

Internal Revenue Manual

Part 4. Examining Process

Chapter 61. International Program Audit Guidelines

Section 6. Boycotts

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4.61.6 Boycotts

4.61.6.1 (05-01-2006)

International Boycott Audit Guidelines

1. Taxpayers must report their operations in boycotting countries. Taxpayers that participate in international boycotts may be subject to penalties that reduce their foreign tax credit, the benefits of foreign sales corporations, and the deferral available to U.S. shareholders of controlled foreign corporations.

2. The guidelines that follow assist IEs developing international boycott issues. They are not all inclusive. IEs must use their judgment in selecting audit techniques.

4.61.6.2 (05-01-2006)

Boycott Defined

1. A boycott involves entering into certain agreements as a condition of doing business in a country. The agreement requires a person to refrain from doing business in (or hiring employees from) another country or with other persons that do business in (or hire employees from) the other country.
2. Not all instances of boycott participation are subject to a penalty. The refusal by one country to buy goods from another country is acceptable under the boycott provisions (this is a *primary boycott*). A boycott that requires the cessation of business with another country as a condition of doing business is not acceptable (this is a *secondary boycott*). A boycott that requires the cessation of business with a U.S. person engaged in trade in a country or company which is the object of a boycott or that requires the cessation of business with a company whose employees are of a particular nationality, religion, or race or to remove directors of a particular nationality, religion, or race is not acceptable (this is a *tertiary boycott*).

4.61.6.2.1 (05-01-2006)

Reporting Requirements

1. Secondary or tertiary boycotts are reportable on the Form 5713 (*International Boycott Report*).

4.61.6.2.2 (05-01-2006)

Referral Requirements

1. An international referral on the web-based specialist referral system will be considered when either of the following situations exists:
 - A. There are significant transactions in boycott countries or.
 - B. A Form 5713 is included with a return.
2. Audit workpapers should support a domestic agent's decision not to make a referral when boycott features are present. Examples of justification are inadequate time on the statute or insignificant dollar amount of transactions involved.

4.61.6.3 (05-01-2006)

Boycott Countries

1. The Treasury Department periodically publishes a list of countries that may require boycott participation. The countries identified in the most recent notice are: Bahrain;

Iraq; Saudi Arabia; United Arab Emirates; Republic of Yemen; Oman; Qatar; Kuwait; Lebanon; Libya; Syria.

2. Other countries may also require boycott participation. When a non-listed country requires boycott participation, IEs will summarize their findings in a memorandum and forward it to the Director, International (LMSB), Manager, International Programs, Internal Revenue Service, SE:LM:IN:IP, 1111 Constitution Ave, NW, Washington, DC 20224, . The Director of International Programs will take steps to update the Department of Treasury list of countries.

4.61.6.4 (05-01-2006)

Background and Effective Dates

1. In 1976, Congress sought to deter participation in non-U.S.-sanctioned boycotts by the imposition of the tax penalties contained in IRC section 999. There are indications that boycott participation typically occurs in the construction and engineering industries. The banking industry frequently participates in boycotting by attaching requirements to Letters of Credit.
2. The Department of the Treasury has issued detailed guidelines to clarify the provisions of IRC section 999. This section highlights several key points.

4.61.6.4.1 (05-01-2006)

Agreement

1. Usually, there must be an oral or written agreement entered into as a condition of doing business in a boycotting country. The agreement must require a prohibited action as specified in IRC section 999(b)(3)(A). The words "abide by" and "comply with" often indicate the existence of an agreement.
2. The focus of the statute is on boycotts. Accordingly, the following are not subject to a penalty:
 - A. Agreement to refrain from doing business with non-U.S. persons or non-boycotted country persons,
 - B. Agreement providing that goods delivered under it are acceptable only on a delivered-in-a-boycotting-country-basis (even if blacklisted companies probably cannot meet the conditions of the contract),
 - C. A contract that has the boycotting country specifically name the companies that will be subcontractors under the contract,
 - D. Agreement providing that a specific number of nationals of the boycotting country will sit on the board of directors,
 - E. Agreement specifying that nationals of the United States or any other country will be employed on the project or that a particular percentage of the employees on a particular project will be nationals of the boycotting country,
 - F. Agreement that goods destined for a boycotting country will not be shipped on board a vessel owned, leased, operated, or chartered by a boycotted country national or that such vessel will not call at the ports of a boycotted country in

- route to the boycotting country (this exception is based on the risk of loss or confiscation of the goods),
- G. Agreement that shipment of goods will occur on a particular vessel, or vessels of a particular country.
3. The following are subject to a penalty:
- A. Agreement to refrain from doing business with a blacklisted U.S. company (whether or not that company engages in trade with a boycotted country),
 - B. Agreement to refrain from doing business with a blacklisted U.S. company as a condition of doing business in a non-boycotting country at the request of a boycotting country,
 - C. Agreement to pick subcontractors for a boycotting country project from a whitelist (a list excluding blacklisted companies),
 - D. Agreement to refrain from doing business based on the race, nationality, or religion of the company's ownership or management,
 - E. Agreement by a company to provide a certificate stating that its board of directors does not contain any boycotted country nationals,
 - F. Agreement to refrain from employing individuals of a particular religion,
 - G. Agreement not to ship goods on a blacklisted ship or, generally, on a ship owned, leased, or operated by a government, company, or national of a boycotted country.
4. Where there is no agreement, actual adherence to the terms of a boycott will not constitute an agreement to participate in an international boycott. This distinction is fine, but critical. For example, penalties apply to the agreement to provide a certificate of national origin or ethnicity, not the mere provision of such information. See Treasury Guidelines referred to in text 4.61.6.5, Sources of Information, for specific examples.

4.61.6.5 (05-01-2006)

Sources of Information

1. The Treasury Guidelines provide detailed interpretations of the law. The Guidelines are in the Federal Register (look under the topic "Treasury" on the following dates: 1/25/78, for the original guidelines; 11/19/79, for supplemental guidelines; and 4/26/84, for additional guidelines). The guidelines are also available in compilations such as CCH, Standard Federal Tax Reports, in the notes under IRC section 999 and BNA (Tax Management) Portfolio 345.
2. Besides the Treasury Guidelines, other sources of information on boycott law include:
 - A. IRC section 999 and the related Treasury Regulations
 - B. Form 5713, Supporting Schedules A, B, and C, and the accompanying instructions
 - C. International Issues Training Publications
 - D. Booklets explaining exporting practices and letters of credit that are available from the international departments of commercial banks
 - E. Articles from business and legal magazines on boycott-related matters listed in the Business Periodicals Index, available in most libraries and the Legal Periodicals Index, available in law libraries

- F. Outside publications, such as *The Shipping Digest* and *Dunn and Bradstreet's Exporters' Encyclopedia World Marketing Guide*
3. Letters of credit also frequently contain boycott provisions. IEs unfamiliar with letters of credit should consider reviewing a business law textbook or banking treatise before undertaking boycott related audit procedures.
 4. Enforcement of IRC 999 is complex due to the lack of uniformity among boycotting countries' laws. The documents required for exporting to one boycotting country may differ from those required by another boycotting country. Publications such as *The Shipping Digest* and *Dunn and Bradstreet's Exporters' Encyclopedia World Marketing Guide* explain the domestic laws of each boycotting country and the document requirements for exporting to each country. These sources may also suggest the location of boycott related agreements.

4.61.6.5.1 (05-01-2006)

Audit Techniques

1. An IE undertaking a boycott examination will determine the extent of taxpayer activity in boycotting countries and obtain copies of all agreements. Boycotting activity includes sales, services and purchases.
2. Review the following forms to decide the extent of the taxpayer's operations and the foreign countries involved:
 1. Form 5713 (*International Boycott Report*)
 2. Form 1118 (*Foreign Tax Credit*)
 3. 1120-FSC or ETI return(*Foreign Sales Corporation Return*)
3. Compare the 1118 and 1120-FSC (or ETI return) with the 5713 to identify omitted transactions.
4. Identify controlled foreign corporations with reportable boycott operations by reviewing Forms 5471 (*Information Return of U.S. Persons with Respect to Foreign Corporations*). Match the CFCs with the names of the U.S. shareholders who should file a Form 5713.
5. Review sales records to and from boycotting countries (invoices, customer orders and contracts, bills of lading, letters of credit, etc.) to find boycott agreements.
6. In cases involving taxpayers with operations in more than one boycotting country, the IE may initially scrutinize transactions involving the boycotting country with the greatest potential.
7. If the examination reveals boycotting activity, the IE must be sure that the factual situation is considered a boycott under the Treasury Guidelines.
8. In instances where the factual situation does not coincide with a published Treasury Guideline, the IE should refer to IRM 4.60 for procedures about obtaining a boycott determination from the National Office.
9. Use the table below, Identification of Boycott Participation, to determine referral or non-referral for fraud.

Identification of Boycott Participation

If	And	Then
Boycott participation is identified	A fraud referral is appropriate	See text 9.6, Filing Requirements, for referral procedures.
	A fraud referral is NOT appropriate	1. Advise taxpayers of their responsibility to compute boycott factor and tax effect on schedules A through C of Form 5713. 2. Determine if technical advice should be requested.

10. Once an IE establishes that the taxpayer participates in or cooperates with any international boycott, there arises a presumption that the taxpayer participates in or cooperates with international boycotts with respect to all other boycotting countries. This presumption disappears when the taxpayer demonstrates that a particular operation is a clearly separate and identifiable operation [see IRC section 999(b)(1) and (2) and Treasury Guidelines, Section D]. The burden of proof rests with the taxpayer to establish that its operations in other boycotting countries are clearly separate and identifiable operations from the operation in the boycotting country.

4.61.6.5.2 (05-01-2006)

Other Sources of Information

1. The Associate Chief Counsel (International) issues boycott determinations under Rev. Proc. 77-9. These determinations are useful as a direct source of information concerning the nature of a taxpayer's business operations. They show whether specific operations constitute boycott participation.
2. Historical files of previous examinations provide considerable information regarding a taxpayer's previous operations in boycotting countries and the extent of previous determinations regarding boycotting activities. Comparing current Forms 5713 with those filed in previous years would indicate whether there has been any change in the taxpayer's business practices that may occur because of an agreement.
3. Copies of the corporate minutes and of meetings involving stockholders and the Board of Directors may indicate whether the subject of boycotting was ever discussed.
4. Annual reports disclose items materially affecting income or assets. Consequently, these reports may contain reference to boycotting operations and the existence of agreements if there is significant boycotting activity.
5. Company policy and operational manuals may contain directives for dealing with boycotting countries. These documents would be helpful in determining the likelihood of boycott participation.
6. Regulatory Reports submitted to the Securities and Exchange Commission (SEC) can provide information regarding boycott activity. The IE will review all material filed with the SEC, such as *Forms 10-K, 10-Q, 8-K, and 8-Q*, to see if the taxpayer has operations in a boycotting country. These SEC reports indicate the locations of CFCs and whether or

not transactions occur in or with boycotting countries. The SEC reports and the Schedule M-1 adjustments may reflect fines levied against the taxpayer by the Commerce Department for failure to file a report of boycott activities.

7. Department of Commerce reports, if required, include the following:
 - A. Form DIB 621 P "Report of Request for Restrictive Trade Practice or Boycott (Multiple Transactions)" — a quarterly report — which summarizes boycott requests
 - B. Form ITA 621 P "Report of Request for Restrictive Trade Practice or Boycott (Single Transactions)" which reports individual boycott requests
8. These reports reflect violations of the Export Administration Act. Any such violation is a good indication that the boycotting penalties may apply due to similarities in the laws.

4.61.6.5.3 (05-01-2006)

Documentation Requests

1. Use Form 4564 (*Information Document Request*) for obtaining all pertinent records. Reg. 1.964-3 requires U.S. shareholders of CFCs to give the Service books and records (in English) within a reasonable time. Guidelines to secure books and records from CFCs appear at Exhibits 4.61.2-1 and 4.61.2-2.
2. Pertinent documents include:
 - A. Purchase orders from customers and attachments, if any, which identify all of the conditions of purchase,
 - B. Sales contracts and agreements relating to business in or with the boycotting countries,
 - C. Acknowledgment documents concerning purchase and sales agreements,
 - D. Information (normally found in separate correspondence files) incidental to contracts or agreements, such as memoranda of negotiation, letters of understanding, bidding statements, etc.,
 - E. Letters of credit, bills of lading, and the applicable invoices,
 - F. Boycott certificates furnished to customers, suppliers, banks, shipping companies, and others that do not appear on the sales invoice,
 - G. Shipping invoices,
 - H. Rejected purchase orders, with attachments, if any, involving customers in a boycotting country and copies of foreign correspondence rejecting the sales,
 - I. Boycott requests and/or agreements (See Exhibit 9-1 for an example),
 - J. Correspondence with the Department of Commerce may indicate whether the taxpayer participates in any boycott related matters,
 - K. Commission agreements with persons or firms from boycotting countries and commission expense invoices,
 - L. Invoices of sizable legal expenditures may identify legal advice obtained on boycott matter,
 - M. Documentation supporting travel and entertainment expenses may reveal business trips to boycotting countries.
3. Written responses to the following inquiries will help in the development of a boycott case.

Note:

All questions may not apply.

- A. Unanswered or incomplete items appearing on Form 5713,
- B. Activities undertaken during visits to any of the boycotting countries by any officers or employees of the company,
- C. Written statements from sales representatives regarding sales policies and procedures for dealing with both boycotting and boycotted countries,
- D. Detail of any employee being denied visas by boycotting countries.
- E. Has the taxpayer ever been on a blacklist? If yes, has the taxpayer managed to get off the blacklist? What are the conditions of delisting?
- F. Is there a system of internal control requiring the reporting of all boycott requests to management? Are there standard procedures for handling such requests?
- G. Is the taxpayer presently being investigated by the Department of Commerce for boycott participation? Does the taxpayer have any knowledge of any imminent boycott investigations?
- H. Has the taxpayer had an export license denied, revoked or suspended?
- I. Has the taxpayer ever been the subject of a boycott-related investigation by the U.S. Department of Justice or Department of Commerce? The IE can also obtain this information by following the procedures for requesting information from other Government agencies.
- J. Some countries frequently require the completion of a questionnaire as a condition of doing business (see, e.g., the Arab Chamber of Commerce Questionnaire at Exhibit 9-1). IEs should request copies of both the requesting letter and the completed questionnaire.

4.61.6.6 (05-01-2006)**Filing Requirements**

1. IRC section 999(a) requires the following persons to file a Form 5713 (*International Boycott Report*):
 - A. Any person or a member of a controlled group with operations in or related to a country on the list of countries identified by the Treasury Department, and
 - B. Any person with operations in a non-listed country that requires participation in or cooperation with an international boycott as a condition of doing business with such country
2. If a Form 5713 is part of the return, proceed with the audit techniques described in text 9.4.1 of this handbook and remain alert to the possibility of a fraudulent Form 5713. If the Form 5713 is fraudulent, the IE will follow the procedures for referring the case to the Criminal Investigation Division.

4.61.6.6.1 (05-01-2006)

Failure to File the International Boycott Report Form 5713

1. When a required Form 5713 is not part of the return, the IE should determine the reason for the failure to file and whether this constitutes a willful omission. In cases where no willfulness is involved, the IE should solicit the delinquent Form 5713 and continue with the examination. No solicitation of Form 5713 is to occur in cases where the failure to file is willful; the IE will refer the case to the Criminal Investigation Division.
2. IRC section 999(f) provides that any person who willfully fails to make a report will, in addition to other penalties provided by law, be fined not more than \$25,000, imprisoned for not more than one year, or both.

4.61.6.7 (05-01-2006)

Boycott Computations

1. If boycott participation or cooperation has occurred, any or all of the following three tax adjustments could apply:
 - A. Denial of the foreign tax credit
 - B. Loss of FSC(or ETI) benefits
 - C. Loss of deferral of CFC income
2. The two methods used to determine the amount of any lost benefits are:
 - A. International Boycott Factor (IBF), and
 - B. Specifically Attributable Taxes and Income Method (SATIM)
3. According to the Conference Committee Reports, the IBF is for use by taxpayers who cannot clearly separate boycott and non-boycott operations. The taxpayer has the option of computing any lost tax benefits under either the IBF or SATIM methods. The taxpayer must explicitly choose between the methods. See Reg. 7.999-1(c) for details on computing the IBF.

4.61.6.7.1 (05-01-2006)

Computation of the International Boycott Factor (IBF)

1. Computing the IBF numerator requires the following information:
 - A. Purchases made from all boycotting countries
 - B. Sales made to or from all boycotting countries, and
 - C. Payroll paid or accrued for services performed in all boycotting countries
2. Computing the IBF denominator requires the following information:
 - A. Purchases made from any country other than the United States
 - B. Sales made to or from any country other than the United States, and
 - C. Payroll paid or accrued for services performed in all non-boycotting countries
3. The definitions for purchases and sales in 7.999-1 (b)(7) for the IBF include the use or right to use property. The right to use property includes leasing and financing activities. Calculate purchases and sales using the cash basis method of accounting. Calculate

wages using payroll paid and accrued (even though this creates the possibility that some payments are in multiple penalty computations).

Example:

A company with branches in two boycotting countries will have every inter-branch transaction classified as both a purchase and a sale.

4. The regulations provide that a transaction that is a sale to a country is not also a sale from a country in computing the numerator of the IBF. There is no similar restriction in the denominator of the IBF.

4.61.6.7.2 (05-01-2006)

Specifically Attributable Taxes and Income Method (SATIM)

1. Under SATIM, the taxpayer must clearly show the foreign taxes paid and income earned for the taxable year that are attributable to specific boycott operations. Treasury Guideline F-6 provides that the taxpayer must clearly demonstrate that the foreign taxes paid and income earned are attributable to specific operations. Adequate evidence involves the analysis of the profit and loss data of each separate and identifiable transaction.

Exhibit 4.61.6-1 (05-01-2006)

Sample Letter from Boycotting Country with Standard Questionnaire

Dear Sirs:

SUBJECT: *ISRAEL BOYCOTT RULES & REGULATIONS*

You are kindly requested to complete the enclosed questionnaire in duplicate and have both copies legalized by the chamber or union of commerce or industry or similar organization or concerned boards or Arab/foreign chamber of commerce and duly attested by the Iraqi commercial attache or his representative in the Iraqi diplomatic service or consular or commercial representative, and return to us as soon as possible.

This arrangement shall facilitate for you the immediate presentation of your shipping documents (consisting of the invoices and bills of lading only) to the bank at your end for collection of amounts due to you without having to await the legalization formalities of the documents in conformity with the Israel boycott rules and regulations.

We appreciate early responses.

With kind regards,

Yours faithfully

Head of Materials and Purchasing
NORTHERN PETROLEUM ORGANIZATION

Standard Questionnaire:

1. Do you have now or ever have had a branch or main company, factory or assembly plant in Israel or have you sold one to Israel?
2. Do you have now or ever have had general agencies or offices in Israel for your Middle Eastern international operations?
3. Have you ever rented the right of using your name trademarks, royalty, patent, copyright or that of any of your subsidiaries to Israeli persons or firms?
4. Do you participate in or own or have you ever participated in or owned shares in an Israeli firm or business?
5. Do you render now or have you ever rendered any services or technical assistance to any Israeli firm or business for consideration?
6. Do you represent now or have you ever represented any Israeli firm or business in Israel or abroad?
7. What companies in whose capital are you shareholders? Please state the name and nationality of each company and the percentage of share to their total capital.
8. What companies are shareholders in your capital? Please state the name and nationality of each company and the percentage of share to your total capital.
9. The above questions should be answered on behalf of the company itself, and of all the branch companies, if any.

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