Chapter 15

Regulations and Policies Affecting Exports

EXPORT LICENSING AND ADMINISTRATION

Governments use export controls for a variety of reasons. Such controls are often intended to achieve certain desired political and economic objectives. The first U.S. export control was introduced in 1775 when Continental Congress outlawed the export of goods to Great Britain. Since then, the United States has restricted exports to certain countries through legislation such as the Embargo Act, Trading with the Enemy Act, The Neutrality Act, and the Export Control Act.

The Export Control Act of 1949 represents the first comprehensive export control program enacted in peacetime. Export controls prior to this time were almost exclusively devoted to the prohibition or curtailment of arms exports (arms embargoes). The 1949 legislation was primarily intended to curtail the export of certain commodities to communist nations during the Cold War era. Export controls were thus allowed for reasons of national security, foreign policy, and short supply. Given America's dominant economic position in the postwar era, it provided leadership in international economic relations and pursued an active foreign policy (Stenger, 1984; Moskowtz, 1996).

In 1969, the often stringent and far-reaching restrictions were curtailed and the new law (Export Administration Act, 1969) attempted to balance the need for export controls with the recognition of the adverse effects of an overly comprehensive export control system on the country's economy. This came at a time when the United States was losing ground to other nations in economic performance, such as balance of trade, exports, and so on. The overvalued dollar and inflation, for example, had adversely affected its competitiveness in foreign markets and shrank its trade surplus from $6.8 billion in 1964 to a mere $400 million in 1969. The promotion of exports was considered essential to improving the country's declining trade surplus and overall competitiveness as well as to reducing the growing unemployment. The general trend in 1969 and thereafter has been to ease and/or strengthen the position of exporters and increase the role of Congress in implementing export control policy. Some examples are as follows:

1. The Equal Export Opportunity Act of 1972 curtailed the use of export controls if the product (that is subject to such restrictions) was available from sources outside the United States in comparable quality and quantity. This was because export controls would be ineffective if certain commodities were available from foreign sources. The 1977 amendment prohibited the president from imposing export controls without providing adequate evidence with regard to its importance to U.S. national security interests. In the event that the president decided to prohibit or control exports, the law required him to negotiate with other countries to eliminate foreign availability.

   The scope of presidential authority to regulate U.S. foreign transactions, including the imposition of export controls, was restricted to wartime only. A statute (the International Emergency Economic Powers Act, 50 U.S. Code 1701 4 seq.) was also passed to regulate presidential powers in the area of export controls during national emergencies. As of 1998, restrictions based on national emergencies have been imposed against Angola, Iraq, Libya, North Korea, Iran, Haiti, and Yugoslavia. In short, the president can impose export controls outside emergency and wartime periods only upon extensive review and consultation with Congress.
2. In 1977, Congress introduced limitations on the power of the executive branch to prohibit or curtail agricultural exports. Any prohibition of such exports was considered ineffective without the approval of Congress by concurrent resolution.
3. The 1979 Export Administration Act (EAA) also emphasized the important contribution of exports to the U.S. economy and acknowledged the necessity of balancing the need for trade and exports and national security interests. The law also gave legal effect to the agreement of the Coordinating Committee for Multilateral Export Controls (COCOM), which was established in 1949 to coordinate export controls of technology to communist countries. It was dissolved in 1994.
4. The 1985 amendments to the Export Administration Act further restricted the power of the president to impose foreign policy controls

that interfere with contracts entered into before the decision to restrict exports, except under very specific circumstances. Congress also established validated licenses for multiple exports, allowing exporters to make successive shipments of the same goods under a single license, waived licensing requirements for certain low-tech goods exports to COCOM nations, and shortened by one-third the time period for issuing licenses for exports to non-COCOM members. In view of certain international incidents, such as the downing of the Korean aircraft by the former Soviet Union, however, the law tightened export controls on the acquisition of critical military goods and technology by the former Soviet Union and its allies.

Export controls were originally intended to be used against former communist countries. However, with the end of the cold war, no longer was there a single, clearly defined adversary, and it became necessary to adjust the system of export controls to take into account the new reality in international relations. An increasingly global economy also presented new challenges for managing export controls. The growing number of global suppliers of high technology and defense-related items, an increased level of global R & D, and the dissemination of dual use technologies, as well as divergent views among Western countries, militated in favor of liberalization of export controls. Prior to September 11, 2001, substantial liberalization of controls had taken place in many areas, such as high performance computers, telecommunication, and so on. Export controls were aimed at, inter alia, restricting a narrow range of transactions that could assist in the development of weapons of mass destruction by certain countries. The control system essentially focused on a small group of critical goods and technology, and on specific end uses and end users, in addition to certain “reckless” nations that must be stopped from acquiring weapons of mass destruction.

Current Developments in Export Controls

Since the events of September 11, 2001, the U.S. government introduced certain restrictions on exports. First, it prohibits the conduct of business with any group whose names appear on the lists of denied persons maintained by the Office of Foreign Assets Control. The list includes terrorists, individuals and/or companies associated with terrorists, or terrorist organizations. Second, a deemed export license is required before foreign nationals engaged in research in the United States (U.S. university campus) receive technology or technical data on the use of export-controlled equipment/materials.

For a deemed license to be required, the information being conveyed would have to both involve controlled equipment (and other materials) and one that is not publicly available. The fundamental research exclusion applies to information in the United States that is broadly shared with the scientific community and not restricted for proprietary reasons or specific national security concerns. Third, there have been efforts to strengthen the multilateral regime on export controls. A focus has been placed on controlling the export of weapons of mass destruction to hostile countries. Since the terrorist attacks of September 11, 2001, many Western governments deny risky exports, while approving legitimate ones more efficiently (Walsh, 2002). (See International Perspective 15.1 for multilateral export controls.)

INTERNATIONAL PERSPECTIVE 15.1. Multilateral Export Regimes

- **The Australian Group (AG):** The AG was formed in 1984 to harmonize export controls on chemical and biological weapons. It has thirty-four member countries. Its activities serve to support the objectives of the Biological Weapons Convention (BWC) and Chemical Weapons Convention (CWC) by enhancing the effectiveness of national export licensing measures. The group considers export licensing as a vital means of ensuring that legitimate trade in chemicals, biological agents, and related equipment is not adversely affected while facilitating transparency to discourage the sale of such products to parties that could develop a biological and chemical weapons program.
- **Nuclear Suppliers Group (NSG):** The NSG was established in 1992 by a group of nuclear supplier countries (forty-four member countries). It seeks to contribute to the nonproliferation of nuclear weapons through the implementation of guidelines for nuclear and nuclear-related exports.
- **Missile Technology Control Regime (MTCR):** The MTCR was established in 1987 to coordinate national export controls in order to prevent missile proliferation. It has thirty-four member countries. Through a system of export licenses, member countries attempt to control transfers that contribute to delivery systems for weapons of mass destruction.
- **Wassenaar Arrangement (WA):** The WA was founded in 1996 to replace the East-West technology control program under the Coordinating Committee for Multilateral Export Controls (COCOM), which was disbanded in 1994. It is intended to review export controls on conventional arms and sensitive dual goods and technologies. It has thirty-three member countries. The agreement provides for enhanced cooperation between members through information exchange on a regular basis.

U.S. Export Administration Regulations

Administration of Export Controls

The Export Administration Regulations (EAR) are designed to implement the Export Administration Act (EAA) of 1979 and subsequent amendments. The EAR is administered by the U.S. Department of Commerce, Bureau of Industry and Security (BIS). The EAR is not permanent legislation. When it lapsed, presidential executive orders under the Emergency Powers Act directed and authorized the continuation of the EAR. The regulations also implement antiboycott law provisions.

U.S. export controls are primarily imposed for the following reasons (EAR, part 742):

1. *Protect national security:* To restrict the export/re-export of items that would make a significant contribution to the military potential of any other country that would prove detrimental to the national security of the United States. This includes the exports of high performance computers, software, and technology to particular destinations, end users, and end uses.
2. *Further foreign policy goals:* To restrict the export/re-export of goods and technology to further the foreign policy objectives of the United States, that is, human rights, regional stability, and antiterrorism. It is also used to implement unilateral or international sanctions such as those imposed by the United Nations or the Organization of American States.
3. *Preserve scarce natural resources:* To restrict the export of goods, wherever necessary, in order to protect the domestic economy from the excessive drain of scarce resources (crude petroleum, certain inorganic chemicals), and to reduce the serious inflationary impact of foreign demand. Domestically produced crude oil and certain unprocessed timber harvested from federal and state lands are controlled for short supply reasons (EAR, part 754).
4. *Control proliferation:* To prevent the proliferation of weapons of mass destruction, such as nuclear, chemical, and biological weapons, which are often maintained as part of multilateral control arrangements (EAR, part 742.2).

The core of the export control provisions of the EAR concerns exports from the United States. However, the term “exports” has been given broad meaning to include activities other than exports or to apply to transactions outside the United States.

The scope of the EAR covers the following:

- *Exports from the United States:* This also includes the release of technology to a foreign national in the United States through such means as demonstration or oral briefing (deemed export). The return of foreign equipment to its country of origin after repair in the United States, shipments from a U.S. foreign trade zone, and the electronic transmission of nonpublic data that will be received abroad also constitute U.S. exports.
- Re-exports by any party of commodities, software, or technology exported from the United States.
- Foreign products that are direct products of technology exported from the United States.
- *U.S. person activities:* The EAR restricts the involvement of "U.S. persons," that is, U.S. firms or individuals, from exporting foreign-origin items or from providing services that may contribute to the proliferation of weapons of mass destruction. The regulations also restrict technical assistance by U.S. persons with respect to encryption commodities or software (EAR, part 732; see International Perspectives 15.2 and 15.3).

The Bureau of Industry and Security (BIS) is the primary licensing agency for dual use exports. The term "dual use" distinguishes items (i.e., commercial items with military applications) covered by EAR from those covered by the regulations of certain other export licensing agencies, such as the Departments of State and Defense. Although dual use is often employed to refer to the entire scope of the EAR, the EAR also applies to some items that have solely civilian uses. It is also important to note that the export of certain goods is subject to the jurisdiction of other agencies, such as the Food and Drug Administration (drugs and medical devices), the Department of State (defense articles), and the Nuclear Regulatory Commission (nuclear materials).

Commerce Export License

Exports and other activities that are subject to the EAR are under the regulatory jurisdiction of the BIS. They may also be controlled under export-related programs of other agencies. Before proceeding to complete any export transaction, it is important to determine whether a license is required. The modalities of transportation is immaterial in the determination

INTERNATIONAL PERSPECTIVE 15.2.
Do You Need a Commerce Export License?

Even though the majority of U.S. export/re-exports does not require a license (EAR 99), it is important to establish whether a license is required for your exports from the United States. In 2004, The Bureau of Industry and Security (BIS) reviewed 15,534 license applications (995 were deemed exports) covering transactions estimated at $15.3 billion and approved over 84 percent of these applications. The average processing time for a completed license application was thirty-six days (2004) compared to forty-four days (2003).

How do you establish whether you need an export license for your product?

A. *Nature of the product intended for export:* It is important to know whether the item you intend to export has a specific Export Control Classification Number (ECCN). You may require a license if your item is listed on the Commerce Control List (CCL) and the country chart in the regulations states that a license is required to that country.

   If your item falls under the jurisdiction of the Department of Commerce and is not listed on the CCL, it is designated as EAR 99 (low-tech items that do not require a license unless they are destined to an embargoed country or to an end user of concern in support of a prohibited end use).

B. *Ultimate destination, end user, and end use of the product intended for export:* A license is required for virtually all exports to embargoed destinations (Cuba, North Korea, etc). You need to consult the list of embargoed countries by three agencies: Departments of Commerce, State, and Treasury. Certain individuals and organizations are prohibited from receiving U.S. exports, while others may only receive such goods if they have been licensed (including EAR 99). It is important to consult the list of individuals and organizations engaging in activities related to the proliferation of weapons of mass destruction, terrorism and narcotics trafficking, and persons whose export privileges have been revoked by BIS. A license requirement may be based on the end use in a transaction, primarily for proliferation purposes.

of export licenses; that is, an item can be sent by regular mail, hand carried on an airplane, or transmitted via e-mail or during a telephone conversation.

The following steps are important in establishing whether a given export item is subject to a license (Figure 15.1).

Step 1: Is the item (intended for export) subject to EAR? Items subject to the EAR regulations include all items in the United States or abroad (including

INTERNATIONAL PERSPECTIVE 15.3. General Prohibitions and License Exceptions

General Prohibitions: Export/re-export and conduct subject to EAR which are prohibited without a license or a license exception from BIS.

- Export/re-export of controlled items to listed countries.
- Re-exports and export from abroad of foreign-made items incorporating more than a de minimis amount of controlled U.S. content. For certain countries and commodities, de minimis is defined as re-exports of foreign-made commodity incorporating controlled U.S.–origin commodities valued at 10 percent or less of the total value of the foreign made commodity.
- Re-export and export from abroad of the foreign-produced direct product of U.S. technology and software.
- Engaging in actions prohibited by a denial order, violation of any order, and proceeding with transactions with knowledge that a violation has occurred or is about to occur.
- Export or re-export to prohibited end uses or end users, to embargoed destinations.
- Engaging in actions that support proliferation activities and export/re-export through or transit through specific countries (Albania, North Korea, Russia, etc.) without a license or license exception (EAR, part 736).

License Exceptions (Items that can be exported without a license)

- GBS: Authorizes export/re-exports to country Group B (Western countries).
- LVS: Authorizes limited value shipments (single shipment) to country Group B.
- CIV: Allows exports/re-exports for civil end uses/users to Group D1 countries (except North Korea).
- TSR: Technology/software export/re-exports destined to country Group B.
- GFT: Allows export/re-exports of gift parcels to an individual, or religious or charitable organization located in any country.
- BAG: Authorizes individuals leaving the United States to take to any destination personal baggage, effects, vehicles, and tools of trade.
- TMP: Authorizes various temporary exports/re-exports (EAR, part 740).

those in a U.S. free trade zone), foreign-made items that are direct products of U.S.–origin technology or software (or that incorporate U.S.–origin materials exceeding certain minimum levels), or certain activities of U.S. persons related to the proliferation of weapons of mass destruction (Figure 15.2) and technical assistance with regard to encryption commodities or soft-

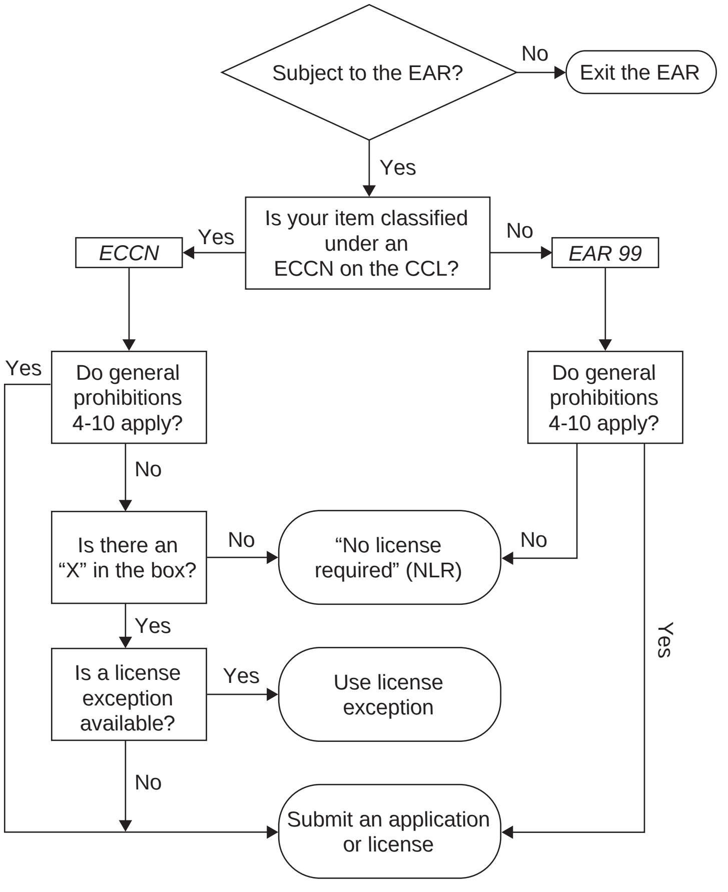

FIGURE 15.1. Steps to Determine Whether a Commerce Export Control License Is Required

ware. It also covers activities of United States or foreign persons prohibited by any order (denied parties). Publicly available technology and software, phonograph records, magazines, and so on, are excluded from the scope of EAR.

If the item is subject to the EAR, it is necessary to classify it under an ECCN (Export Control Classification Number) on the CCL (Commerce

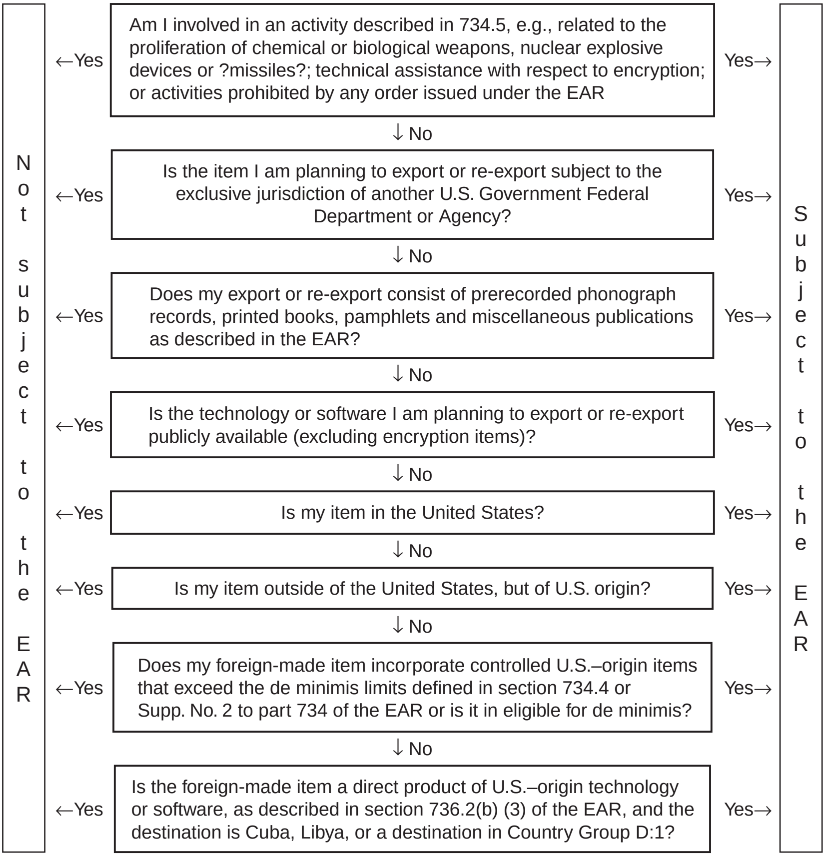

FIGURE 15.2. Steps to Determine Whether a Transaction Is Subject to the EAR

Control List). If it is not subject to EAR, there is no need to comply with the EAR. It may be necessary to comply with the regulations of another agency.

Step 2: Is the item classified under the ECCN on the CCL? Any item controlled by the Department of Commerce has an ECCN. Exporters should classify their product against the CCL. They can also send an export classification request to the Department of Commerce. A request can also be made if an item has been incorrectly classified and/or should be transferred to another agency. Given certain changes that are made with regard to product classifications and the EAR, it is important to monitor for any modifications to your product including eligibility for a license exception to certain destinations. Some companies may opt to use a computerized product/country license determination matrix.

Step 3: Do the general prohibitions (4-10) apply? Whether a product is listed under an ECCN on the CCL or not (EAR 99), it is important to determine if general prohibitions apply, that is, export/re-export to prohibited end uses, users, or to embargoed destinations. The general prohibitions also include engaging in activities prohibited by a denial order or supportive of proliferation activities as well as in-transit shipments through certain destinations.

If an item is not listed under the ECCN on the commerce control list (EAR 99), and general prohibitions do not apply, no license is required. However, if the prohibitions apply (for items listed/not listed on ECCN), an application for a license should be submitted.

Step 4: Are there any controls on the country chart? The commerce country chart allows you to determine the export/re-export requirements for most items listed on the CCL. If an "X" appears in a particular cell, transactions subject to that particular reason for control (national security, antiterrorism, etc.)/destination combination require a license unless a license exception applies. No license is required if there is no "X" indicated in the CCL and the country chart (see sample analysis using the CCL and country chart).

Step 5: Applying for an export license: The Bureau of Industry and Security provides formal classification for a product or service, advisory opinion, or licensing decision upon review of a completed application submitted in writing or electronically. Even though it is the applicant's responsibility to classify the export, the BIS could be requested to provide information on whether the item is subject to the EAR and, if so, its correct ECCN. In addition to the classification requests, potential applicants could also seek advisory opinions on whether a license is required or is likely to be granted for a particular transaction. Such opinions, however, do not bind the BIS from issuing a license in the future (see International Perspective 15.4 for automated services).

Step 6: Destination Control Statement, shipper's export declaration, and record keeping: A destination control statement (DCS) is intended to prevent items licensed for exports from being diverted while in transit or thereafter. A typical DCS reads as follows:

> These commodities, technology, or software were exported from the United States in accordance with the Export Administration Regulations for ultimate destination (name of country). Diversion contrary to U.S. law is prohibited.

A DCS must be entered on all documents covering exports from the United States of items on the CCL and is not required for items classified as

INTERNATIONAL PERSPECTIVE 15.4. Automated Services

AES (Automated Export System): A computerized method for filing shipper's export declarations. It streamlines the export reporting process by reducing the paper work burden on the trade community.

ELAIN (Export License Application and Information Network): A system that allows electronic submission of license applications through private vendors.

ERIC (Electronic Request for Item Classification): A supplementary service to ELAIN that allows exporters to submit commodity classification requests electronically to BIS.

SNAP (Simplified Network Application Process): A method for submitting applications over the internet with a web browser.

STELA (System for Tracking Export License Applications): An automated voice response system that provides applicants with the status of their license and product classification applications. When the application is approved without conditions, STELA allows exporters to ship their goods without the need to wait for a formal letter from BIS.

EAR 99 (unless it is made under license exception BAG or GFT). Destination control statement requirements do not often apply to re-exports. For holders of a special comprehensive license (SCL), use of a DCS does not preclude the consignee from re-exporting to any of the SCL holder's other approved consignees or to other countries for which prior BIS approval has been received. A SCL allows experienced, high volume exporters to export a broad range of items. It was introduced in lieu of special license and allows exportation of all commodities to all destinations (with some exceptions). Another DCS may be required on a case-by-case basis. The DCS must be shown on all copies of the bill of lading, the air waybill, and the commercial invoice (EAR, part 748).

Even though there are few exceptions, submission of a shipper's export declaration (SED) to the U.S. government is generally required under the EAR. Information on the SED, such as value of shipment, quantity, and so on, is also used by the Census Bureau for statistical purposes. The exporter or the authorized forwarding agent submits the SED, which includes information such as criteria under which the item is exported (i.e., license exception, no license required, license number, and expiration date), ECCN, and other relevant information.

The exporter is required to keep records for every export transaction for a period of five years from the date of export. The records to be retained include contracts, invitation to bid, books of account, financial records, restrictive trade practices, and boycott documents or reports (EAR, part 762).

Following is an analysis using the CCL and country chart. In order to determine whether a license is required to export/re-export a particular item to a specific destination it is essential to use the CCL in conjunction with the country chart (EAR, part 774).

To demonstrate the type of thought process needed to complete this procedure, a sample entry and related analysis is provided.

> *Example:* The item destined for export to India is valued at approximately $10,000 and classified under ECCN 2A000a. Based on the item classification, we know that the entire entry is controlled for national security and antiterrorism reasons. The item appears in the Country Chart column and the applicable restrictions are NS Column 2 and AT Column 1. An "X" appears in the NS Column 2 cell for India, but not in the AT Column 1 cell. This means that a license is required unless it qualifies for a license exception or Special Comprehensive License. It may qualify under a license exception (GBS).

Sanctions and Violations

The enforcement of the EAR is the responsibility of the BIS, Office of Export Enforcement (Department of Commerce). The Office of Export Enforcement (OEE) works with various government agencies to deter violations and impose appropriate sanctions. Its major areas of responsibility include preventive enforcement, export enforcement, and prosecution of violators.

Preventive enforcement is intended to stop violations before they occur by conducting prelicense checks to determine diversion risks, reliability of overseas recipients/end users of U.S. commodities/technology, and post-shipment verifications. In 2004, BIS's investigations resulted in the criminal convictions of twenty eight individuals and businesses, with $2.9 million in penalties (www.bis.doc.gov). The BIS's Office of Export Enforcement also conducts investigations of potential export control violations. When preventive measures fail, it pursues criminal and administrative sanctions. Violations of the EAR are subject to both criminal and administrative penalties. Fines for export violations can reach up to $1 million (U.S.) per violation in criminal cases, $11,000 per violation in most administrative cases, and $120,000 in cases involving national security issues. In addition, violators may be subject to prison time and denial of export privileges by placing them on the denied persons list.

The EAR also provides certain indicators to help exporters recognize and report a possible violation. It reminds exporters to look for the following in export transactions:

- If one of the parties to the transaction has a name or address that is similar to an entity on the U.S. Department of Commerce's list of denied persons.
- If the transaction has "red flags," that is, (1) the customer or purchasing agent is reluctant to offer information about the end use of the product; (2) the customer is willing to pay cash for a very expensive item (when the terms provide for financing), has little or no business background, and is unfamiliar with the product, or the customer declines routine training installation or other services; (3) the product ordered is incompatible with the technical level of the country and its packaging is inconsistent with the stated method of shipment or destination; and (4) the shipping routes are abnormal for the producer and destination, delivery dates are vague, and a freight forwarding firm is listed as the product's final destination.

ANTIBOYCOTT REGULATIONS

The U.S. antiboycott provisions of the Export Administration Act prohibits U.S. firms from participating in foreign boycotts or embargoes not authorized by the U.S. government. Even though this law was primarily aimed at the Arab boycott against Israel, it prevents U.S. firms from being used to implement foreign policies of other nations that are inconsistent or contrary to U.S. policy. The law requires companies to report boycott-related requests by other nations and imposes a range of sanctions in the event of violations. In September, 2004, for example, St. Jude Medical Export, an Australian subsidiary of a Minnesota-based U.S. exporter, agreed to pay a $30,000 civil penalty to settle charges that it violated the antiboycott provisions of the EAR. The Bureau of Industry and Security charged that the firm violated the EAR by (1) its failure to report its receipt of three requests from the Iraqi government agency to adhere to the rules of the Israeli boycott during the 2000-2001 reporting period, and (2) its agreement to refuse to do business with blacklisted persons.

Scope of Coverage

Who Is Covered by the Laws?

The sources of U.S. antiboycott regulations can be found in the Export Administration Act (EAA) and its implementing regulation, the Export Administration Regulations (EAR), and the Internal Revenue Code. The EAR applies to all "U.S. persons" (individuals and companies located in the United States). It also covers foreign subsidiaries that are controlled by a U.S. company in terms of ownership or management. In such cases, the foreign affiliate will be subject to the antiboycott laws and the U.S. parent will be held responsible for any noncompliance. The regulations cover the activities of individuals or companies relating to the sale purchase or transfer of goods or services within the United States or between the United States and a foreign country. This includes U.S. exports, imports, financing, forwarding and shipping, and certain other transactions that may take place outside the United States. To trigger the application of the antiboycott laws, the activity must involve U.S. Commerce with foreign countries (EAR, part 760).

What do the Laws Prohibit?

Refusals to do business. The law prohibits any U.S. person from refusing to do business (expressly or implicitly) with any person pursuant to a request, agreement, or requirement from a boycotting country. The use of a designated list of persons also constitutes a refusal to do business prohibited under the act.

Discriminatory actions. The statute prohibits any U.S. person from discriminating against an individual (who is a U.S. person) on the basis of race, religion, gender, or national origin. It also prohibits similar action against a U.S. corporation based on the race, religion of the owner, officer, director, or employee. Such prohibitions apply when the action is taken in order to comply with or support an unsanctioned foreign boycott.

Furnishing information to a boycotting country. The statute prohibits furnishing information about any business relationship with or in a boycotted country or with black-listed firms or persons. It also prohibits actual furnishing of, or agreements to furnish, information about the race, religion, sex, or national origin of another U.S. person, or any U.S. person's association with any charitable organization that supports the boycotted country.

Implementing letters of credit with prohibited conditions or requirements. The statute also prohibits any U.S. person from implementing a letter of credit that contains a condition or requirement from a boycotting country.

This includes issuing, honoring, paying, or confirming a letter of credit. The prohibition applies when a beneficiary is a U.S. person and the transaction involves the export of U.S. goods (i.e., shipment of U.S.–origin goods or goods from the United States).

Some exceptions to the prohibitions include the following:

- Compliance with import requirements of a boycotting country
- Compliance with unilateral and specific selections by buyers in a boycotting country
- Compliance with a boycotting country's requirements regarding shipment and transshipment of exports
- Compliance with immigration, passport, visa, employment, and local requirements of a boycotting country

Reporting Requirements

The regulations require U.S. persons to report quarterly to the U.S. Department of Commerce any requests they have received to take any action to comply with, further, or support an unsanctioned foreign boycott. The U.S. Treasury also requires taxpayers to report activities in or with a boycotting country and any requests to participate in a foreign boycott (see International Perspective 15.5).

INTERNATIONAL PERSPECTIVE 15.5.
Requests That Are Not Reportable

- To refrain from shipping on a carrier owned or leased by a particular country or its nationals, or a request to certify to that effect.
- To ship goods via a prescribed route, or refrain from shipping via a prescribed route, or to certify to that effect.
- To supply information regarding the country of origin of goods, the name of the supplier, provider of services, or the destination of exports.
- To comply with the laws of another country other than one that requires compliance with the country's boycott laws.
- To supply information about the exporter or exporter's family for immigration, passport, or employment purposes.
- To supply a certificate by owner/master that the vessel, aircraft, etc., is eligible to enter a particular port pursuant to its laws.
- To supply a certificate from an insurance company stating that the company has an agent or representative in the boycotting country including the name and address of such agent.

Penalties for Noncompliance

The law provides both criminal and civil penalties for violations of the antiboycott statute. On the criminal side, a person who knowingly violates the regulations is subject to a fine of up to $50,000 or five times the value of the exports involved, whichever is greater. It may also include imprisonment of up to five years. In cases in which the violator has knowledge that the items will be used for the benefit of countries or persons to which exports are restricted for national security or foreign policy purposes, the criminal penalty varies. For individuals, a fine may be imposed up to $250,000 and/or imprisonment of up to ten years. For firms, the penalty for each violation can be $1 million or up to five times the value of the exports involved, whichever is greater. Administrative or civil penalties may include any or all of the following: revocation of export licenses, denial of export privileges, exclusion from practice, and imposition of fines of up to $11,000 per violation, or $100,000 if the violation involves items controlled for national security reasons. The treasury may also deny all or part of the foreign tax benefits.

FOREIGN CORRUPT PRACTICES

The Foreign Corrupt Practices Act (FCPA) of 1977 was enacted as a public response to the Watergate Scandal and the disclosure of corrupt payments by U.S. multinationals to foreign government officials in order to obtain business. The Security Exchange Commission (SEC) investigations revealed that 117 Fortune 500 companies had paid millions of dollars to foreign governments. Substantial payments were made by companies such as Exxon ($56.7 million), Northrop ($30.7 million), and Lockheed Martin ($25 million) to foreign officials (Impert, 1990). The overriding public concern was that this practice could tarnish the reputation of the United States in the world and was not in the best interest of U.S. corporations.

The legislation represents an attempt to enforce morality and ethics in the conduct of international business transactions. The FCPA was enacted as an amendment to the Securities and Exchange Act of 1934. It was later amended in 1988, as part of the Omnibus Trade and Competitiveness Act. In 1998, the FCPA was again amended to implement the OECD convention on combating bribery of foreign public officials in international business transactions (see International Perspective 15.6 for corruption index in certain countries).

The principal objectives of the legislation are:

- To prohibit the bribery of foreign officials by U.S. individuals and corporations to obtain or retain a business and
- To establish standards for maintaining corporate records and internal accounting control objectives.
- The anti-bribery provision applies to all publicly held corporations registered with SEC and all domestic concerns. The 1998 amendments expanded the application of the antibribery provisions to cover "any person" who commits bribery on U.S. territory regardless of whether the accused is a resident or does business in the United States. In addition, individual corporate employees can be prosecuted even if the corporation is found not guilty of violating the FCPA (Gleich and Woodward, 2005). The accounting standards and objectives apply only to SEC registrants or those that are required to file reports with the SEC.

INTERNATIONAL PERSPECTIVE 15.6.
Corruption Perception Index Selected Countries (2005)

Country	Level of Corruption	Country	Level of Corruption
Argentina	2.8	Japan	7.3
Australia	5.8	Kenya	2.1
Brazil	3.7	Mexico	3.5
Canada	8.4	Nigeria	1.9
China	3.2	Pakistan	2.1
Colombia	4.0	Russia	2.4
Costa Rica	4.2	Thailand	3.8
Egypt	3.4	United States	7.6
France	7.5	Uruguay	5.9
India	2.9	Venezuela	2.3
Indonesia	2.2	Zimbabwe	2.6

Source: Adapted from Transparency International, 2005.

Note: The measure is taken out of ten points. It ranges from 10 (squeaky clean) to 0 (highly corrupt).

Scope of Coverage

Who Is Subject to the FCPA?

The act applies to all publicly held corporations registered with the SEC and other domestic concerns. Domestic concerns are broadly defined to include all U.S. citizens and residents as well as any entity whose principal place of business is in the United States or incorporated under the laws of the United States.

A U.S. parent company may be liable for corrupt payments by its foreign subsidiary if the U.S. parent company knew or participated in the subsidiary's corrupt action or took no measures to discourage such payments. The FCPA covers activities of foreign agents and employees of domestic concerns and U.S. nationals living anywhere in the world who have little contact with the United States (Atkinson and Tillen, 2005).

What Is Covered by the FCPA?

The antibribery provision prohibits American businesses from using interstate commerce to pay off foreign officials to obtain or retain a business. Payment to any foreign official to obtain the performance of routine governmental action is explicitly exempted. The 1988 amendments to the FCPA changed the knowledge requirement and the definition of grease payments, added certain defenses to charges of bribery under the statute, increased penalties, and authorized the president to negotiate an international agreement prohibiting bribery.

The knowledge requirement. The 1977 act prohibited any payments while knowing or having reason to know that they would be used to bribe foreign officials. It was believed that a broad application of the "reason to know" standard would put many multinational companies under the risk of liability for the actions of their sales agents who engage in bribery without their approval. Such a standard would also invite unwarranted scrutiny of distributors or sales agents in countries that are considered to be corrupt. Given such legitimate business concerns, the "reason to know" standard was removed from the act and objective criteria established with respect to such conduct. This standard is narrower and holds businesses liable only if they are substantially certain that the illicit payments are to occur or that such a circumstance exists (Hall, 1994).

Exemption of payments for ministerial or clerical duties. The amendment based permissible bribes on the purpose for which payment is made, as opposed to the official position of the recipient. It excludes payments for routine governmental actions from the application of the act.

Additional defenses against charges of bribery. Payments are not considered corrupt if they are lawful under the laws of the foreign country and if they are used to reimburse foreign officials for reasonable expenditures, such as visits to manufacturing facilities, promotion, and so on.

Increased penalties. The maximum fine for a corporation was increased from $1 million to $2 million. For individuals, the maximum fine was also increased from $10,000 to $100,000. Individuals and corporate employees were made criminally liable even when the corporation is not in contravention of the FCPA.

Authorization to negotiate an international agreement. The act authorizes the president to negotiate an international agreement with countries that are members of the OECD to prohibit bribery.

The accounting provisions of the FCPA are intended to prevent companies from escaping detection by maintaining dubious accounts or slush funds. It requires any corporation that has certain classes of shares with the SEC to (1) make and keep accurate books and accounts that fairly reflect the transactions and (2) maintain a system of internal accounting controls in order to prevent the unauthorized use of corporate assets and transactions and to ensure the accuracy of corporate records.

Enforcement and Penalties

Enforcement of the FCPA is the joint responsibility of the SEC and the Department of Justice (DOJ). The DOJ has authority for civil enforcement of violations by domestic concerns with respect to the antibribery provisions. It also has exclusive jurisdiction over criminal prosecution in relation to the accounting as well as antibribery provisions of the statute. The SEC has similar authority for civil enforcement of violations of the antibribery and accounting provisions.

Criminal penalties may reach up to $2 million for public corporations and domestic concerns, and $100,000 and/or a maximum of five years for officers, directors, or employees who commit willful violations of the antibribery provisions. With regard to civil penalties, a maximum of $10,000 may be levied against any company, employee, officer, or director. Injunctive relief is also available to forestall a violation. Violations of the accounting provisions can result in a fine of $2.5 million for companies or up to ten years of imprisonment for individuals.

Since the introduction of the FCPA, several U.S. companies have been investigated for bribing foreign officials to obtain contracts. Over the past few years, some companies were indicted and fined for bribing foreign officials in order to use their influence to secure government contracts. Here are some examples:

- In 1995, Lockheed Martin was indicted for paying an Egyptian legislator $1 million through a consulting firm for helping Lockheed secure the sale of three transport planes. The company agreed to a settlement by paying a $24.8 million penalty (Anonymous, 1995).
- In 1990, Young and Rubicam, a New York-based advertising firm, entered a guilty plea and paid a $500,000 fine for bribing a former official of the Jamaican Ministry of Tourism to secure a contract with the Jamaican Tourist Board (Lipman, 1990).

U.S. companies could seek an advisory opinion from the DOJ on whether a particular transaction would violate the FCPA. Any opinion by the DOJ that sanctions a proposed transaction would create a presumption of legality.

Measures for Compliance with the FCPA

Implementing Due Diligence Procedures

It is advisable to prepare internal procedures to evaluate and select foreign partners and agents. Once an appointment has been made consistent with the internal procedures, a written agreement is needed to govern the relationship between the parties. Such an agreement should generally state that the agent/partner has no authority to bind the exporter and that the agreement is valid insofar as the foreign agent/partner complies with the FCPA and the foreign country's laws. It should also stipulate that the agent/partner is not an employee, officer, or representative of any government agency. The exporter should be promptly notified of any changes in representation.

Seeking an Advisory Opinion from the Government

The DOJ provides an advisory opinion on the legitimacy of a proposed transaction. Other federal agencies also provide an advisory opinion.

Adopting Internal Measures and Controls

Internal procedures should be established to guide employees. Such programs include procedures for reporting and investigations; seeking the opinion of counsel; policies for employees, agents, or joint venture partners; and training programs for officers and employees.

International Efforts to Control Corruption

- The OECD Antibribery Recommendation, 1994
- The OECD Convention on Combating Bribery, 1997
- The ICC Rules of Conduct to Combat Extortion and Bribery, 1977 (revised in 1996)
- Transparency International (TI), which has as its mission to enhance public transparency and accountability in international business transactions and in the administration of public procurement

ANTITRUST LAWS AND TRADE REGULATION

Antitrust laws are intended to enhance efficiency and consumer welfare by proscribing practices that lessen competition or create a monopoly. Such laws also meet the sociopolitical objective of dispersing economic power. Historically, monopolies were often sanctioned in the area of trade and commerce. During the colonial period, for example, private companies such as the East India Company (1600), The Dutch West India Company (1621), and The Hudson Bay Company (1670) received charters from governments that granted them a monopoly of trade. In North America, British merchants were given monopolies over the export and import of goods.

The idea of monopoly rights was soon found unacceptable, as it restricted the rights of individuals from competing freely. In many European countries, it was viewed as incompatible with the competitive integrity of markets and free trade. By 1860, Britain had unilaterally abrogated the rights of commercial monopolies given to particular companies (Johns, 1988). In the United States, there was a call for legislation to control "dangerous conspiracies against the public good" (Shenefield and Stelzer, 1993). The Sherman Act was passed in 1890.

Antitrust laws are often referred to as the Magna Carta of free enterprise because they preserve free competition in domestic and foreign trade as well as minimize government intervention in business affairs.

U.S. Antitrust Regulations

U.S. antitrust laws can be grouped into three categories:

1. *General prohibitions:* The Sherman Act, the Federal Trade Commission (FTC)
2. *Specific prohibitions:* The Clayton Act and amendments
3. *Exemptions*

General Prohibitions

The Sherman Act outlaws certain concerted activity in restraint of trade between two or more parties. The U.S. Supreme Court has developed certain criteria to determine the lawfulness of a given restraint: the per se rule and the rule of reason. The per se rule applies to those restraints of trade which are prohibited regardless of their effect on competition or economic welfare.

Per se violations include price-fixing, division of markets (market sharing) between competitors, and certain boycotts by sellers or buyers (i.e., an agreement between competitors not to deal with a customer or supplier). Restraints that are not categorized as per se violations are subject to the rule of reason; that is, practices are restricted only if they have an adverse effect on competition. This often requires analysis of the competitive structure of the firm, the firm's market share and/or power, and other relevant factors. The Sherman Act also prohibits monopoly abuse and attempts or conspiracies to monopolize trade or commerce with foreign nations. If a firm has a high market share as a result of improved productivity, it is not considered objectionable unless it is obtained through systematic conduct designed to harm competitors.

The FTC proscribes unfair competitive practices even though they do not violate specific provisions of either the Sherman Act or the Clayton Act. It also prohibits unfair or deceptive practices in or affecting foreign commerce. The commission has authority to issue interpretative rules and general statements of policy, rules, and guidelines that define unfair or deceptive business practices.

Specific Prohibitions

The Clayton Act proscribes any acquisition of the stocks or assets of another entity affecting commerce in any part of the United States that results in the creation of a monopoly or a substantial lessening of competition. The Clayton Act is not limited to the acquisition of a competitor. It also prohibits price discrimination between two purchasers without just cause or exclusive dealing in foreign commerce that tends to create a monopoly or lessen competition in the United States. Exclusive dealing (tying) occurs when the seller sells a product only on the condition that the purchaser will not deal in the goods of the seller's competitor.

Exemptions

Certain export activities of U.S. companies are exempt from the reach of U.S. antitrust laws. These exemptions came in the wake of increasing U.S. trade deficits and were intended to encourage U.S. companies to form alliances in order to increase exports overseas. The development of export trading companies (ETCs) was sought to benefit export firms through the creation of economies of scale and diffusion of risk. The following are some of the exemptions in the area of export trade.

The Webb-Pomerene Act. The Webb-Pomerene Act allows U.S. firms to establish export cartels for the sole purpose of marketing their products overseas. This exemption from the antitrust laws allows competing firms to set prices, allocate orders, consolidate freight, or arrange shipments and, until 1982, applied only to merchandise exports. The Export Trading Company Act (ETC) of 1982 extended the application of the Webb-Pomerene Act to services.

Export trade certificate of review. The ETC Act provides a procedure for issuing a certificate of review exempting U.S. applicants from antitrust liability. Under this procedure, applicants disclose their plans for overseas trade with the government and obtain preclearance, that is, obtain the government's approval for their future export activity. The Commerce and Justice Departments issue the certificate to potential exporters after establishing that their conduct or activity does not substantially lessen competition or unreasonably affect prices in the United States. Applicants are exempt from antitrust laws so long as the minimum standards are met under the act. The ETC Act also provides protection to certificate holders against frivolous lawsuits by competitors that are intended to forestall their export activities.

Application of antitrust laws to international business transactions. Title IV of the ETC Act exempts exporting and other international business transactions from the application of the Sherman and FTC Acts unless the export conduct has a direct, substantial, and reasonably foreseeable effect on domestic trade or commerce. Anticompetitive acts directed at exports without effect on domestic commerce of a U.S. person are treated as foreign transactions and out of reach of U.S. antitrust laws. In the absence of this legislation, the antitrust laws would otherwise have extended to any anticompetitive conduct (agreements, conspiracy, etc.), regardless of its effect on U.S. import, export, or domestic commerce. Although this exemption could be used as an alternative to export certification or preclearance, it does not provide the immunity from prosecution that is available under the latter arrangement.

The following are generally considered to be a checklist of practices that businesses should avoid:

1. Discussing prices with competitors
2. Pricing below cost to drive out a competitor or discourage a new entrant
3. Dividing markets with other competitors
4. Compelling dealers to charge a given price
5. Tying the sale of one product to another
6. Charging customers different prices without reasonable justification
7. Terminating a customer without reasonable justification
8. Abusing market power to the disadvantage of consumers and competitors
9. Joining with a competitor to the disadvantage of other competitors
10. Suggesting that a supplier purchase from another division of the subsidiary

It is also important for companies to establish an antitrust compliance program.

Extraterritorial Application of U.S. Antitrust Laws

The U.S. antitrust laws are not limited to transactions that take place within U.S. borders. Overseas transactions with a substantial and foreseeable effect on U.S. commerce are subject to U.S. antitrust laws. Efforts by the United States to exercise its jurisdiction outside its borders have often been frustrated by foreign governments that did not want any infringements of their sovereignty. Some countries have enacted legislation to block the enforcement of U.S. laws within their countries, including any cooperation with respect to submission of evidence and documents. In view of such opposition, the U.S. government has resorted to bilateral antitrust agreements with various countries concerning the extraterritorial application of national antitrust laws. The agreements generally provide for the exchange of information, prior notification of enforcement actions, and consultation on policy matters.

Enforcement and Penalties

The DOJ and the FTC enforce U.S. antitrust laws. Whereas the DOJ can initiate civil or criminal suits against alleged violators, the FTC or states, through the attorney general, are empowered to bring only civil cases. Private parties that have been adversely affected by a violation of antitrust laws can also sue in federal court for an injunction or damages.

Penalties in criminal cases may involve fines up to $100,000 and imprisonment for up to three years for individuals. Corporations may be fined up to $1 million. Civil penalties could also result in hefty fines (see International Perspective 15.7).

INTERNATIONAL PERSPECTIVE 15.7.
Matsushita Co. Ltd. versus Zenith Radio Corporation

Background and facts: In 1974, Zenith filed a suit against a group of Japanese firms, including Matsushita, claiming that they had engaged in predatory pricing (pricing below cost) as part of a collusive plan to drive U.S. firms out of the color television market (CTV). It was alleged that the Japanese producers had agreed to limit the number of U.S. distributors to five and to set minimum prices in the U.S. market. It was also alleged that, notwithstanding the minimum prices, the companies agreed to provide substantial rebates to their U.S. distributors. In Japan, the producers controlled the retail outlets and used their control to fix retail prices, and retail market shares, and to restrict retailers from selling competitive products. It was also found that the Japanese firms never gained more than 45 percent of the U.S. market share and did not raise prices in twenty years. The district court held for Matsushita and other defendants and Zenith appealed. The appellate court reversed the trial court's decision. Matsushita and others appealed to the U.S. Supreme Court.

Decision: The Supreme court reversed the decision of the appellate court. The court stated that Zenith's accusations that Japanese firms were conspiring to drive U.S. industry out of business in order to monopolize the U.S. CTV market not only were untrue but could not have been possibly true. Elaborating on this issue, the court stated:

"If predatory pricing conspiracies are generally unlikely to occur, they are especially so, where, as here, the prospect of attaining monopoly power seems slight. Two decades after their conspiracy is alleged to have commenced, petitioners appear to be far from achieving this goal: the two largest shares of the retail market are held by RCA and the respondent Zenith. The alleged conspiracy's failure to achieve its ends in the two decades of its asserted operation is strong evidence that the conspiracy does not in fact exist. . . . Petitioners had every incentive not to engage in the conduct with which they are charged, for its likely effect would be to generate losses for the petitioners with no corresponding gains."

Source: 106 S. Court 1349 (1986).

INCENTIVES TO PROMOTE EXPORTS

From the 1870s until 1971, U.S. exports typically exceeded U.S. imports, except during World War II. Even during this period, U.S. exports fell below imports because a substantial percentage of the exports was not sold, but provided to allies under the Marshall Plan. All this began to change in the 1970s. The U.S. registered a trade deficit in 1971. The merchandise trade balance showed a $2.27 billion deficit (1971) in contrast to the previous decades when exports exceeded imports. Some of the contributing factors to this state of affairs included the overvalued dollar and increased government expenditures at home and abroad that often resulted in purchases of foreign products and services. This situation was further exacerbated in 1973 when oil prices sharply increased and worsened the U.S. trade deficit due to large increases in expenditures for imports for petroleum products (Stein and Foss, 1992).

Domestic International Sales Corporation and the GATT

In an effort to remedy the worsening trade imbalance, the government enacted the Revenue Act of 1972. The act created the Domestic International Sales Corporation (DISC) to promote U.S. exports by providing tax incentives that would lower the cost of exporting goods in foreign markets. The legislation was also intended to remove the disadvantage of U.S. companies engaged in export activities through domestic corporations (Chou, 2005).

The DISC statute was also intended to offset the competitive disadvantage faced by U.S. firms in view of the various incentives provided by major trading nations to their export firms. Under the DISC scheme, a U.S. corporation could export its products through a subsidiary (DISC) organized in the United States (a shell corporation) with minimum capital of $2,500. The DISC was required to engage almost exclusively in export sales. The tax implications of a corporation that elected to be treated as a DISC were as follows:

- Approximately half of DISC's earnings were taxed at the shareholder level regardless of whether they were distributed to shareholders (constructive dividends).
- The remainder of DISC's earnings was not taxable to the shareholder until actually distributed. This allowed for an indefinite deferral of tax. In effect, this amounted to a de facto tax exemption on about half of DISC's earnings because deferred taxes may never become due.

- Deferred taxes became due when distributed to shareholders, when a shareholder disposed of its DISC stock, or the corporation ceased to qualify as a DISC.

The DISC came under increasing attack by U.S. trading partners as an unfair and illegal subsidy to U.S. exporters. In a complaint by the EEC and Canada against the United States, the GATT panel issued a report stating that the DISC scheme conferred a tax benefit to exports and resulted in the price of exports being lower than similar goods for domestic consumption. The panel concluded that the scheme was in violation of the GATT treaty (GATT, 1977). Even though the United States never conceded to the inconsistency of the DISC with the GATT agreement, it nevertheless proceeded to replace the DISC with an alternative scheme that was acceptable to the GATT. (A vestige of the old DISC, the Interest Charge-DISC remains to date.)

The Tax Reform Act of 1984 created the Foreign Sales Corporation (FSC) to promote U.S. exports. Once the FSC is incorporated outside the United States and satisfies other requirements in the statute, its earnings are exempt from U.S. taxation. Although the FSC provides a benefit to U.S. exporters comparable to the DISC, it is permitted under the GATT because the GATT treaty does not require member countries to tax “economic processes” that take place outside their territory (Levin, 2004).

The European Union filed a complaint with the WTO asserting that the FSC regime was an illegal subsidy inconsistent with the GATT treaty (1998). In 1999, the WTO ruled in favor of the EU and called for the elimination of the FSC regime by 2000. In response to the WTO ruling, the United States repealed the FSC and enacted the Extraterritorial Income Exclusion Act (ETI) (2000) which provides U.S. exporters with the same tax benefit as the FSC. It allows U.S. exporters to exclude from federal income tax 15 percent of their net income from the export sale of qualified U.S.–origin goods. Alternatively, exporters of low profit items could exclude 1.2 percent of their gross receipts (not to exceed 30 percent of the net) from the export sale of qualified U.S.–origin goods (not more than 50 percent of the value is attributable to foreign content). The EU again challenged the ETI as an unfair subsidy to U.S. corporations and the WTO dispute settlement body found that it violated the treaty (2001). The ETI was phased out in 2004. The IC-DISC appears to be one of the few remaining tax incentives for U.S. exporters (Clausing, 2005; Gravelle, 2005) (see International Perspective 15.8 for export incentives in agriculture).

INTERNATIONAL PERSPECTIVE 15.8.
Agricultural Export Incentives

- **Market development:** The largest promotional programs are those pertaining to foreign market development and access to foreign markets. The programs allow for reimbursement of expenses incurred in approved activities.
- **Commercial export financing:** Provision of short and intermediate term commercial financing through the Commodity Credit Corporation. A buyer/supplier guarantee program is available for the purchase of U.S. agricultural exports.
- **Concessional sales:** Under Public Law 480, the U.S. government provides food aid under different arrangements (Title I, II and III).
- **Programs to offset the effects of unfair trade practices:** Such programs are intended to expand U.S. agricultural exports and to challenge unfair trade practices through the provision of subsidies and so on.

Interest-Charge Domestic International Sales Corporations (IC-DISCs)

The IC-DISC is a tax deferral vehicle (on the first $10 million U.S. export sales) that can be used by small and medium-sized exporting companies. It provides a 20 percent tax savings for qualifying U.S. exporters in view of the favorable dividend tax rules under the Jobs and Growth Tax Relief Reconciliation Act of 2003 (Loizeau, 2004).

To be eligible for IC-DISC status, corporations must satisfy certain requirements:

1. It must be a U.S. corporation.
2. At least 95 percent of its foreign trading gross receipts for the tax year must be "qualified exports receipts." Qualified export receipts include receipts from sales, leases, or rental of export property (Section 993 (a)). It also includes gross receipts for services related to warranty, repair, transportation of export property, engineering or architectural services from overseas projects, and interest on qualified export assets.
3. The adjusted basis of its qualified export assets must be at least 95 percent of its total assets at the end of the tax year. Qualified export assets include accounts receivable, temporary investments, export property, assets used primarily in connection with the production of qualified export receipts and loans to producers.

4. It has one class of stock with a minimum value (capital) of $2,500.
5. A timely election to be treated as an IC-DISC for the current tax year.
6. Certain personal holding companies, financial, insurance institutions as well as companies that are members of any controlled group of which an FSC is a member are ineligible to be treated as an IC-DISC.

How Does an IC-DISC Work?

Step 1: A U.S. exporter (or shareholder) forms a tax-exempt IC-DISC corporation.

Step 2: The U.S. exporter pays the IC-DISC commission. The allowable commission rate is the greater of either 50 percent export net income or 4 percent of gross export income.

Step 3: The U.S. exporter deducts the commission paid to the IC-DISC from its income taxed at 35 percent. (The IC-DISC pays no U.S. income tax on the commission income.)

Step 4: When the IC-DISC pays dividend to its shareholders, the shareholders pay dividend income tax of 15 percent. (On income at IC-DISC, which is accumulated and untaxed, shareholders are required to pay interest.)

Tax Benefits of IC-DISC

1. *Reduced taxable income:* The U.S. exporter pays an annual tax deductible commission on its export sales to the IC-DISC. This reduces its taxable base at the corporate level by the commission paid to the IC-DISC.
2. *Increased dividend income to shareholders:* The entire commission paid to the IC-DISC can then be distributed as a dividend at the end of taxable year. This payment could be subject to only a 15 percent individual dividend tax rate rather than the corporate tax rate of 35 percent.
3. *Deferral of IC-DISC income from taxation:* The IC-DISC is not subject to tax. However, its U.S. shareholders are subject to tax on deemed dividend distributions from the IC-DISC, which does not include income derived from the first $10 million of the IC-DISC's qualified export receipts each year. Thus, the IC-DISC allows a U.S. shareholder to defer paying tax on income attributable to $10 million of export sales. The U.S. shareholder must, however, pay an interest charge on its IC-DISC earnings (deferred tax liability) until it is distributed (see Table 15.1).

TABLE 15.1. An Example to Illustrate IC-DISC Tax Savings

	Without IC-DISC	With IC-DISC		
		Combined	**Exporter**	**IC-DISC**
Foreign trading gross receipts	5,000,000	5,000,000		
Cost of goods sold	3,000,000	3,000,000		
Selling, administrative expenses	1,000,000	1,000,000		
Export net income	1,000,000	1,000,000	1,000,000	
Tax rate	35%			
Tax paid	350,000			
IC-DISC greater of				
4% export gross receipts			200,000	
50% export net income			500,000	
IC-DISC commission			500,000	
IC-DISC commission deduction			500,000	500,000
Tax base after IC-DISC commission			500,000	500,000
Tax base after			35%	15%
Tax paid		250,000	175,000	75,000
Tax saving (net)		350,000 – 250,000 = 100,000		

CHAPTER SUMMARY

Objectives of Export Controls

These include national security, foreign policy, nonproliferation of weapons of mass destruction, and prevention of excessive draining of scarce natural resources.

Export Controls and Major Developments

With the end of the Cold War, controls have been substantially liberalized and simplified. Present controls focus on a small group of critical goods, technology, and countries. However, after the events of September 2001, certain restrictions have been imposed on exports.

Scope of Export Administration Regulations (EAR)

The EAR covers exports, re-exports, foreign products that are made using U.S. technology, and U.S. person activities.

Determining License Requirements

Step 1: Is the (item subject to export) transaction subject to Export Administration Regulations (EAR)?

Step 2: If so, is an export license required based on product characteristics, destination, and use/user, and the general prohibitions?

Step 3: If yes, is there a license exception?

Step 4: If no, apply for a license. If yes, no license required.

Step 5: Whether export is made under a license or not, exporters have to comply with SED/DCS and record-keeping requirements.

Indicators That Help Identify and Report Possible Violations

One of the parties to the transaction is on the list of denied persons or the transaction has red flags.

The U.S. Antiboycott Law

The law prohibits U.S. firms from participating in foreign boycotts not authorized by the U.S. government.

Who Is Covered by the Laws?

Individuals and companies located in the United States, foreign subsidiaries controlled by a U.S. company, and all activities involving U.S. commerce with foreign nations are covered.

What Do the Laws Prohibit?

Prohibitions include refusals to do business, discriminatory actions against a U.S. individual or company in order to support an unsanctioned foreign boycott, furnishing information to a boycotting country, and implementing letters of credit with prohibited conditions.

Exceptions to the Prohibitions

These include compliance with import/shipping and documentary requirements of boycotting country, compliance with shipment/transshipment/

specific carrier or route selection requirements of boycotting country, compliance with immigration/passport/employment, and other local law requirements of boycotting country.

Enforcement and Penalties

Penalties for noncompliance:

1. *Criminal penalties:* Fines and/or imprisonment
2. *Civil penalties:* Revocation of export license, denial of export privileges, imposition of a fine, denial of tax benefits

The Foreign Corrupt Practices Act (FCPA)

Principal objectives behind FCPA: To prohibit bribery of foreign officials by U.S. individuals and corporations to obtain or retain a business; to establish standards for maintaining corporate records and internal accounting control objectives.

Who Is Subject to the FCPA?

1. All U.S. citizens and residents
2. All entities with their principal place of business in the United States or incorporated in the United States.

Enforcement and Penalties

FCPA is enforced by the SEC and the U.S. DOJ.

Criminal penalties: $2 million for corporations and/or a maximum of five years for officers, directors, or employees who commit willful violations of the FCPA.

Civil penalties: Fine of $10,000 against any company, employee, or officer, $2.5 million fine imposed for violating the accounting provisions. Injunctive relief is also available.

Measures for Compliance with the FCPA

These include implementing due diligence procedures, seeking an advisory opinion from the government, and adopting internal measures and controls.

Antitrust Regulation and U.S. Trade

There are three categories of antitrust laws:

1. *General prohibitions:* The Sherman Act, The FTC.
2. *Specific prohibitions:* The Clayton Act. Covers restraints to commerce through mergers, acquisitions, exclusive dealing, and similar arrangements that lessen competition.
3. *Exemptions:* Exemptions from antitrust laws in the area of export trade include the Webb-Pomerene Act, Export Trade Certificate of Review, and Title IV of the ETC Act.

Extraterritorial Application of U.S. Antitrust Laws

Overseas transactions with a substantial and foreseeable effect on U.S. commerce are subject to U.S. antitrust laws.

Enforcement and Penalties

Institutions that enforce U.S. antitrust laws:

1. The DOJ initiates civil or criminal suits against alleged violators.
2. The FTC initiates only civil cases.

Penalties:

1. *Criminal penalties:* Fines up to $100,000 and imprisonment for up to three years (individuals); fines of up to $1 million for corporations.
2. *Civil penalties:* Hefty fines.

Incentives to Promote Exports

Interest-charge DISCs: Under this arrangement, taxes on export sales can be deferred. However, shareholders must pay interest on their proportionate share of the accumulated taxes deferred. Operational rules are similar to pre-1985 DISCs.

REVIEW QUESTIONS

1. State the major U.S. regulations that have a major impact on exports.
2. Discuss current developments in U.S. export controls.

3. What are the major objectives of U.S. export regulations? How do you establish whether a product needs an export license?
4. What types of actions does the U.S. antiboycott law prohibit? What kinds of requests are not reportable?
5. Discuss the knowledge requirement under the FCPA. Provide examples of U.S. companies indicted for bribing foreign officials.
6. Describe some of the international efforts to control corruption.
7. Discuss the major antitrust exemptions in the area of export trade.
8. Discuss the major incentives to promote exporters since 1972.
9. How does the IC-DISC work?
10. Do you think the IC-DISC will be attacked by U.S. trading partners as an unfair subsidy to U.S. exporters? Why/why not?

CASE 15.1. EXPORT TRADE CERTIFICATE OF REVIEW

Joint Export Activities to Reduce Costs and Risks: Export Trade Certificates of Reviews (COR) are issued by the Department of Commerce (with concurrence of the DOJ) and provide antitrust protection for certain specified export activities. Companies holding certificates can work together in the appointment of exclusive agents or distributors, limitations of pricing, or the handling of competitive products. The benefits of COR include the reduction of transportation, warehousing, and marketing costs. It also allows firms to establish joint facilities, set common prices, divide markets and sales territories, bid on large contracts, as well as share space in overseas trade shows. Small and medium-sized companies are able to spread costs and minimize risks in exporting without violating U.S. antitrust legislation. Congress viewed the uncertain application of U.S. laws to export activities as impediments to the growth and expansion of U.S. exports. The certificate provides antitrust preclearance for the specified export activities.

U.S. residents, partnerships, or corporations as well as state and local government entities can apply for COR. Over the past few years, a large number of trade associations have taken advantage of the program for their member firms. If the application meets certification standards, the Commerce Department is required to issue the COR within 90 days of submission. With COR, companies are immune from federal and state antitrust actions. In private antitrust actions, it alters the burden of proof to the advantage of the certificate holder (CH), shortens the statute of limitations covering the CH's conduct, provides for recovery of legal expenses (in cases where the CH prevails), and reduces liability. Since the introduction of the legislation in 1982, COR was challenged in court (1998) by Horizon International only over the certificate issued to another firm. The United States appeals court unanimously upheld the validity of the certificate (COR).

It is important to note that COR will not be granted if the export activity does any of the following:

1. Reduces competition in the United States or results in the substantial restraint of export trade of any U.S. competitor
2. Unreasonably affects prices of the covered product or services in the United States
3. Is carried out with the expectation that the products or services will be re-exported to the United States

Selected Holders of COR

- The Association of Manufacturing Technology (AMT) of McLean, Virginia, represents the interests of American providers of manufacturing machinery and equipment. Founded in 1902, its goal is to promote technological advancements in the design, manufacture, and sale of members' products as well as act as industry advocate on trade matters to governments and trade organizations throughout the world. The AMT received its COR in 1987 with a view to enhancing the trade competitiveness of its members. Recently, its members were able to cooperate in order to win the contract to supply a large Chinese aircraft plant with the requisite machinery to modernize and win Western aircraft parts contracts. Such cooperation would have been difficult without the COR.
- American Film Export Association (AFEA) of Los Angeles, California, is a trade association that provides members with marketing support services, government relations, and statistical data. It received COR in 1987 and has used this opportunity to expand export opportunities for its members. American Film Export Association fosters the exchange of information among its exporting members on foreign market conditions including vital credit data on more than 500 film and television buyers in over 50 countries. It also assists members in reducing delays in product delivery to overseas distributors, provides international model licensing agreements, and administers its arbitration tribunal, which resolves disputes regarding distribution.
- Florida Citrus Exports (FCE) operates as an export joint venture of nine members including grower-owned cooperatives and packing houses. It received COR in 1995 and has been able to assist members to cut export costs and increase export effectiveness. The COR allows mem-

bers to share transportation and market development costs, engage in joint promotional activities, speak with one voice in negotiations with export service providers and foreign buyers, prepare joint bids, assist each other in maintaining quality standards, and spread risks. The coordination of transportation is particularly important in exporting perishable commodities.

Questions

1. What are the benefits of certificates of review to U.S. exporters?
2. A certificate of review is not granted in certain cases. Discuss.

CASE 15.2. ENFORCEMENT OF EXPORT REGULATIONS

Bureau of Industry and Security (BIS): Export Enforcement

Export of national security controlled technology to China: In April 2004, Suntek Microwave, Inc., of Newark, California, pled guilty to charges that (1) it shipped detector log video amplifiers (DLVA), items controlled for national security reasons, to a company controlled by the Chinese government without obtaining the required export license; (2) it failed to obtain export licenses under the "deemed export" provisions of the EAR for Chinese nationals who worked at the company and were trained in DLVA manufacturing technology controlled by the EAR. Bureau of Industry and Security imposed on Suntek a $275,000 administrative penalty (and its former president, $187,000) and issued orders denying them export privileges for twenty years. Both were also subject to criminal penalties (Suntek: $339,000 fine; former president: one year imprisonment).

Export of pulse generators to denied persons in India: In June 2004, BNC Corp of California was sentenced to five years probation and a $300,000 criminal fine for illegally exporting pulse generators to two end users in India that were listed on the BIS entity list for nuclear nonproliferation reasons. BIS also issued a five-year suspended denial of export privileges.

Bureau of Industry and Security (BIS): Antiboycott Compliance

Furnishing prohibited business information to end user in Syria (2004): Invitrogen, Inc., of Rockville, Maryland, furnished its business relationship with Israel when it certified to the end user that the U.S.–origin goods the company sold to Syria were "not of Israeli origin and did not contain any Israeli materials." The antiboycott provisions of the EAR prohibit U.S. persons from complying with certain requirements of unsanctioned foreign boycotts, including providing information about business relationships with Israel and refusing to do business with persons on boycott lists. The EAR also requires that persons report their receipt of certain boycott requests to the Department of Commerce. The company agreed to a $2,000 civil penalty.

Security and Exchange Commission (SEC)/Department of Justice (DOJ): FCPA

Schering-Plough (SP) settles with SEC for its alleged violation of FCPA's accounting provisions (2004): Schering-Plough (SP) of Kenilworth, New Jersey, accepted to settle an SEC investigation into its alleged violations of the FCPA's accounting provisions. The SEC alleged that SP-Poland paid about $76,000 to the Chudow Castle Foundation (CC Foundation) (February 1999 to March 2002) in order to induce the director to influence the purchase of its pharmaceutical products with the health fund. The president of the CC Foundation was also director of the Silesian Health Fund. The SEC alleged that, even though the payments were made to a bona fide charity, they were made with the intention of inducing the foundation's president to use his authority as director of the fund to promote the purchase of SP-Poland's pharmaceutical products. None of the payments made by SP-Poland to the CC Foundation were accurately reflected on the books and records of the parent company. SP's system of internal accounting controls was inadequate to prevent or detect improper payments. SP agreed to pay a $500,000 penalty, and institute adequate internal controls.

ABB Vetco Gray Inc. pleads guilty to foreign bribery charges (2004): ABB Vetco Gray, Inc. (Vetco U.S.), and ABB Vetco Gray UK Ltd. (Vetco U.K.), both subsidiaries of Swiss Co. ABB Ltd. pleaded guilty to two counts of bribery in violation of the FCPA. The two companies paid bribes and other things of value (including automobile, shopping trips, etc.) to Nigerian government officials that evaluate and approve potential bidders for contract work on oil exploration projects in Nigeria, including bidders that seek subcontracts with foreign oil and gas companies. They paid more than $1 million in exchange for obtaining confidential bid information and favorable recommendations from Nigerian government officials in connection with seven oil and gas construction contracts in Nigeria from which the companies expected to realize profits of almost $12 million. The SEC also filed a complaint against the parent company, ABB Ltd. (whose stock is traded in the United States), for alleged violations of antibribery, books and records, and internal control provisions of the FCPA.

Vetco U.S. and Vetco U.K. each agreed to pay criminal fines of $5.25 million. This means that the DOJ will prosecute non–U.S. companies for violations of FCPA in antibribery provisions, even if the conduct leading to the violation took place outside the United States. It appears that the DOJ has to show that the non–U.S. companies conspired/acted with U.S. persons when engaging in the prohibited conduct. ABB Ltd. (parent company) agreed to establish adequate system of internal control, pay civil penalty of $10.5 million and $5.9 million in disgorgement and prejudgement interest.

Questions

1. In the case of Schering-Plough and Vetco Gray, do you think that adequate internal controls would have prevented corruption?
2. Do you think that preventing certain shipments from going to firms controlled by the Chinese government (Suntek case) would achieve the goal of protecting U.S. national security?