§ 8:1 Violation of FCPA

§ 8:1.1 The Accounting Provisions

The civil remedies and penalties for a violation of the accounting provisions by issuers are those available to the SEC under the general enforcement authority for a violation of the federal securities laws.1

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§ 8:1 Violation of FCPA

§ 8:1.1 The Accounting Provisions

The civil remedies and penalties for a violation of the accounting provisions by issuers are those available to the SEC under the general enforcement authority for a violation of the federal securities laws.1

1. 15 U.S.C. § 78u (Supp. 2006). When the SEC seeks civil penalties, it is subject to a five-year statute of limitation pursuant to 28 U.S.C. § 2462. In Gabelli v. SEC, 568 U.S. 133 (2013), the U.S. Supreme Court held that the statute of limitations period begins to run when the fraud occurs, not when it is discovered. However, the statute of limitations period may be delayed if the defendant is not physically within the United States during this period. 28 U.S.C. § 2462. United States v. Straub, 11 Civ. 9645 [RJS] (S.D.N.Y. Feb. 8, 2013). In addition, the statute of limitation period is not applicable to equitable relief, including disgorgement of profits. See A Resource Guide to the U.S. Foreign Corrupt Practices Act, issued by the Criminal Division of the DoJ and the Enforcement Division of the SEC.
This includes authority to seek injunctive relief, cease and desist orders, and the imposition of civil fines. The SEC also has the authority to institute administrative proceedings and to fashion remedies in administrative proceedings, including the authority to issue cease and desist orders, to impose civil penalties, and to order an accounting or disgorgement.

The SEC has, in recent settlements of enforcement actions, required the disgorgement of profits plus the payment of prejudgment interest.
A violation of the accounting provisions may be subject to criminal sanctions under the general criminal penalty provision of the Exchange Act. Under this provision, a violation would be subject to a
maximum fine of $5 million and/or imprisonment of not more than twenty years\textsuperscript{6} for individuals, and a maximum fine of $25 million for organizations.

The Exchange Act’s general criminal penalty provision\textsuperscript{7} states in relevant part:

Any person who \textit{willfully} violates any provision of this chapter. . . , or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who \textit{willfully and knowingly} makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement . . . , which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $5,000,000, or imprisoned not more


\textsuperscript{7} Id. Unlike the accounting provisions, the bribery section of the FCPA is a criminal statute and separately provides for penalties and sanctions for violation of the foreign payment provisions. See infra section 8:1.2.
than 20 years, or both, . . . ; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.\(^8\)

Notwithstanding section 78ff(a), the 1988 Amendments provided for criminal liability for a violation of the accounting provisions where a person "knowingly circumvent[s] or knowingly fail[s] to implement a system of internal accounting controls or knowingly falsif[ies] any book, record, or account. . . ." \(^9\)

The legislative history to the 1988 Amendments regarding the addition of the "knowingly" requirement specifies that "[i]t is not intended that the use of the term 'knowingly' . . . affect the general requirement that criminal violations of the 1934 Act be 'willful.'"\(^10\) While this statement is less than clear, it indicates that Congress intended the standard for a criminal violation of section 13(b)(2) to therefore encompass both "willful" and "knowing" conduct.\(^11\)

Whether the addition of the "knowingly" requirement makes any significant substantive change is less than clear. The addition of "knowingly" to the second clause of section 78ff(a) suggests some distinction between the meaning of the terms "willful" and "knowing," at least in the context of the Exchange Act's general penalty provision.\(^12\)

A commentator, writing at the time of the Exchange Act's enactment, suggested that the addition of "knowingly" in the second clause of section 78ff(a) requires a finding that the alleged violator had knowledge of the precise illegality of the act in question, as opposed to a mere general awareness that he was doing a wrongful act [which would be required for "willful" conduct].\(^13\) Under this definition, "knowingly" would require a finding that the defendant had actual knowledge of the false or misleading character of the statement made by him.\(^14\)

\(^8\) Id. [emphasis added].
\(^9\) 15 U.S.C. § 78m(b)[4], [5].
\(^10\) S. REP. NO. 99-486, at 9 [1986].
\(^11\) No corresponding change was made to SEC Rules 13b2-1 and 13b2-2. Accordingly, a criminal violation of these rules would require a finding that the defendant acted "willfully," or in the case of a false or misleading filing, "willfully and knowingly," under 15 U.S.C. § 78ff(a).
\(^13\) Herlands, supra note 12, at 148–49. See discussion supra, chapter 4, notes 124–130 and accompanying text.
\(^14\) Id. at 149.
Nevertheless, “willfully” has been interpreted to include some element of knowledge. For example, in United States v. Peltz, the court held that the mental state that must be proved to establish a “willful” violation is

a realization on the defendant’s part that he was doing a wrongful act . . . that the act be wrongful under the securities laws and that the knowingly wrongful act involve[d] a significant risk of effecting the violation that has occurred.

In United States v. Reyes and Jensen, the Ninth Circuit rejected the assertion that a knowing falsification of the books and records required knowledge of the securities laws being violated or was intended to connote a higher scienter requirement than willfully. Rather, the defendant need only knowingly commit the act of falsification.

While it may be argued that “knowingly” requires a greater level of awareness on the part of the defendant of the wrongfulness or illegality of his conduct, the case law is far from clear on this issue.


17. 577 F.3d [1069] [Nov. 5, 2009].

§ 8:1.2 The Bribery Provisions

The bribery section of the FCPA is a criminal statute.\(^{19}\) The bribery section provides maximum penalties and sanctions per each violation of the Act by individuals and corporations or other legal entities. Violation by a U.S. entity carries a maximum fine of $2 million per violation.\(^{20}\) However, where the offense results in pecuniary gain or loss, the provisions of 18 U.S.C. § 3571(d) provide an alternative statutory maximum fine: the greater of twice the gross gain or twice the gross loss. Violations by individuals carry a maximum fine of $250,000 or up to twice the amount of the gross gain or loss that any person derived from the offense,\(^{21}\) or imprisonment of not more than five years,\(^{22}\) or both.\(^{23}\)

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22. On April 19, 2010, Charles Paul Edward Jumet, a former executive of Ports Engineering Consultants Corporation, was sentenced to the longest term of incarceration ever imposed in an FCPA case—eighty-seven months. Department of Justice Press Release [Apr. 10, 2010], www.justice.gov/opa/pr/2010/April/10-CRM-442.html. This record term of incarceration was surpassed one year later. On October 25, 2011, Joel Esquenazi, the former President of Terra Telecommunications Corp., received a sentence of fifteen years in prison for his role in a scheme to pay bribes to Haitian government officials. This sentence constitutes the longest period of incarceration for a defendant found to have violated the FCPA. Department of Justice Press Release [Oct. 25, 2011], www.justice.gov/opa/pr/2011/October/11-crm-1407.html.
23. 15 U.S.C. §§ 78ff(c)(2)(A), 78ff(c)(2)(B), 78dd-2(g)(2)(A), 78dd-2(g)(2)(B). The FCPA has a five-year statute of limitations. 18 U.S.C. § 3282. See Resource Guide, at 35. In FCPA investigations, the government may be able to utilize the extended statute of limitations period, up to three years, to enable it to obtain evidence located outside the United States. 18 U.S.C. § 3292. The rationale for the extended tolling is that obtaining foreign evidence, such as transaction records, often involves a process that is cumbersome and may have delays beyond the government’s control. If a trial court approves the request by the government to obtain evidence that “reasonably appears” to be in the foreign country, then the government may have an extension period of up to three years. In United States v. Kozeny, 493 F. Supp. 2d 693, 714 (S.D.N.Y. 2007), the Southern District of New York issued a rare and first impression opinion on the statute of limitations, dismissing all counts of an indictment for violations of the FCPA, because the government did not move to “suspend the running of the statute of limitations until after it had expired.” However, on reconsideration, the court reinstated three counts where it appeared that illegal conduct occurred within the limitation period. The court held that if violations are performed within the limitations period, then the prosecutors can reach back further to cover conduct that transpired before those acts. In Kozeny, the court let some counts stand because at least some of the conduct that was alleged to be part of the violation occurred during the limitations period.
Within the limitations of the statutory maximum, the determination of the amount of the fine is now governed by the Federal Sentencing Guidelines. These Guidelines took effect with regard to individuals on November 1, 1987, and apply to all offenses committed by individuals on or after that date. On November 1, 1991, the United States Organizational Sentencing Guidelines became effective, and apply to offenses committed by corporations and other organizations on or after that date.

One effect of the application of the Guidelines is generally to raise the fines and sentences imposed for white collar crimes, including violations of the FCPA. The manner of ascertaining the penalty is also more closely aligned to the amount of the money involved in the bribe or the gain resulting from the bribe. The Sentencing Guidelines require the individual or the corporation to make restitution or take other action to remedy the harm that has occurred and to prevent future injury from the violators. In addition to restitution, the Sentencing Guidelines require that a mandatory fine be imposed upon a corporation and individual.

For individuals, the sanctions are determined by a variety of factors including the base offense level, the characteristics of the offense, including the value of the bribe or the benefit to be conferred; the

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24. See United States Sentencing Commission, GUIDELINES MANUAL § 8C3.1 (2012) [hereinafter GUIDELINES MANUAL], available at www.ussc.gov/guidelines/manual_pdf/Chapter_8.pdf. However, where the organization is convicted of multiple counts, the maximum fine authorized by statute will increase accordingly.

25. See id. § 2B4.1.

26. Id. at ch. 1, pt. A, intro. comment. However, in United States v. Booker, 543 U.S. 220, 125 S. Ct. 738 (2005), the Supreme Court determined that the Federal Sentencing Guidelines violated the Sixth Amendment’s guarantee to a trial by jury, as they allowed judicial (rather than jury) fact-finding to form the basis for sentencing. The Court therefore held that the appropriate remedy was to make the guidelines advisory rather than mandatory.

27. Id. at ch. 8, intro. comment.

28. “Organizations” means a person other than an individual. The term includes corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions thereof, and non-profit organizations. GUIDELINES MANUAL, supra note 24, § 8A1.1.

29. Id. § 2C1.1(d)(v).

30. See id. §§ 2C1.1(a), 5E1.2(a), (c).

31. A violation of the bribery provision of the FCPA is placed in the same category as the domestic bribery offense, at a base level of 12. Id. § 2C1.1. Willful violation of the accounting provisions is placed under the fraud and deceit category at a base level of 6. Id. § 2B1.1.
individual’s role in the activity; and the defendant’s criminal history.\textsuperscript{32} For corporations, the sentencing factors include the base offense level; the greater of the value of the unlawful payment, the benefit to be received, or the consequential damages resulting therefrom;\textsuperscript{33} prior misconduct;\textsuperscript{34} the existence of an effective compliance program to prevent violations;\textsuperscript{35} the voluntary disclosure of the offense by the organization; the extent of cooperation in an investigation; and the acceptance of responsibility for the conduct.\textsuperscript{36}

In addition to criminal penalties, the Act also authorizes civil fines. For violations by an issuer, the SEC may bring a civil action to impose a civil penalty against a corporation, or any officers, directors, employees, agents or stockholders acting on behalf of the issuer in an amount up to $10,000.\textsuperscript{37} The SEC can also bring a civil action to enjoin any act or practice of an issuer (or an officer, director, employee, agent, or stockholder acting on its behalf) that is or may be violative of the FCPA.\textsuperscript{38} For violations by other domestic corporations, or any officer, director, employee, agent or stockholder acting on its behalf, the Department of Justice is authorized to institute a civil action for fines up to $10,000.\textsuperscript{39} In addition, the Department of Justice has civil injunctive and subpoena power with respect to domestic concerns.\textsuperscript{40}

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\textsuperscript{32} See id. On October 25, 2011 Joel Esquenazi, former president of Terra Telecommunications Corp., was sentenced to 180 months in prison, the longest prison term ever imposed under the FCPA. See Department of Justice Press Release [Oct. 25, 2011], available at www.justice.gov/opa/pr/2011/October/11-crm-1407.html. This sentence came just six months after Charles Jumet, a former executive of Ports Engineering Consultants Corp., was sentenced to a then-record term of eighty-seven months in April 2010. See Department of Justice Press Release [Apr. 10, 2010] available at www.justice.gov/opa/pr/2010/April/10-CRIM-442.html.

\textsuperscript{33} See id. §§ 8C2.1, 2C1.1[c].

\textsuperscript{34} Id. § 8C2.5[c].

\textsuperscript{35} Id. § 8C2.5[f].

\textsuperscript{36} Id. § 8C2.5[g].


\textsuperscript{39} 15 U.S.C. § 78dd-2[g][1][B].

\textsuperscript{40} Id. § 78dd-2[d].
Fines imposed upon individuals, for either criminal or civil penalties, may not be paid by the corporation.\textsuperscript{41}

Recent FCPA enforcement actions have seen the imposition of substantial criminal and civil penalties. The combined enforcement actions of the Department of Justice and the SEC against Siemens AG and three of its subsidiaries resulted in criminal and civil fines totaling $800 million, the largest settlement in FCPA history. Several months later, the Department of Justice and SEC once again combined to make history, this time producing the largest FCPA settlement ever paid by a U.S. company. The Texas-based company Halliburton, and its former subsidiary Kellogg Brown & Root LLC, agreed to pay a combined fine of $579 million.\textsuperscript{42} At the same time, the Department of Justice has entered into Deferred Prosecution and Non-Prosecution Agreements with corporate defendants in numerous enforcement actions.\textsuperscript{43} Recently, the SEC entered into its first

\begin{itemize}
\item \textsuperscript{41} Id. § 78ff(c)(3).
\end{itemize}
Deferred Prosecution Agreement\textsuperscript{44} and first-ever Non-Prosecution Agreement.\textsuperscript{45}

\section*{\textbf{§ 8:2} Ineligibility for Government Programs}

In addition to the possibility of criminal and civil sanctions and fines, a violation of the bribery provisions of the FCPA by a U.S. company can have serious ramifications with regard to its eligibility for certain U.S. government programs. The adverse impact on eligibility can have a far greater commercial and financial effect upon a company than the fines and penalties assessed for a violation of the FCPA. An indictment alone can lead to the suspension of export licensing privileges for defense articles or services, or the suspension/debarment of participation in U.S. government procurement activity.

We summarize some of these collateral areas below.

\textsuperscript{44} The SEC entered into a Deferred Prosecution Agreement with Tenaris S.A. arising from allegations of bribing Uzbekistan officials. The agreement, intended to reward cooperation in SEC investigations, is available at www.sec.gov/news/press/2011/2011-112.htm. The SEC has continued to utilize deferred prosecution agreements. \textit{See}, \textit{e.g.}, United States v. Pfizer H.C.P. Co., No. 12-CR-169 \textit{(Aug. 2012)} [SEC entered into a deferred prosecution agreement with corporation to pay over $26 million in disgorgement and prejudgment interest].

\textsuperscript{45} The SEC entered into a Non-Prosecution Agreement with Ralph Lauren Corporation in which the corporation agreed to disgorge over $700,000 in illicit profits and interest obtained in connection with bribes paid by a subsidiary to government officials in Argentina from 2005–2009. The agreement is available at www.sec.gov/news/press/2013/2013-65.htm.
§ 8:2.1 U.S. Government Procurement

The Federal Acquisition Regulations (FAR), 46 which comprise the regulatory framework for U.S. government procurement, provide for the suspension or debarment of a contractor or subcontractor from continuing to do business with the U.S. government if it engages in certain improper conduct. One of the grounds for suspension or debarment is the commission of bribery. 47

A party can be suspended upon adequate evidence of the commission of a bribe. An indictment under the FCPA has provided the basis for such a suspension. 48 Suspension is intended as a temporary exclusion from government contracting pending completion of an investigation or legal proceeding. 49 A party can be debarred upon the criminal conviction of or civil judgment for the commission of bribery.

A decision to suspend or debar a company is discretionary and essentially concerns an assessment of the contractor’s character and integrity. Remedial measures taken by the company and other mitigating factors will also be taken into account in making such a determination. 50

It is also theoretically possible that a foreign company that engages in bribery abroad, even though it may not be subject to the FCPA, may be subject to suspension or debarment under the FAR. Since the decision to suspend a party is essentially a statement of the contractor’s character/integrity, illicit payments made by a foreign company to foreign officials abroad could provide a basis for a suspension decision against the foreign company. This could be the case whether or not the bribe would be a crime under U.S. law, or even if the foreign bribe was

46. 48 C.F.R. ch. 1 [2008].
47. 48 C.F.R. § 9.406-2[a][3] [2012]. The reference to “bribery” does not refer to the violation of any specific law or regulation.
48. For example, Harris Corporation was suspended for authorizing its consultant to pay a portion of his commission to a foreign official. See supra note 5.
49. If legal proceedings are not initiated within twelve months after the date of suspension notice, the suspension must be terminated except in the case of an extension [up to six months] by the Assistant Attorney General. See 48 C.F.R. § 9.407-4[b] [2008]; Frequency Elecs., Inc. v. U.S. Air Force, 151 F.3d 1029 [4th Cir. 1998] (applying eighteen-month maximum debarment unless legal proceedings are initiated).
50. See 48 C.F.R. § 9.406-1[a] [2012]. For example, in United States v. Siemens AG, No. 08-367 [D.D.C. 2008], the corporation only pled guilty to criminal violations of the FCPA’s internal controls and books and records provisions. It avoided a plea against bribery charges in part due to its “uncommonly sweeping remedial actions,” such as replacing all of its top leadership and expanding its compliance organization.
not discovered or prosecuted by foreign authorities. A foreign bribery conviction could also provide the basis for debarment if it provided a basis to conclude that the foreign contractor lacked integrity. As a practical matter, such action is unlikely absent a violation of some U.S. law or regulation, or unless the matter is of such a nature as to create significant political pressure for some action.

In addition to the possible suspension or debarment from U.S. government procurement under the FAR, other government agencies also have specific provisions that provide for suspension or debarment, or other sanctions, for a violation of the FCPA. For example, the conviction for a violation of the FCPA that is related to a project supported by the Overseas Private Investment Corporation (OPIC) may result in the denial of an insurance payment and the suspension from eligibility for OPIC services. Moreover, the indictment or conviction for bribery or any offense that indicates a lack of business integrity can result in the suspension or debarment of a party for federal financial and nonfinancial assistance and benefits. The suspension or debarment by one agency generally has government-wide effect. A person debarred or suspended by any federal agency may therefore be excluded from federal financial and nonfinancial assistance and benefits by other federal agencies.

§ 8:2.2 Export Licenses for Defense Articles

The Arms Export Control Act (AECA) authorizes the President to control the import and export of defense articles and defense services. Under the AECA, if an applicant for a license to export is subject to an indictment for a violation of the FCPA, the President may disapprove the application. If the applicant has been convicted of a violation, a license to export a defense article or defense service may not be issued, except as may be determined on a case-by-case basis.

The International Traffic in Arms Regulations (ITAR) implement the AECA. The authority under the statute has been delegated to the

51. 22 C.F.R. § 709 [2012].
52. See, e.g., 2 C.F.R. ch. VII, pt. 780 [Agency for International Development].
56. Id. § 2778[g][3] and [g][1][A][vi].
57. Id. § 2778[g][4] and [g][1][A][vi].
58. 22 C.F.R. § 120 [2012].

(Zarin, Rel. #1, 10/14) 8–13
State Department.\(^59\) The defense articles and services subject to the ITAR are set forth in the U.S. Munitions List.\(^60\)

The ITAR\(^61\) provide for the suspension, revocation, amendment or denial of an export license whenever an applicant is the subject of an indictment for a violation of the FCPA, or has been convicted of a violation of the FCPA.\(^62\)

The practice of the Department of State has generally been to automatically disapprove an export license application of any company indicted under the FCPA.\(^63\) In such instances, an export license application will be approved, on a case-by-case basis, only if there is an overriding foreign policy or national security reason to do so.\(^64\)

In some instances, the suspension may apply only to the offending division or subsidiary.\(^65\) In other instances, the suspension may be applied to the parent entity as well as the subsidiary that violated the FCPA.

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59. On April 11, 2013, 22 C.F.R. § 120.1(a) was amended to read: “[a] Section 38 of the Arms Export Control Act [22 U.S.C. 2778], as amended, authorizes the President to control the export and import of defense articles and defense services. The statutory authority of the President to promulgate regulations with respect to exports of defense articles and defense services was delegated to the Secretary of State by Executive Order 13,637. This subchapter implements that authority. By virtue of delegations of authority by the Secretary of State, these regulations are primarily administered by the Deputy Assistant Secretary of State for Defense Trade and Regional Security and the Managing Director of the Directorate of Defense Trade Controls, Bureau of Political-Military Affairs.” 78 FR 21523-01.

60. 22 C.F.R. § 121 (2012).

61. 22 C.F.R. § 126.7(a) (2012).

62. See 22 C.F.R. § 126.7[a][3] and [4], § 120.27[a][6] (2012).

63. For example, Lockheed was barred indefinitely from exporting its C-130 Hercules aircraft as a result of charges that the company bribed an Egyptian official. This had the effect of undermining its $1.6 billion bid to supply the United Kingdom with replacement transport aircraft. See Fin. Times (Aug. 26, 1994).

64. In the wake of the corruption related settlement by BAE Systems plc for conspiracy to make false statements to the U.S. government and pay a fine of $400 million (DOJ Press Release No. 10-209, March 1, 2010), the U.S. State Department proposed a freeze on export licenses for products made by, or products with components made by BAE and its U.S. subsidiary. On March 9, 2010, the State Department modified the freeze by allowing new licenses for BAE products that support the war efforts in Iraq and Afghanistan or related to existing programs for allied countries. Nevertheless, the freeze on BAE-related export licenses illustrates the potential collateral consequences a company may face as a result of an anti-bribery investigation, even if the DOJ plea agreement does not contain substantive FCPA violations.

65. Id.
While the export privileges of the company may be reinstated, this generally requires an extensive interagency review regarding the circumstances surrounding the indictment or conviction and a finding that appropriate steps have been taken to mitigate the enforcement concerns.\textsuperscript{66}

It can, therefore, take a considerable period of time, even in the best of circumstances, to regain export licensing privileges in the event of an indictment or conviction under the FCPA. For companies that require export licenses for some or all of their business operations, the adverse commercial ramification from a loss of export licensing privileges can be far more substantial than the penalties and fines imposed under the FCPA.\textsuperscript{67}

\section*{§ 8:3 Tax Consequences\textsuperscript{68}}

Congress was sensitive to the fact that the prohibition in the FCPA on the bribery of foreign officials would be weakened if an illicit payment could be taken as a deductible business expense or U.S. taxes otherwise could be reduced through the payment of a bribe. To address these concerns, Congress included in the Internal Revenue Code (Code) provisions to (1) deny deductions for payments to officials or employees of a foreign government if such payments are unlawful under the FCPA, and (2) require that payments made by certain foreign subsidiaries of U.S. companies be treated as taxable income to the U.S. company where such payments, if made by a U.S. corporation, would

\begin{footnotesize}
\begin{enumerate}
\item See 22 U.S.C. § 2778(g)(4) [Supp. 2006]. The Department of State has applied this same standard to the reinstatement of export privileges for indictments.
\item See also 22 C.F.R. § 126.7(a)--(b), which provides for the disapproval of a license where any party to the export, any manufacturer of the defense article or service or any person who has a significant interest in the transaction has been debarred or suspended under the ITAR, 22 C.F.R. § 127.1(c), which prohibits a person who knows that a party is suspended or debarred under the ITAR from purchasing for export any defense article or service from such person. The Contractor’s Certification and Agreement with Defense Security Assistance Agency requires, for any defense articles or services sold under the Foreign Military Sales program, the certification that the contractor is not suspended or debarred from conducting business with the U.S. government, that export privileges are not suspended or revoked, and that no suspended or debarred firm will be used as a source of supplies or as a subcontractor. Guidelines for Military Financing of Direct Commercial Contracts, issued by the Defense Security Cooperation Agency [Aug. 2001].
\item Ronald S. Cohn, a former tax partner in Dechert Price & Rhoads, contributed to this section.
\end{enumerate}
\end{footnotesize}
have been unlawful under the FCPA. Summarized below are the applicable tax provisions and some practical issues that may arise under them.

§ 8:3.1 Disallowance of Deductions

Code section 162 generally provides that ordinary and necessary expenses incurred in operating a business are tax deductible. However, section 162(c) eliminates the deduction for a payment to a foreign government official or employee that is unlawful under the FCPA. Significantly, section 162(c) and the regulations thereunder also provide that the Internal Revenue Service (IRS) bears the burden of proving with clear and convincing evidence that a payment is unlawful under the FCPA. While this departs from the normal rule in tax cases that places the burden of proof on the taxpayer, the IRS nonetheless often requests information directly from a taxpayer that it believes may have claimed a deduction in contravention of section 162(c) or failed to include subpart F income as described below.

§ 8:3.2 Inclusion of Unlawful Payments in Taxable Income

Under the “subpart F” rules of Code sections 951 through 965, a U.S. person (which includes U.S. individuals, corporations, partnerships, trusts, and estates) having a substantial interest in a “controlled foreign corporation” (CFC) generally is required to include in taxable income its share of the CFC’s “subpart F income” for the year. Consequently, under these rules, a U.S. parent company normally will be currently taxed on its share of its foreign subsidiary’s subpart F income whether or not the income is currently distributed by the subsidiary to the parent.

70. In United States v. Titan Corp., Case No. 05CR0314 [S.D. Cal. Mar. 1, 2005], Titan pled guilty to a three-count Information for violating the FCPA. One of the counts was for the preparation and filing of a tax return which included the improper payments as a tax deduction, in violation of 26 U.S.C. § 7206(2).
72. In general, a CFC is a foreign corporation that is majority-owned or majority-controlled by U.S. persons who hold significant interests in the foreign entity. For this purpose, a significant interest is, in general, ownership of stock in the foreign corporation representing 25% or more of the value of, or voting power in, that company. See 26 U.S.C. § 957.
As one means of effectuating fully Congress’s intent in enacting the FCPA, section 952(a)(4) provides that subpart F income includes any payment by a CFC that would be unlawful under the FCPA if the CFC were a U.S. corporation. Absent this provision, foreign subsidiaries of U.S. corporations could use income not currently taxable in the United States to make illicit payments. Section 952(a)(4) treats such payments as Subpart F income, thereby subjecting them to U.S. tax in the current year. Here, too, the IRS bears the burden of proving that the payment is unlawful under the FCPA.

While the tax law clearly provides that payments unlawful under the FCPA (or that would be unlawful under the FCPA if the payor were a U.S. entity) will either be disallowed as a deduction or result in an income inclusion (in the latter case where the payor is a CFC), the practicalities of dealing with these tax law rules rarely are as clear. This stems from the fact that, in many situations, potential violations of the FCPA are discovered by a taxpayer only after its tax return is filed for the year in which the payment was made. Moreover, regardless of when a potential violation is discovered, whether a payment is in fact “unlawful” may be subject to differing views. How should the U.S. corporation’s tax returns be handled in these situations? Could the U.S. company be charged with fraud for failing to correct returns already filed once facts are discovered indicating that an FCPA violation has or might have occurred? Might civil penalties be due?

Assuming that the taxpayer believed in good faith that its return was correct when filed, the later discovery of information regarding a possible FCPA violation generally should not subject the taxpayer to charges of criminal fraud or to civil fraud penalties, even if the taxpayer does not amend the return to disclose information discovered after the filing. However, the taxpayer may still be subject to regular civil penalties. These penalties generally are imposed at the rate of 20% of the underpaid tax where a taxpayer is found to have been negligent, to have disregarded the tax rules and regulations in computing its tax liability, or, in the case of a substantial understatement of tax, does not have substantial authority for its treatment of the item on its original return.

The regular civil penalties may be eliminated if the taxpayer is able to demonstrate that there were reasonable grounds for the position taken on the return filed originally and that the taxpayer acted in good faith in taking that position. The success of this defense likely will

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73. For most corporations, an understatement is substantial if it is more than the greater of $10,000 or 10% of the correct tax liability.
depend upon what the taxpayer knew or should have known about potential FCPA violations at the time its return was filed. Thus, it would be important for the taxpayer to be able to demonstrate the facts known (or not known) at the time its tax return was filed.\textsuperscript{74}

\textsuperscript{74} See United States v. Gerald Green and Patricia Green, DOJ Press Release No. 09-952 (Sept. 14, 2009) (in addition to being found guilty of violations of the FCPA and money laundering laws, Patricia Green was also found guilty of falsely subscribing U.S. income tax returns in connection with the bribery scheme).