition of the ship. Its explanation also notes that it applies a number of laws and regulations to the entry of ships into its ports. 44 Fed. Reg. 66,272, at 66,274 (1979).

47. In Guideline M-13, Country X states that the insurance certification is required to facilitate dealings with insurers by Country X importers in the event of damage to insured goods. 44 Fed. Reg. 66,272, at 66,274 (1979).

inserted as the beneficiary of the letter of credit solely for the purpose of funnelling payment to another, the letter of credit will be viewed as also having that other person as a beneficiary.

E. Diplomatic Recognition as a Distinguishing Index

Part "L" of the Guidelines relates to participation in or cooperation with an international boycott by refraining from employing individuals of a particular nationality, race, or religion. New Guideline L-6 expands on the rationale of Guideline L-2. Unfortunately, it appears to expand such rationale into a rule ripe for abuse. Guideline L-2 provides that, where there is no evidence of an attempt to specifically exclude persons of a particular nationality, race, or religion because the contract requires the contracting company to hire only those individuals who are nationals of the U.S. or Country X, the signing of such a contract does not constitute participation in or cooperation with an international boycott. Part of the stated rationale is that persons of a number of different nationalities, including those from both friendly and unfriendly countries, have been evenhandedly excluded.⁴⁸

The situation posited in New Guideline L-6 appears innocent enough. Company C signs a construction contract that provides that Company C is not to employ individuals or nationals of any country not diplomatically recognized by Country X. The New Guideline rules that, to the extent that Country Y is only one of several countries not recognized by Country X, the exclusion is not, on its face, boycott related. In those circumstances, agreement to the clause in question would not constitute an agreement to participate in or cooperate with an international boycott. However, where Country Y is the only country not recognized by Country X, agreement to such a clause will constitute an agreement to participate in or cooperate with an international boycott.

It may first be noted that under New Guideline L-6 the justification of an evenhanded exclusion of nationals from both friendly and unfriendly countries as rationalized in Guideline L-2 is not present. Under the statute, however, such a rationale could not justifiably be a necessary condition to a finding that an agreement regarding refusal to employ a certain class of individuals does not constitute an agreement to participate in or cooperate with an international boycott.

More fundamentally, though, none of the listed boycotting countries in fact diplomatically recognizes all other countries of the world.⁴⁹ New Guideline L-6 can thus easily be utilized to accomplish what Guidelines

48. 49 Fed. Reg. 18,061, 18,062 (1984).

49. Based on a telephone poll of selected embassies in Washington, D.C., nonrecognition of both Israel and South Africa appears to be the general pattern among the listed boycotting countries. Several also do not recognize Egypt, South Korea, or Zaire.

L-4 and L-5 penalize: agreements differentiating on the basis of a particular nationality. Assuming the other unrecognized countries do not field qualified employees in any case, New Guideline L-6 allows corporations whose actions would otherwise have adverse consequences under the antiboycott provisions to cooperate with boycotting countries' smartly-cloaked boycott policies. It is therefore suggested that this New Guideline should be abandoned.

F. Presumption on Alternative Means of Satisfaction

New Guideline M-14 creates an interesting new contractual presumption regarding alternative ways of fulfilling a contract with a boycotting country where the contract provides at least one alternative which is acceptable under the antiboycott provisions. It may also perhaps be expanded to give comfort regarding any transaction within its rationale. New Guideline M-14 would apply to situations in which Company C signs a contract to export goods to Country X which contract provides for payment by means of a letter of credit confirmed by Bank C. The letter of credit requires Company C to provide to Bank C a certificate stating that the goods are being shipped on a U.S. or Country X flag carrier *or*, alternatively, that the ship on which the goods are being shipped is eligible to enter the port of Country X. The laws and regulations of Country X prohibit, *inter alia*, blacklisted vessels from calling at its ports. Company C provides a certificate stating that the goods have been shipped on a U.S. or Country X flag carrier.

New Guideline M-14 provides that, if such a letter of credit requires alternative certifications, one of which is acceptable under section 999, and Company C performs in accordance with that acceptable alternative, such as shipping on a U.S. or Country X flag carrier, it is presumed that Company C's agreement included only the acceptable alternative. If Company C were to utilize a ship eligible to enter the ports of Country X that was neither a U.S. nor Country X ship, then, in the absence of additional circumstances, Company C's contract is deemed to be an agreement to participate in or cooperate with an international boycott.

New Guideline M-14 thus appears to override any substantive contract law principles regarding the actual content of the agreement. For example, suppose Company C were somehow unable to ship the goods on a U.S. or Country X flag carrier, and yet was excused from any obligation to do so. If it then, upon realizing the antiboycott law consequences of doing so, refused to ship the goods on a carrier eligible to enter the ports of Country X, it might well be in breach of its "agreement" under substantive contract law, covering *both* alternatives. Where the breach is only hypothetical, such law appears to be overridden.

Where there is an actual breach of this nature, however, New Guideline M-14 appears to leave open the issue of whether Company C should be considered in violation of section 999, inasmuch as it had not performed in

accordance with the acceptable alternative. In other words, is fulfilling the contract in an acceptable manner *necessary* in order to raise the presumption that the agreement included only the acceptable alternative? It should not be because to the extent that "acceptable" fulfillment is necessary as curative of any agreement violating section 999, it would be inconsistent with Guideline H-18 which provides that, once an agreement in violation of section 999 is entered into, breach of such agreement is not curative.

New Guideline M-14 should be expandable to stand for the proposition that, if Company C can fulfill an agreement one of many ways, at least one of which is acceptable under section 999, there will be a presumption that no proscribed agreement has been made so long as the transaction is completed without fulfilling the unacceptable alternative. The New Guideline should be construed with a chronological emphasis; the Service should examine all the facts after the reaching of the agreement. Because no proscribed "agreement" should be presumed until all the relevant facts are at hand, Guideline H-18, holding that a later breach of a boycott-related agreement is not curative, should be inapplicable.

To illustrate, suppose that Company C negotiates a contract with Country X to export goods to Country X. The contract provides that payment will be made by means of a letter of credit confirmed by Bank C. The letter of credit requires Company C to provide Bank C with a certificate stating that the goods do not consist of materials: (1) originating in Country Y; (2) manufactured, produced, or furnished by companies organized under the laws of Country Y; or (3) manufactured, produced, or furnished by nationals or residents of Country Y. Realizing the antiboycott law consequences of agreeing to such a payment clause, Company C insists that a clause be inserted in the contract to the effect that Company C reserves the right to receive payment "in any manner acceptable to the Seller." Under Guideline M-14, Company C at this point should clearly not be considered to be in violation of section 999, as Company C can fulfill the contract in a way which may be acceptable under section 999.

Suppose, further, that Company C delivers the goods; Country X accepts delivery and makes use of them. Company C initially seeks to draw on the letter of credit by tendering the bills of lading and a certificate which contains none of the boycott-related terms prescribed in the contract, but merely indicates that the goods are of Country W origin. Under ordinary circumstances, agreement to provide such a certificate would not constitute a violation under section 999.⁵⁰ Interpreting New Guideline M-14 strictly, however, Company C may not rely on the guideline for comfort. It has not fulfilled the contract using the "acceptable" method of payment, and thus is not entitled to the presumption that its agreement included only the acceptable alternative.

50. See Guideline H-36, 44 Fed. Reg. 66,272, at 66,273 (1979).

This result makes nonsense of the rules, since Company C is penalized for agreeing to provide a violative certificate at the very moment it provides a nonviolative certificate. The analysis under New Guideline M-14 should instead be that Company C is not considered to be in violation of section 999 upon conclusion of the contract negotiations because it had reserved an acceptable method of completing the transaction.⁵¹ Because Company C completed the contract without in fact violating section 999, Company C's agreement should be presumed to have included only an acceptable alternative, regardless of whether there was a breach of the contract.

CONCLUSION

The New Guidelines, on the whole, represent an improvement over the existing Guidelines in terms of clarity and certainty. They confirm that entering into condoned agreements need not be reported (Guideline A-9). They confirm the reach of the antiboycott provisions (Guidelines M-7 & H-40). They provide useful guidance regarding where particular language falls on the "shall apply—shall comply" line and regarding whether a boycott compliance disclaimer may be effective (Guidelines H-37 through H-39). Finally, the New Guidelines provide for a liberal presumption that agreement to a contract which may be fulfilled in alternative ways, at least one of which is acceptable under the antiboycott rules, includes only an agreement to the acceptable alternative if the contract is in fact so fulfilled. This New Guideline should be expandable to allow fulfillment in any acceptable manner (Guideline M-14).

Unfortunately, the New Guidelines also raise novel and sometimes disturbing issues. The definition of "import" appears to be expanded with respect to whether an agreement qualifies as a "condoned agreement" (Guideline J-3).⁵² Goods which are "imported" now appear to include goods which will be used in a project outside the boycotting country and where the boycotting country is only financing, and not actually purchasing, the goods going into the project. In other words, the New Guidelines may allow the boycotting countries to expand their economic influence well beyond their sovereign borders, a result perhaps not intended in the original legislation.

The "war risk" exception now appears to require the taxpayer to determine whether countries are hostile to each other in order to take comfort in such exception (Guidelines C-2 & M-5). This burden should not be imposed on the taxpayer, and the prior "war risk" exception Guideline, which did not appear to impose such a burden, should be reinstated.

51. Guideline H-18, holding that a later breach of a boycott-related agreement is not curative, should thus be inapplicable.

52. For example, an agreement to comply with a prohibition on the importation of goods produced in whole or in part in a boycotted country. See I.R.C. § 999(b)(4)(B).

The “disclaimers” rule may technically require the taxpayer to determine complex conflict-of-laws and offer-and-acceptance issues to derive benefit therefrom if no clear embodiment of the “contract” appears in the course of a transaction (Guideline H-38). These issues should be clarified in order to give substance to the “disclaimers” rule.

Finally, the condoning of the exclusion of individuals from consideration for employment on the basis of the state of diplomatic recognition of their home country appears to be open to abuse, given the facts as presented above (Guideline L-6). It is suggested that this New Guideline should be abandoned.