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## a closer look

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**SUBJECTS** TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

**SECTORS** MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

**COUNTRIES AND REGIONS** EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU

## Did You Pay Taxes On That Bribe? The Tax Consequences Of FCPA Violations

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The US Government prosecutes more corporations for bribery and corruption under the Foreign Corrupt Practices Act ("FCPA") than the rest of the world combined.<sup>1</sup> With approximately sixty devoted prosecutors and enforcement attorneys between the US Securities and Exchange Commission ("SEC") and the US Department of Justice ("DOJ"), the US Government's efforts to enforce the FCPA have never been more robust. The FCPA's anti-bribery provisions make it illegal to offer or provide money or anything of value to officials of foreign governments or foreign political parties in order to obtain or retain business. While the looming threat of billion-dollar settlements holds corporate America's attention, the tax consequences of violating the FCPA are not well known. Yet, it should come as no surprise that bribes and kickbacks are not tax deductible.

The FCPA has two major components: the "anti-bribery provisions" and the "books and records provisions." Together, the provisions essentially prohibit companies and their agents from giving improper payments to foreign government officials as well as disguising improper payments from the US Government. The FCPA's books-and-records provision requires issuers to make and keep books, records, and accounts, which, in reasonable detail,



accurately and fairly reflect the issuer's transactions and disposition of assets. In other words, it is an independent violation, under the FCPA, to record illegal payments as commissions, consultant fees, or other legitimate business expenditures.

FCPA charges are often coupled with alleged violations of other federal statutes such as mail and wire fraud, money laundering, RICO, and conspiracy. Several FCPA cases have included prosecution of tax violations.<sup>2</sup> The United States Internal Revenue Code ("the Code") typically allows taxpayers to deduct from income all ordinary and necessary expenses incurred in the operation of any trade or business. However, the Code specifically prohibits taxpayers from deducting any direct or indirect payment made to an official or employee of any government, or of any agency or instrumentality of any government, if the payment constitutes an illegal bribe or kickback or is unlawful under the FCPA.

### Tax Penalties For FCPA Violations

The Tax Equity and Fiscal Responsibility Act of 1982 specifically bars the tax deduction of bribe payments made under the FCPA:

No deduction shall be allowed under subsection 162(a) for any payment made, directly or indirectly, to an official or employee of any government [ . . . ] if the payment constitutes an illegal bribe or kickback or, if the payment is to an official or employee of a foreign government, the payment is unlawful under the Foreign Corrupt Practices Act of 1977.<sup>3</sup>

The improper recording of bribes as legitimate business expenses does open corporations to significant civil tax liabilities on the amount of taxes underpaid. Because civil fraud charges have a lower burden of proof than that required for successful FCPA prosecution, a company or individual corporate officer may be acquitted of FCPA charges and still lose the tax fraud count. Civil liability for underpayment of taxes ranges from accuracy-related penalties of twenty percent<sup>4</sup> to fraudulent filing penalties of seventy-five percent.<sup>5</sup>

Criminal tax charges are also an issue. Over the past decade, the DOJ has pursued at least five cases involving criminal tax charges in FCPA actions,<sup>6</sup> resulting from the taxpayers' failure to disclose improper payments received, concealing interest in foreign bank accounts, or taking improper deductions for prohibited payments. The Code provides criminal charges for tax evasion, fraudulent statements, fraudulent returns, and attempts to interfere with administration of tax laws.<sup>7</sup> Because internal audits may not catch violations when bribes are disguised as legitimate business expenses, corporations must be vigilant

in monitoring book and tax accounting of all fees, commissions, rebates, discounts, and gifts given in connection with foreign business.

For example, movie producer Patricia Green was sentenced to 19 concurrent six-month sentences and paid USD250,000 in restitution for FCPA violations, money laundering, and criminal tax fraud in August 2010.<sup>8</sup> Green was convicted of paying kickbacks to the former governor of the Tourism Authority of Thailand in exchange for allegedly receiving contracts to manage and operate Thailand's yearly Bangkok International Film Festival, as well as contracts to provide an elite tourism "privilege card" marketed to wealthy foreigners. Patricia Green and her husband allegedly paid approximately USD1.8 million in bribes to the former governor through numerous bank accounts in Singapore, the United Kingdom, and the Isle of Jersey in exchange for contracts worth more than USD13.5m. She was also found guilty of falsely subscribing US income tax returns in connection with this scheme. In a 2004 tax return for SASO Entertainment, Green claimed USD303,074 in "sales commissions" deductible from the gross income.<sup>9</sup> The same year, Green was also charged with filing a false income tax return that reported USD140,503 as deductible commissions. According to the second superseding indictment, the Greens caused "the corrupt payments [ . . . ] to be characterized as 'sales commissions' on the profit and loss statements and other company books and records prepared and maintained by the Green businesses."<sup>10</sup> The indictment further charges that Green participated in the preparation of corporate

tax returns that "took unlawful tax deductions for the bribes by calling them 'commissions' as part of costs of goods sold," thereby reducing corporate tax liabilities and using tax-free income to pay the bribes to the governor and increasing their profits from the businesses.<sup>11</sup>

In another FCPA case, Titan Corporation ("Titan"), a San Diego-based military intelligence and communications company pled guilty to one felony count of bribery under the FCPA, one felony count of falsification of books and records under the FCPA, and one felony count of aiding or assisting in the filing of a false tax return under the Code. Beginning in 1999, Titan allegedly engaged the services of an agent who claimed to have close ties to the then-President of Benin in order to secure and retain its wireless telephone network in that country. Without performing adequate due diligence to determine if its agent was complying with the FCPA, Titan allegedly began paying this agent hundreds of thousands of dollars for "consulting" services that were never properly documented or shown to have been performed. By using false invoices to conceal its improper payments in Benin, Titan knowingly falsified its books, records, and accounts. In addition, Titan violated federal tax laws by claiming the bribes as deductible business expenses on its federal income tax return. Specifically, Titan recorded in its books and records approximately USD2.1m in improper payments made to the Benin agent, and falsely characterized these payments as customs exonerations and other apparently legitimate business expenses.<sup>12</sup> In 2002, Titan allegedly wrote-off

the remaining accounts receivable related to the Benin contract valued at approximately USD20m, a portion of which contained the remaining balance of the "Reimbursable Operating Expenses."<sup>13</sup> This bad debt expense write-off included some portion of the Benin payments made by Titan in violation of the FCPA, and Titan deducted on the company's tax returns the entire USD20m write-off of accounts receivable related to the Benin contract, including the remaining balance of the "Reimbursable Operating Expenses."<sup>14</sup> As a result of these actions, Titan agreed to pay a USD13m criminal fine and to pay USD15.4m in disgorgement and prejudgment interest in a parallel civil case to be filed by the SEC. Titan agreed to pay a combined penalty of USD28m.

### **Non-Deductibility Of Settlements**

When a corporation must pay disgorgement, settlement, or restitution, the amount given to the government may not be tax deductible. Under IRC section 162, no tax deductions are allowed for any "fine or similar penalty paid to a government for the violation of any law." For tax purposes, penalties include any amounts paid in settlement of actual or potential liability for a civil or criminal fine or penalty. Therefore, if a corporation pays an amount "for the purposes of enforcing the law and as punishment for violation," then the payment is not deductible.<sup>15</sup> Whereas, if the payment is imposed to prompt compliance with the law or as compensation, the sum can be tax deductible so long as allowing the deductions does not "severely frustrate" the national policy.<sup>16</sup>

In short, whether an FCPA settlement is eligible for tax deductions is a fact-specific inquiry that depends on the purpose of the payment. Courts have typically concluded that payments are punitive when they are made in consideration of the government's forbearance from seeking criminal penalty, as is usually the case in FCPA settlements.<sup>17</sup> SEC resolutions regarding the FCPA have recently contained similar language prohibiting settling companies from deducting the penalty components.<sup>18</sup>

### Conclusion

Federal tax charges are increasingly serving as additional tools in the government's FCPA enforcement effort. Outside of the illegality of the actual bribes, the DOJ and SEC can prosecute corporations for the concealment of the bribes in their books and records, and the resulting underpayment of taxes. Civil and criminal charges, independent of the FCPA-related allegations, may be brought under the Code against corporations and individual agents. Settlements paid to foreclose the possibility of criminal convictions are usually not tax deductible, which present corporations with another significant obstacle – especially when settlements can cost companies significant amounts.

The possibility of federal tax charges should be considered by companies when assessing corruption risks and the amount they should spend to preventing FCPA violations. With the disproportionately large costs of settlements, internal investigations, and compliance-related penalties, comprehensive prevention is a company's best option.

### ENDNOTES

- <sup>1</sup> 2012 TRACE International Global Enforcement Report.
- <sup>2</sup> See, e.g., *United States v. Titan Corp.*, 05-CR-314-BEN, at 42-46 (S.D. Cal. 2005); *United States v. Liebo*, 923 F.2d 1308, 1310 n.8 (8th Cir. 1991); *United States v. Green*, No. 08-CR-59(B)-GW, at 30 (C.D. Cal. Mar. 11, 2009).
- <sup>3</sup> Pub. L. No. 97-248 § 288, 96 Stat. 324 at 571 (1982); 26 USC. § 162(c)(1).
- <sup>4</sup> I.R.C. section 6662.
- <sup>5</sup> I.R.C. section 6663.
- <sup>6</sup> See, e.g., *United States v. Titan Corp.*, No. 05-CF-314-BEN, information at 14-15 (S.D. Cal. 2005); *United States v. Liebo*, 923 F.2d 1308, 130 n.1 (8th Cir. 1991); *United States v. Green*, No. 08-CR-59(B)-GW, Second Superseding Indictment at 30 (C.D. Cal. Mar. 11, 2009); *United States v. Williams*, No. 03-CR-406-HB (S.D.N.Y. June 12, 2003); *United States v. Smith*, No. 08-CR-069-AG (C.D. Cal. Apr. 25, 2007).
- <sup>7</sup> I.R.C. sections 7201, 7206(1), 7206(2), 7207, 7212.
- <sup>8</sup> *United States v. Green*, 08-cr-59-GW-1 (9th Cir. 2013) (affirming restitution order).
- <sup>9</sup> *United States v. Green*, 08-cr-59-GW-1, Complaint at 20 (C.D. Cal. Dec. 27, 2007).
- <sup>10</sup> *United States v. Green*, No. 08-CR-59(B)-GW, Second Superseding Indictment at 30 (C.D. Cal. Mar. 11, 2009).
- <sup>11</sup> *Id.*
- <sup>12</sup> *United States v. Titan Corp.*, No. 05-CF-314-BEN, information at 14-15 (S.D. Cal. 2005).
- <sup>13</sup> *Id.*
- <sup>14</sup> *Id.*
- <sup>15</sup> *Fresenius Med. Care Holdings, Inc. v. United States*, No. 08-Civ.-12118, 2010 WL 2595541, at \*4 (D. Mass. June 24, 2010).

<sup>16</sup> *Bailey v. United States*, No. 122-77, 1887 WL 759654, at \*4 (Fed. Cl. Sept. 30, 1997).

<sup>17</sup> See *Allied Signal, Inc. v. Comm'r*, T.C. Memo 1992-204, 1992 WL 67399 (T.C. 1992), *aff'd* 54 F.3d (3d Cir. 1995); *Cavaretta v. Comm'r*, No. 24823-07, 201 WL 23331, at \*4 (T.C. 2010).

<sup>18</sup> See, e.g., *In re Tenaris*, Deferred Prosecution Agreement at 7 (May 17, 2011); *SEC v. IBM Corp.*, No. 11-CV-0563, Consent of Defendant International Business Machine Corp. at 3 (D.D.C. Apr. 5, 2011); *Barnes v. Comm'r*, T.C. Memo. 1997-25, 1997 WL 12138, at \*5 (Jan. 15, 1997).