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News Analysis: Facilitating Payments vs. Bribes Under the Tax Law

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The United States set the global standard for anticorruption legislation when it passed the Foreign Corrupt Practices Act (FCPA) in 1977, which criminalized the bribery of foreign officials by U.S. companies engaged in overseas business. It also set out rules for public companies to maintain accounting controls and accurate records of financial dealings.

The Securities and Exchange Commission and the Justice Department, which enforce the FCPA antibribery and record-keeping provisions, brought only 40 successful prosecutions under the FCPA from 1977 until 2000. Since 2000, however, enforcement actions have increased, with 58 successful prosecutions and at least 50 other investigations launched. (For prior coverage, see *Tax Notes Int'l*, Dec. 17, 2007, p. 1171, *Doc 2007-25721* [**PDF**], or *2007 WTD 245-8* .)

U.S. companies that have business operations abroad obviously want to avoid FCPA criminal prosecutions. The FCPA also influences tax practitioners, however, by helping to delineate what types of payments to foreign officials qualify for a U.S. tax deduction and what types of payments do not.

The FCPA allows payments to foreign officials made to expedite or secure the performance of routine governmental action, which are called facilitating payments. This story focuses on those payments, but it also discusses Germany's recent successful prosecution of Siemens on bribery charges and the need for companies to understand local laws everywhere they do business.

This article does not discuss section 952(a)(4), which includes in the definition of subpart F income all bribery payments by U.S. controlled foreign corporations, but that section is another notable U.S. antibribery provision.

Facilitating Payments

A U.S. company that is taxed on its worldwide income may deduct all ordinary and necessary business expenses under section 162(a), but the taxpayer may not enjoy a deduction for amounts that are disallowed under section 162(c).

If a payment to an official or employee of a foreign government is unlawful under the FCPA, section 162(c) disallows the deduction for the payment. For that

reason, tax departments in U.S. multinational companies must understand the definition of unlawful bribery under the FCPA.

Under the FCPA, bribery payments are payments of money or anything of value to a foreign official for the purpose of influencing that official's acts or decisions.

For example, a foreign government may announce that it will build three new power plants and request bids for the project. If a large U.S. engineering contractor bids on the project and influences the foreign government's contract award decision by giving $500,000 in cash to a government official, the cash gift would be an unlawful bribe.

For tax purposes, because this cash gift is unlawful under the FCPA, the U.S. engineering firm could not deduct the bribery payment as a business expense. (Presumably, the U.S. contractor would choose not to make the payment at all because it would be illegal under the FCPA.)

The FCPA does not ban outright all payments to foreign officials, however. The FCPA allows facilitating payments.

For example, a customs inspector in a foreign country may have the duty to review customs papers for goods being imported through a local port facility and to clear the goods on to a warehouse. A U.S. company that exports goods to that foreign country can lawfully make a facilitating payment to the inspector to secure the timely review of its papers.

Because facilitating payments are lawful under the FCPA, section 162(c) does not disallow the deduction for those payments. The result is that a U.S. exporter making facilitating payments to the foreign inspector could deduct the amount of the payment as a business expense under section 162(a).

As neat and simple as that may seem, the devil is in the details of those rules. "It's a fine line between what is a lawful facilitating payment and what is bribery under the FCPA," James G. Tillen, with of the law firm of Miller & Chevalier in Washington, told Tax Analysts.

In the context of a payment made to a foreign customs inspector to secure the performance of his duties, for instance, the inspector might in fact pass goods that he would not otherwise have passed but for the cash payment, Tillen said. Or if the U.S. company innocently presents the inspector with improper paperwork and also gives the inspector a cash payment, the payment may have the effect of influencing the inspector's acts (gaining his approval for otherwise improper paperwork), rather than simply facilitating routine official action.

"You don't know what he's thinking," Tillen said, referring to the inspector's understanding of the payment's purpose. Actions also occur quickly in a busy and crowded port customs office, he said. Even if the U.S. company tries to properly account for the cash payment, the company may not be able to do so if the inspector's name is lost or the company's local employee doesn't submit an expense reimbursement form.

Without the proper evidentiary record, the company couldn't show the enforcement agencies that it had made a lawful payment for normal business reasons. If the SEC or Justice Department reviews a company's payments to foreign officials six months or a year after they happen, it could be all but impossible to verify that a payment was a facilitating payment and not a bribe, according to Tillen.

Therefore, U.S. companies with global operations face a real challenge in properly applying the FCPA when making payments to foreign officials. Without the evidentiary record, a facilitating payment could be seen as an unlawful bribe, and the amount of the payment wouldn't be deductible.

Tillen also said that the amounts of facilitating payments are almost always in the range of $100 or less. Payments that are $1,000 or more "are less likely" to be facilitating payments and more likely to attract the enforcement agencies' scrutiny, he said.

Tillen said that even though facilitating payments are small and infrequent, they are a business cost, and denying a tax deduction for them "would be inconsistent with the FCPA."

Tillen said that today, although a lot of U.S. companies still make facilitating payments, the trend is away from doing that. "All countries for the most part have prohibited bribery of public officials," he said. Even if facilitating payments are lawful under U.S. law, U.S. companies could find that those same payments are unlawful bribes in the foreign jurisdiction.

Other considerations also discourage the use of facilitating payments. If U.S. companies prohibit facilitating payments, Tillen said, they won't have to explain to employees the distinction between unlawful bribery payments and lawful facilitating payments. That distinction confuses employees, and relying on it makes corporate anticorruption compliance programs more difficult to administer.

"Liability for third parties is a huge area for FCPA compliance," Tillen said, referring to the indirect liability that a U.S. company can have for the actions of a foreign customs broker or consultant. A U.S. company must monitor the actions of its third parties, or the company itself could be seen as liable. Therefore, if a U.S. company hires a customs broker or a consultant in a foreign country, the

company could violate the FCPA if the third party makes an unlawful payment and if proper records related to the third party's activities aren't maintained.

"Facilitating payments are still a struggle with a lot of companies," Tillen said, "depending on where they do business."

Siemens Prosecution

Adoption of the FCPA in 1977 began a global effort to fight corruption that resulted in antibribery and anticorruption laws in both developed and developing countries. It also gave rise to the 1997 OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions, which required signing countries to end tax breaks for bribes paid to foreign public officials.

"The United States is certainly a pioneer in transnational anticorruption, but certain other countries are catching up," Tillen said. He cited Germany's recent successful prosecution of Siemens for unlawful bribery payments as an example of well- functioning anticorruption laws outside the United States.

German prosecutors investigated Siemens, the engineering and electronics company, for making large bribery payments to secure contracts in violation of Germany's antibribery laws. The probe focused on the company's telecommunications equipment unit. Siemens in October 2007 agreed to a settlement that required Siemens to pay a €201 million penalty and €179 million in extra taxes as a result of claiming more than €400 million in unlawful tax deductions.

The total amount of Siemens' bribery payments may reach €1.6 billion, according to Miller & Chevalier's *FCPA 2007 Autumn Review*. The company also faces anticorruption investigations by the SEC and Justice in the United States and investigations by Swiss, Greek, and Italian enforcement agencies.

The German authorities have also indicted a former Siemens employee for his role in the bribery payments, and other individuals from the company are under investigation. A separate German investigation into Siemens' bribery of an Italian utility company led to the May 2007 conviction of a former finance chief and another employee on charges of bribery and assisting bribery, according to the *Autumn Review*.

Knowledge of Foreign Laws

"I think it has been successful, but it still has a ways to go," Tillen said when asked about the impact of the OECD antibribery convention.

The real story with anticorruption initiatives may be that all companies need to understand the laws in all the countries where they operate. "With globalization,

companies are going to be subject to these laws someplace" where they operate, Tillen said.

Returning to the FCPA, Tillen said that U.S. companies must take care in paying for gifts and entertainment for business contacts in foreign countries and claiming that the spending is for a business purpose. Although spending for gifts and entertainment, like sports tickets or restaurant meals, may be acceptable under the FCPA, a U.S. company making those payments must still comply with local law in the foreign jurisdiction.

"U.S. enforcement agencies are developing a global jurisdiction," Tillen said, and they are learning what types of payments are acceptable in each foreign country. If the payments made overseas are not lawful under local law, U.S. enforcement agencies might determine that the payment was not for a bona fide business purpose.

If small amounts of money are involved, the agencies will be less inclined to scrutinize the business spending, he said. Gifts of T-shirts with the company logo, or of company products or samples, would probably be allowed. Likewise, a U.S. company could probably pay for foreign business partners to travel to the United States to tour production facilities, if that is recognized as a normal way of doing business.

"But it's another gray area," Tillen said, like the discussion over facilitating payments. "To mitigate risks, U.S. companies must be aware of foreign laws," he said.

Relevant Code Sections

Section 162 -- Business Expenses