International Boycott Reports, 2003 and 2004

By Melissa Redmiles

The Antiboycott Laws

In the 1970s, the United States Congress responded to the Arab League's boycott of Israel by passing legislation designed to discourage U.S. persons from participating in unsanctioned boycotts of other countries [1]. One law, the 1977 amendments to the Export Administration Act of 1969, requires U.S. persons to report quarterly to the Commerce Department the requests they have received to participate in, support, or further a prohibited boycott. Those U.S. persons who agree to participate in such boycotts are subject to criminal and civil penalties. The other antiboycott law is the Ribicoff Amendment to the Tax Reform Act of 1976 (TRA76). It requires all U.S taxpayers and their related "persons" [2] to report operations in, with, or related to, boycotting countries or their nationals to the Internal Revenue Service. Operations include any business or commercial transactions, even if they do not generate income. Per Internal Revenue Code section 999(a), taxpayers report these operations on Form 5713, *International Boycott Report*, filed annually with their Federal income tax returns.

The U.S. Department of Treasury publishes a quarterly list of countries that request participation in unsanctioned boycotts. Although the law addresses all prohibited boycotts by any foreign country, the Arab League nations remain the principal boycotting countries. For 2003, the Treasury Department-listed countries included Bahrain, Iraq, Kuwait, Lebanon, Libya, Oman, Qatar, Saudi Arabia, Syria, the United Arab Emirates, and Yemen. Iraq was removed from the list in 2004.

U.S. taxpayers must also report certain types of requests to participate in an international boycott, any agreements to comply with those requests, and any tax consequences. Because the United States does not wish to infringe upon the right of any country to choose its own trading partners, the antiboycott laws do not target primary boycotts—limitations on the import and export of products from a specific country. They are directed instead against secondary and tertiary boycotts. In a secondary boycott, a country demands, as a condition of doing business, that a U.S. person does not conduct any business with the boycotted country. In a tertiary boycott, a country prohibits a U.S person from engaging in business with other entities that have business with the boycotted country.

Specifically, Internal Revenue Code section 999(b)(3) classifies the disallowed boycotts into the five types below:

1) If the person agrees, as a condition of doing business directly or indirectly within a country or with the government, a company, or a national of the country:

    a) to 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 [Type 1 request, as shown in Figure A]; or

    b) to 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 [Type 2]; or

    c) to refrain from doing business with any company whose ownership or management is made up, all or in part, of individuals of a particular nationality, race, or religion [Type 3]; or

    d) to refrain from employing individuals of a particular nationality, race, or religion [Type 4]; or

2) if the person agrees, as a condition of the sale of a product to the government, a company, or a national of a country, to refrain from shipping or insuring the product(s) on a carrier owned, leased, or operated by a person who does not participate in or cooperate with a boycott [Type 5] [3].

Tax Penalties

U.S. taxpayers who participated in the boycotts listed may lose their right to claim certain tax benefits provided by U.S. domestic law. For 2003 and 2004, these benefits included the foreign tax credit, the benefits of Foreign Sales Corporations (FSCs), the

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exclusion of extraterritorial income, and the tax-deferral available to U.S. shareholders of Controlled Foreign Corporations (CFCs) or of an Interest-Charge Domestic Sales Corporation (IC-DISCs). Taxpayers who had operations in a boycotting country were required to reduce the foreign trade income qualifying for the extraterritorial income exclusion, even if they did not receive any requests to participate in a boycott [4].

Figure A

Number of Persons Receiving Boycott Requests and Number of Requests Received, by Type of Request, 2003-2004

Type of boycott request	Number of persons receiving requests [1]		Number of boycott requests received [2]	
	2003	2004	2003	2004
	(1)	(2)	(3)	(4)
Total	**124**	**131**	**2,758**	**3,205**
Type 1	82	72	949	1,191
Type 2	14	12	314	301
Type 3	13	12	293	282
Type 4	8	6	278	289
Type 5	73	85	924	1,142

[1] A person could receive more than one type of request.
[2] Many taxpayers fail to report the total number of requests.
This figure counts an unknown number of requests as one request.

Taxpayers compute the loss of their extraterritorial income exclusion using the international boycott factor method. Under this method, the loss of tax benefit is determined by the ratio of purchases, sales, and payroll in boycotting countries to total foreign purchases, sales, and payroll. The amount of foreign trade income qualifying for the exclusion is reduced by the same proportion as the international boycott factor.

For the denial of other tax benefits, taxpayers may use either the international boycott factor method or the specifically attributable method. Under the specifically attributable method, taxpayers reduce each benefit by the foreign taxes paid or foreign income earned that is associated with the operation in the boycotting countries with whom the agreement was made and that would otherwise be eligible for the tax benefits. The choice of method is an annual election.

Taxpayers who use the international boycott factor reduce their foreign tax credit by the same proportion as the boycott factor. Those who use the specifically attributable method subtract the foreign taxes paid to the boycotting countries with whom they established agreements from the amount of taxes eligible for the credit. Regardless of the method selected, taxpayers may still deduct the taxes ineligible for the credit under the boycott provisions from their U.S. gross incomes.

Under both methods, shareholders of Controlled Foreign Corporations must convert some of their CFC's undistributed (and hence otherwise nontaxable) income into a "deemed distribution." This distribution is then subject to tax, which may increase the U.S tax liability. No taxpayer has reported a loss of IC-DISC or FSC benefits in recent years.

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For 2003, taxpayers filed 1,268 Forms 5713, while 1,343 Forms were filed for 2004. Corporations filed approximately 90 percent of the Forms 5713 for both years, while partnerships accounted for roughly 8 percent of the total. Trusts, estates, and individuals filed most of the remainder.

The majority of Forms 5713 were filed to report the taxpayer's operations in boycotting countries. Most of these operations were in countries on the Treasury List. However, taxpayers reported operations in other countries known to require participation or cooperation with an unsanctioned boycott. The most frequently reported nonlisted country for 2004 was Iraq. Other nonlisted countries often reported for both 2003 and 2004 included, in order of frequency, Jordan, Pakistan, Egypt, and Iran.

For both years, slightly less than 10 percent of the filers reported receiving requests. For 2003, some 124 taxpayers reported 2,758 requests, while 131 taxpayers received 3,205 requests in 2004. Appeals to refrain from doing business with a specified country and petitions to refrain from shipping or insuring products on a carrier associated with someone who does not participate with a boycott each comprised slightly over a third of the requests for both study years (Figure A).

Approximately 3 percent of the filers in both study years agreed to participate in an unsanctioned boycott; 36 in 2003 and 45 in 2004. Likewise, the percentage of filers who lost a portion of their tax benefits was roughly 3 percent for each study year. For 2003, some 41 taxpayers reported tax consequences. These included 16 persons who agreed to participate in a boycott and 25 filers who did not enter into any boycott agreements, but who claimed an extraterritorial income exclusion. For 2004, some 46 taxpayers reported a loss of tax benefits. Of the latter, 15 persons had agreed to participate in a boycott, while 31 filers lost tax benefits because they claimed an extraterritorial income exclusion.

Table 1 provides the number of persons receiving requests, the number of persons agreeing to participate, and the number of requests and agreements, for the Treasury-Listed countries. Treasury-Listed countries were responsible for 88 percent of the total requests for 2003 and 78 percent for 2004. The United Arab Emirates accounted for the largest percentage of requests for both years, followed by Saudi Arabia and Qatar. In both study years, taxpayers agreed to participate with 15 percent of the requests they received. They were most likely to comply with requests from Lebanon. In fact, they agreed to 50 percent of such requests in 2003 and 39 percent in 2004.

Table 2 shows the amount of tax consequences reported for the past 11 years, in constant 2004 dollars, by method of computation. After declining to zero for 1998 through 2001, the reduction of the foreign tax credit under the boycott factor method rose to roughly $10,000 for 2004. Similarly, the reduction in foreign taxes eligible for credit under the specifically attributable taxes and income method dipped from a real value of almost $583,000 for 1994, to zero for 1998 before rising to a high of nearly $726,000 for 2002. The increase in subpart F income from CFCs (see Explanation of Selected Terms) under both methods falls into a similar pattern. In constant 2004 dollars, it fell from $8.2 million for 1994 to a low of approximately $802,000 for 1998 and then hit a new peak of $5.7 million for 2002. It dipped again in 2003 to $1.9 million and then rose to $3.2 million for 2004. While the amount of reduction from the extraterritorial income exclusion has grown steadily since its addition as a tax consequence of operating in a country known to participate in a boycott, it is expected to decline in future years as Congress repealed the extraterritorial income exclusion in the American Jobs Act of 2004.

Explanation of Selected Terms

Controlled Foreign Corporation (CFC).—As defined in Internal Revenue Code section 957(a), any foreign corporation in which the U.S. shareholders own directly, indirectly, or constructively, more than 50 percent of either the total combined voting power or total value of all stock on any day of the taxable year of the corporation.

Extraterritorial Income Exclusion.—This exclusion allows businesses to deduct qualifying foreign trade income from their U.S. gross incomes. Qualifying foreign trade income is defined as the greatest of the following income, that when excluded would reduce taxable income by (1) 1.2 percent of foreign trading gross receipts, or (2) 15 percent of foreign trade income, or (3) 30 percent of foreign sales and leasing income.

Foreign Sales Corporation (FSC).—A company incorporated abroad and usually controlled by a U.S. "person" (defined below). A portion of the FSC "foreign trade income" is exempt from U.S. taxation.

Interest Charge Domestic International Sales Corporation (IC-DISC).—A corporation whose "qualified export receipts" constitute at least 95 percent of its gross receipts and which can classify at least 95 percent of its assets as "qualified export assets" can claim IC-DISC status. A small portion of the IC-DISCs income is deemed distributed to the shareholder. The rest is not subject to U.S. taxation until it is actually distributed, although interest on the tax must be paid annually.

Subpart F Income.—Certain earnings and profits from Controlled Foreign Corporations that the parent company must treat as a deemed distribution for tax purposes, even if the income has not been repatriated to the United States.

U.S. Persons.—As defined in IR Code section 7701(a)(30), U.S. persons are U.S. citizens or residents, domestic partnerships, domestic corporations, and estates or trusts. This excludes foreign trusts or estates whose income from sources outside the United States is not includible in the income of its beneficiaries.

Data Sources and Limitations

Data for the 2003 and 2004 studies were based on a 100-percent sample of Forms 5713, *International Boycott Report*, attached to U.S income tax returns with accounting periods ending in those years.

Notes and References

[1] Doernberg, Richard L., *International Taxation,* West Group, St. Paul, MN, 1999, pp. 413.

[2] Taxpayers must file a Form 5713 if they or any of the following have operations in, or related to, a boycotting country: a controlled group in which they are a member, a foreign corporation in which they have stock, a partner, or a trust owned by the taxpayer.

[3] For a more detailed discussion on activities that are not permitted under the boycott provisions, see Doernberg, pp. 414-420.

[4] Congress repealed the FSC provisions in 1999. Transition rules exempting transactions that were part of a binding contract with a FSC before September 17, 2003, were repealed in May 2006. Congress added the extraterritorial income exclusion in 1999, but repealed it in the American Jobs Act of 2004.

Table 1. International Boycott Reports, 2003-2004: Number of Persons Receiving Requests, Number of Requests Received, and Number of Agreements, by Boycotting Country

Country	Number of persons receiving requests [1]		Number of boycott requests received [2]		Number of persons with agreements [1]		Number of boycott agreements		Boycott agreements as a percentage of requests received	
	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
All countries	**124**	**131**	**2,758**	**3,205**	**36**	**45**	**404**	**484**	**14.6**	**15.1**
Treasury-listed countries	**113**	**119**	**2,431**	**2,515**	**32**	**43**	**393**	**414**	**16.2**	**16.5**
Bahrain	25	24	75	62	7	9	12	11	16.0	17.7
Iraq	5	0	12	0	0	0	0	0	0	0
Kuwait	43	39	218	218	17	12	58	25	26.6	11.5
Lebanon	28	30	154	285	13	14	77	110	50.0	38.6
Libya	13	22	35	112	**	3	**	3	**	2.7
Oman	19	30	253	221	**	6	**	6	**	2.7
Qatar	38	35	313	329	15	6	28	13	8.9	4.0
Saudi Arabia	44	44	358	385	24	25	74	73	20.7	19.0
Syria	45	35	285	156	13	12	20	31	7.0	19.9
United Arab Emirates	79	83	647	616	28	29	106	134	16.4	21.8
Yemen, Republic of	19	16	81	131	5	5	11	8	13.6	6.1
Nonlisted countries	**31**	**44**	**327**	**690**	**31**	**5**	**11**	**70**	**3.4**	**10.1**

**Data deleted to avoid disclosure of information about specific taxpayers. However, data are included in the appropriate totals.

[1] Data in these columns do not add to totals because persons could have received requests from, or made agreements with, more than one country.

[2] The number of requests is undercounted to the extent that many taxpayers do not specify the number of requests they received. This table counts an unknown number of requests as one request.

Table 2. International Boycott Reports, 1994-2004: Lost Tax Benefits Due to Boycott Participation, by Method of Computation

[Money amounts are in whole dollars]

Method	Calendar year	Reduction of foreign tax credit [1]	Increase of Subpart F income [1]	Denial of Foreign Sales Corporation benefits [1]	Reduction of extraterritorial income exclusion [1] [2]
	(1)	(2)	(3)	(4)	(5)
Boycott factor	1994	25,395	102,685	5,194	0
	1995	8,930	0	4,009	0
	1996	30,871	275,588	0	0
	1997	27,369	264,272	0	0
	1998	0	-18,323	5,149	0
	1999	0	-4,992	0	0
	2000	0	6,539	0	0
	2001	0	0	0	0
	2002	5,925	350,402	0	273,433
	2003	4,131	36,423	0	298,234
	2004	10,008	190,321	0	529,544
Specifically attributable taxes and income	1994	582,735	8,076,342	181,784	0
	1995	339,057	7,602,304	859,347	0
	1996	108,366	2,875,317	12,089	0
	1997	137	1,750,884	344,958	0
	1998	0	820,164	501,140	0
	1999	34,181	890,011	0	0
	2000	22,464	1,705,930	0	0
	2001	**	2,067,216	0	0
	2002	725,868	5,388,892	0	0
	2003	546,591	1,820,468	0	0
	2004	648,814	3,005,695	0	0

**Data deleted to avoid disclosure of infromation about specific taxpayers.

[1] Money amounts have been adjusted for inflation to constant 2004 dollars using the consumer price index.

[2] The reduction of the extraterritorial income exclusion was added to the November 2001 Form 5713 revision.