

3-1-1998

## Fundamentals of Importing and the Customs Modernization Act

Daniel L. Fulkerson

Follow this and additional works at: <http://digitalcommons.law.utulsa.edu/tjcil>

 Part of the [Law Commons](#)

---

### Recommended Citation

Daniel L. Fulkerson, *Fundamentals of Importing and the Customs Modernization Act*, 5 Tulsa J. Comp. & Int'l L. 335 (1997).

Available at: <http://digitalcommons.law.utulsa.edu/tjcil/vol5/iss2/4>

This Casenote/Comment is brought to you for free and open access by TU Law Digital Commons. It has been accepted for inclusion in Tulsa Journal of Comparative and International Law by an authorized administrator of TU Law Digital Commons. For more information, please contact [daniel-bell@utulsa.edu](mailto:daniel-bell@utulsa.edu).



## FUNDAMENTALS OF IMPORTING AND THE CUSTOMS MODERNIZATION ACT

*Daniel L. Fulkerson*

### I. INTRODUCTION

More industries are finding themselves in the global marketplace. A basic understanding of U.S. Customs procedure is necessary to comply with the myriad of regulations placed upon importers. It is rare for any business not to have some overseas contact. Customs can become involved even if a local business has purchased imported products domestically. One mishandled importation can have serious and expensive long term consequences. While some of the basic areas will be touched on here, the best advice is always to contact your Customs Attorney.

As business becomes globalized the U.S. Customs Service predicts exponential growth in imports.<sup>1</sup> This increase in international traffic is controlled by an agency with static resources. Fiscal reality in Washington demands the increase in trade be served with the same level of workforce. To meet the challenge Customs has streamlined the agency and moved to an enforcement oriented strategy with the Customs Modernization Act (Mod Act).<sup>2</sup> The Mod Act, passed as part of the North America Free Trade Implementation Act of 1993,<sup>3</sup> streamlines and updates U.S. Customs Service procedure. The agency is shifting responsibility for compliance squarely on the shoulders of the importer. While the basic importation process will remain the same, the Mod Act creates new responsibilities for every member of the import stream and is expected to

---

1. See George Weise, *Customs Informed Compliance Strategy* (visited Oct. 18, 1997) <<http://www.customs.ustreas.gov/imp-exp/rulings/comply/ma-incmp.htm>>.

Workload Challenge: Customs expects to have to continue its reliance on a static work-force for handling an increasing workload in the foreseeable future. From the period 1993 to the 1999, it is projected that the duty collected by Customs will increase from \$18 billion to \$31 billion, the volume of imports into the United States will increase from \$575 billion to \$1.4 trillion, and the number of entries will increase similarly. *Id.*

2. Pub. L. No. 103-182, 107 Stat. 2057 (1993).

3. H.R. REP. NO. 103-361 (I) (1993).

rewrite up to 90 percent of the Customs Service Regulations.<sup>4</sup>

## II. THE ENTRY PROCESS

### A. *Preparing the Invoice*

Many problems begin before the goods are shipped. Careful attention to invoice format and detail will go a long way to assure a smooth entry. The invoice will be prepared by a foreign vendor who may not be familiar with U.S. Customs Regulations. However, as part of the informed compliance strategy<sup>5</sup> the importer of record<sup>6</sup> now has responsibility to ensure the documentation is correct before the entry is filed.

The importer must maintain quite detailed information.<sup>7</sup> The invoice is required to show port of entry, seller, purchaser, detailed description of the merchandise, quantities, contents of each package, price paid or payable, and type of currency (preferably U.S. Dollars).<sup>8</sup> The invoice must be in English and also show the country of origin for the goods (where they were manufactured).<sup>9</sup> Anything that affects the purchase price must also be described, such as rebates, commissions or discounts. Shipping costs, as well as inland freight to the port of lading, export crating, and insurance costs should be included in the invoice. Depending on the terms of sale,<sup>10</sup> some items may be deducted from invoice price which reduces the duty amount.<sup>11</sup>

### B. *Surety*

A bond must be issued on all formal entries.<sup>12</sup> This is to guarantee

4. Barry E. Powell, *Customs Tailored, Modernization Act increases the Customs Services enforcement powers-and its assistance to importers*, L.A. LAW., Sep. 1994, at 34.

5. See George Weise, *Customs Informed Compliance Strategy* (visited Oct. 18, 1997) <<http://www.customs.ustreas.gov/imp-exp/rulings/comply/ma-incmp.htm>>.

6. 19 C.F.R. § 1484 (2)(B) (1997). "For the purposes of this chapter, the importer of record must be one of the parties who is eligible to file the documentation or information required by this section." 19 C.F.R. § 141.11(b) (1997). Importer of record is commonly the consignee, owner of the goods, or "nominal consignee" such as a common carrier. *Id.*

7. 19 U.S.C.A. § 1509 (a)(1)(A) (West 1978 & Supp. 1997).

8. 19 C.F.R. § 141.86 (1997).

9. 19 C.F.R. § 134.1(b) (1997).

Country of origin means the country of manufacture, production or growth of any article of foreign origin entering the United States. Further work or material added to an article in another country must effect a substantial transformation in order to render such other country the 'country of origin' within the meaning of this part. *Id.*

10. Duty is based on the price actually paid or payable, which includes packaging the shipment for export or possibly foreign inland freight (if the terms of sale are Ex-Works). Costs for international transportation and/or insurance might be deducted from the invoice price if the terms of sale include such charges. See generally 19 C.F.R. § 152 (1997).

11. See generally 19 C.F.R. § 152 (1997).

12. 19 C.F.R. § 143.22 (1997). Formal entry may be required "when individual shipments

duty payment to Customs.<sup>13</sup> Single entry bonds are most frequently used for small importers with a low volume of inbound traffic. An importer can secure multiple transactions with a continuous bond.<sup>14</sup> This type of bond is most appropriate for importers with a total annual imported value of roughly \$100,000.<sup>15</sup>

A bond guarantees to Customs the payment of all duties and taxes. It also serves to secure payment of any fines or penalties related to the entry. Often merchandise is released into the stream of commerce before the right of admission has been decided.<sup>16</sup> If Customs determines there is a problem with the entry it may demand the goods be redelivered.<sup>17</sup> The bond serves to guarantee payment to Customs for any failure to redeliver.

### C. Duty

The duty calculation is the sum of four elements: tariff classification, value, where the goods were manufactured and the type of entry.

#### 1. Classification

Tariff classification will determine the rate of duty. The importer should consider proper classification before the goods are shipped. Few importers devote serious consideration to classification issues despite the extra layer of taxation that is imposed on a product. Payment to Customs may be higher than the corporate tax rate and requires a commensurate level of planning.<sup>18</sup> Proper classification can insure compliance with Customs regulations as well as secure a lower duty payment.

All imported products are classified with a ten digit number according to their essential nature. The Harmonized Tariff Schedule of the United States (HTSUS) is divided into sections and chapters that deal with merchandise in broad categories.<sup>19</sup> Each section deals with a class of commodities. HTSUS begins with animals, vegetables and raw materials, then moves on to components, and ends with highly manufactured assemblies, such as scientific equipment. Inside each section are chapters that further detail and narrow commodity classifications. Many items might seem to fit several HTSUS classifications. To properly define the

---

for the same consignee, when such shipments are valued at \$1250. . . " *Id.*

13. 19 C.F.R. § 113.1 (1997). "to require, such bonds as necessary for the collection of revenue. . ." *Id.*

14. 19 C.F.R. § 113.12 (1997).

15. Always consult your Customs attorney or broker to see if a continuous bond is suitable for your needs.

16. 19 C.F.R. §142.21 (1997).

17. 19 C.F.R. § 113.62(d) (1997).

18. See Adrienne Braumiller, *Legal Aspects of Importing*, INT'L. SMALL BUS. DEV. CTR. (1996).

19. *Importing in the United States*, DEPT. OF THE TREASURY, U.S. CUSTOMS SERV., (1991).

product refer to the chapter headnotes found at the beginning of each chapter and the General Rules of Interpretation found at the start of the HTSUS or on the Customs Service web page.<sup>20</sup> All elements being equal,

---

20. *General Rules of Interpretation* (visited Nov. 8, 1997) <<http://www.customs.ustreas.gov/imp-exp/rulings/harmonize/html148.html>>.

General Rules of Interpretation

Classification of goods in the tariff schedule shall be governed by the following principles:

1. The table of contents, alphabetical index, and titles of sections, chapter and sub-chapters are provided for ease of reference only; for legal purposes, classification shall be determined according to the terms of the headings and any relative section or chapter notes and, provided such headings or notes do not otherwise require, according to the following provisions:

2(a). Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as entered, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also include a reference to that article complete or finished (or failing to be classified as complete or finished by virtue of this rule), entered unassembled or disassembled.

2(b). Any reference in a heading to a material or substance shall be taken to include a reference to mixtures or combinations of that material or substance with other materials or substances. Any reference to goods of a given material or substance shall be taken to include a reference to mixtures or combinations of that material or substance with other materials or substances. Any reference to goods of a given material or substance shall be taken to include a reference to goods consisting wholly or partly of such material or substance. The classification of goods consisting of more than one material or substance shall be according to the principles of rule 3.

3. When, by application of rule 2(b) or for any other reason, goods are, *prima facie*, classifiable under two or more headings, classification shall be effected as follows:

(a) The heading which provides the most specific description shall be preferred to headings providing a more general description. However, when two or more headings each refer to part only of the materials or substances contained in mixed or composite goods or to part only of the items in a set put up for retail sale, those headings are to be regarded as equally specific in relation to those goods, even if one of them gives a more complete or precise description of the goods.

(b) Mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, which cannot be classified by reference to 3(a), shall be classified as if they consisted of the material or component which gives them their essential character, insofar as this criterion is applicable.

(c) When goods cannot be classified by reference to 3(a) or 3(b), they shall be classified under the heading which occurs last in numerical order among those which equally merit consideration.

4. Goods which cannot be classified in accordance with the above rules shall be classified under the heading appropriate to the goods to which they are most akin.

5. In addition to the foregoing provisions, the following rules shall apply in respect of the goods referred to therein:

(a) Camera cases, musical instrument cases, gun cases, drawing instrument cases, necklace cases and similar containers, specially shaped to contain a specific article or set of articles, suitable for long-term use and entered with the articles for which they are intended, shall be classified with such articles when of a kind normally sold therewith. This rule does not, however, apply to containers which give the whole its essential character;

(b) Subject to the provisions of rule 5(a) above, packing materials and packing containers entered with the goods therein shall be classified with the goods if they are of a kind normally used for packing such goods. However, this provision is not binding when such packing materials or packing containers are

the higher numerical classification in the HTSUS will prevail.<sup>21</sup> Customs has issued rulings for many products<sup>22</sup> that may be binding on a shipment. These rulings are available through any computer on the Customs Electronic Bulletin Board<sup>23</sup> or available directly from Customs.<sup>24</sup>

## 2. Valuation

Duty is a percentage of the price actually paid or payable. This is the transaction value<sup>25</sup> of the merchandise when sold for export to the United States. Many factors that affect the transaction value are often not included on the invoice. Trademark licenses or patent royalties can significantly affect the value of the importation.<sup>26</sup> These costs must be reported with the entry to ensure that duty will not be underpaid.

Dutiable value is affected when the importer provides any assistance to the exporter. An 'assist' is anything supplied by the importer to the exporter, at below cost, for use in the production of goods for export to the United States.<sup>27</sup> This includes any materials, or parts used in the imported product or any machinery, tools or dies used in production. Even the transportation costs of the assist to the exporter must be included.<sup>28</sup> An assist also includes engineering or design work if it is done outside the U.S. The assist has a direct relationship to the price actually paid or payable and must be reported to Customs.

Transaction value is the preferred method of appraisement. However,

---

clearly suitable for repetitive use.

6. For legal purposes, the classification of goods in the subheadings of a heading shall be determined according to the terms of those subheadings and any related subheading notes and, *mutatis mutandis*, to the above rules, on the understanding that only subheadings at the same level are comparable, for the purposes of this rule, the relative section chapter and subchapter notes also apply, unless the context otherwise requires. *Id.*

21. E. Charles Routh, *A Few Pointers on Customs Law*, SB04 ALI-ABA 13 (1996).

22. *See generally* 19 C.F.R. §177 (1997).

23. The Customs Electronic Bulletin Board (CEEB) may be accessed through any computer by dialing (703) 440-6155. For information regarding access to CEEB, (703) 440-6236.

24. Office of Regulations and Rulings, U.S. Customs Service, 1301 Constitution Avenue, N.W., Washington, D.C. 20229.

25. 19 C.F.R. §152.103

In determining transaction value, the price actually paid or payable will be considered without regard to its method of derivation. It may be the result of discount, increases, or negotiations, or may be arrived at by the application of a formula, such as the price in effect on the date of export in the London Commodity Market. The word "payable" refers to a situation in which the price has been agreed upon, but actual payment has not been made at the time of importation. *Id.*

26. 19 C.F.R. §152.103(f). "Royalties or license fees for patents covering processes to manufacture the imported merchandise generally will be dutiable." *Id.*

27. 19 C.F.R. § 152.102(a) (1997).

28. 19 C.F.R. § 152.102(f) (1997).

special relationships between the buyer and seller can affect the price. If the parties are related in some way,<sup>29</sup> transaction value may not be the appropriate method of valuation. Related party transactions are not at arms-length. If the transaction value cannot be determined duty will be based on alternative valuation methods.

a. Transaction Value of Identical or Similar Merchandise

An arms length transaction with merchandise "at the same commercial level and in substantially the same quantity as the sales of the merchandise being appraised"<sup>30</sup> will be acceptable as an appraised value. If no such sale is found, dissimilar quantities will be used, but adjusted to account for the difference. If two or more sales of similar merchandise are found the entry "will be appraised on the basis of the lower or lowest of those values."<sup>31</sup>

b. Deductive Value

The dutiable value will be the price of the greatest quantity the goods are actually sold for in the United States. All material and transportation costs, as well as an allowance for the importers profit and general expenses, will be deducted from the total dutiable amount.<sup>32</sup>

c. Computed Value

Computed value calculates a total value for the entry by adding the cost of the materials, any processing or assist, and export packing with the profit and general expenses of the importer.<sup>33</sup>

d. Value If All Other Values Cannot Be Determined

If the first three valuation methods do not prove satisfactory, 19 C.F.R. § 152.107 allows Customs to interpret the transaction, deductive and computed value calculations "flexibly."

---

29. 19 C.F.R. §152.102(g) (1997).

Related persons means: (1) Members of the same family, including brothers and sisters (whether by whole or half blood), spouse, ancestors, and lineal descendants. (2) Any officer or director of an organization, and that organization. (3) An officer or director of an organization and an officer or director of another organization, if each individual also is an officer or director in the other organization. (4) Partners. (5) Employer and employee. (6) Any person directly or indirectly owning, controlling, or holding with power to vote, five percent or more of the outstanding voting stock or shares of any organization, and that organization. (7) Two or more persons directly or indirectly controlling, controlled by or under common control with, any person. *Id.*

30. 19 C.F.R. §152.104(d) (1997).

31. *Id.*

32. 19 C.F.R. §152.105 (1997).

33. 19 C.F.R. §152.106(a) (1997).

### 3. Country of Origin

Where an item is manufactured can significantly impact the duty amount. Aside from NAFTA the United States extends duty free treatment to the products of many countries. Several tariff programs allow preferential treatment to products of Israel, Central and South America, and most developing countries. A common pitfall in multi-country manufacturing is correctly identifying where something was made.

Country of origin means the country in which the good was manufactured, produced or grown. If the item was processed or added to with material from another country it will be declared to originate in the country where it underwent "substantial transformation." For countries that are part of a duty preference program 35 percent of total value of the good must be a direct cost of processing. "'Direct cost of processing' includes costs directly incurred or reasonably allocated to the processing of the article, such as the cost of all actual labor, dies, molds, tooling, depreciation on machinery, research and development and inspection and testing. Business overhead, administrative salaries, casualty and liability insurance, advertising and salesmen's salaries are not considered as direct costs of processing."<sup>34</sup> To ensure only designated countries receive the benefit of trade preference programs the shipment must be imported directly into the United States from the beneficiary country.<sup>35</sup> Transshipment through other countries will only be allowed in strictly defined circumstances.<sup>36</sup>

#### a. Generalized System of Preferences

"The Generalized System of Preference is a program providing for free rates of duty for merchandise from beneficiary developing independent countries and dependent countries and territories to encourage their economic growth. . . ."<sup>37</sup> Over 120 countries are presently eligible for duty free importation under GSP.

#### b. Andean Trade Preferences Act and the Caribbean Basin Economic Recovery Act

These programs direct tariff preferences to nearly every nation in Central and South America, as well as the Caribbean Common Market.

#### c. United States-Israel Free Trade Area

The United States-Israel Free Trade Area Implementation Act of 1985 (FTA) was passed to stimulate trade between the U.S. and Israel.

---

34. DEPT. OF THE TREASURY, *supra* note 19, at 24.

35. See 19 C.F.R. § 10.174 (1997).

36. See 19 C.F.R. § 10.175 (1997).

37. DEPT. OF THE TREASURY, *supra* note 19, at 23.



The FTA relates to most items in the HTSUS<sup>38</sup> and allows products of Israel to be imported duty free into the U.S.

d. North American Free Trade Act (NAFTA)

The NAFTA eliminates tariffs on most goods originating in Canada, Mexico, and the United States over a maximum transition period of fifteen years. All trade between Canada and the United States is duty free in 1998. For most Mexico-United States and Canada-Mexico trade, the NAFTA will either eliminate existing customs duties immediately or phase them out in five to ten years. On a few sensitive items, the Agreement will phase out tariffs over fifteen years.<sup>39</sup>

NAFTA has radically changed the dynamics of our trade environment. Allowing goods to flow through three countries with out a duty payment required much negotiation as to what is "originating in a country." Article 401 of the agreement defines a NAFTA originating good and denies goods from non-NAFTA countries preferential tariff treatment for mere transshipment through a member state. A good may originate even if it contains non-NAFTA member state material. When NAFTA origin is sought for material from outside North America, that material must undergo a tariff classification change. This occurs when the material is incorporated in production in a NAFTA member state.<sup>40</sup>

NAFTA Rules of origin require that a certain percentage of a good's value must be from North America. Article 401 allows two methods for calculating regional value content; the exporter or producer may choose the method that is most beneficial.<sup>41</sup>

(1). Transaction Value Method

Transaction Value determines if a good is originating by comparing the total value of NAFTA originating materials and labor with foreign content. The total value of North American content must be at least 60 percent of the final cost to be considered NAFTA originating. The regional value calculation is transaction value of the goods less the value of the non-originating material divided by the transaction value, multiplied by 100. An advantage of this method is allows all costs and profit to be counted as NAFTA originating material.<sup>42</sup>  $RVC = ((TV - VNM)/TV)100$ .

(2). Net Cost Method

Under this method the percentage of originating material must be at

---

38. DEPT. OF THE TREASURY, *supra* note 19, at 27.

39. NAFTA, *The North American Free Trade Agreement, A Guide to Customs Procedures*, DEPT OF THE TREASURY, U.S. Customs Serv., Jan. 1994, Customs Publication No. 571, at 1.

40. *Id.* at 3.

41. *Id.* at 4.

42. *Id.* at 4.

least 50 percent of the net cost.

The net cost method calculates the regional value content as a percentage of the net cost to produce the good. Net cost represents all of the costs incurred by the producer minus expenses for sales promotion (including marketing and after-sales service), royalties, shipping and packing costs and non-allowable interest costs. The percentage content required for the net cost method is lower than the percentage content required under the transaction value method because some expenses are excluded from the net cost calculation.<sup>43</sup>

Regional Value Content under this method will equal Net Cost less the value of the Non-Originating Materials divided by the Net Cost multiplied by 100.  $RVC = ((NC - VNM) / NC) 100$ .

### (3). Dispute Resolution

The NAFTA encourages trade through several innovative dispute resolution mechanisms. Binding international arbitration may be utilized if a member state fails to treat another member state's investors as favorably as its own.<sup>44</sup> The agreement offers arbitration to investors through the International Center for Settlement of Investment Disputes or the United Nations Commission on International Trade Law Arbitration.<sup>45</sup>

Several conditions exist before an investor can use the dispute resolution mechanisms. First the investor must have been harmed due to a breach of NAFTA provisions, and then he can then file a claim for arbitration no sooner than three months or later than three years from discovery of the breach; the injured party must attempt to resolve the dispute before resorting to arbitration and give ninety days notice before filing a claim. Finally, the injured party must waive the right to pursue the claim in any other forum.<sup>46</sup>

In the United States, Antidumping and Countervailing issues will be determined by the Department of Commerce. If a product is found to have been produced with subsidies or is being sold at below cost it will be subject to an increase in duty to offset the unfair advantage. The Department of Commerce will determine if a product is being subsidized or dumped into the U.S. market. The International Trade Commission will determine if the unfair competition has injured domestic industry. The producer can then take these findings to an arbitration panel of the NAFTA countries. A party under United States jurisdiction has the option

---

43. *Id.* at 5.

44. NAFTA, Article 1103, 32 I.L.M. 605.

45. Horlick & DeBusk, *Dispute Resolution Under NAFTA*, 27 J. WORLD TRADE 21-41 (1993).

46. *Id.*

of bringing the findings before the arbitration panel.

All parties involved in an ADD/CVD arbitration will be treated as they would in their home county. The treaty provides for a level of judicial review commensurate with that found in their domestic courts. "NAFTA panels must apply the same standard of review that a reviewing court of the country whose decision is challenged would apply. In the United States, the standard is whether the decision is: (a) unsupported by substantial evidence on the record; or (b) otherwise not in accordance with the law."<sup>47</sup>

#### 4. Entry Type

The type of entry can have a significant effect on the amount of duty owed. The regulations provide for several types of duty free entry designed to benefit importers in certain situations. Temporary Importation allows for a suspension of duty if the item will be exported. Another program allows material to come into the country duty free if it is entered into a Foreign Trade Zone. An FTZ is considered outside the Customs territory of the United States. Duty is not due until the merchandise is withdrawn from the zone.

##### a. Temporary Importation Under Bond, (TIB)

Merchandise that will be exported may be entered duty free by posting a Customs bond for double the estimated duty.<sup>48</sup> The importer must submit a statement of how the article will be used, that it will not be put to any other use, and that the article is not for sale or sale on approval.<sup>49</sup> The merchandise must be exported within one year of entry, although the time may be "extended for not more than two further periods of 1 year each."<sup>50</sup> From an operations standpoint Temporary Importations are difficult to work with. Customs has strict requirements regarding exportation of TIB merchandise.<sup>51</sup> These regulations necessitate coordination with several company operations. If the merchandise has not been exported or destroyed in accordance with Customs regulations the district director shall make a demand for payment of double the estimated duties.<sup>52</sup>

##### b. Carnets

Carnets are designed for the international business traveler making many stops in one trip. The carnet is designed to facilitate the entry of

---

47. *Id.*

48. 19 C.F.R. § 10.31(f) (1997).

49. 19 C.F.R. § 10.31(a)(3)(ii)-(iii) (1997).

50. 19 C.F.R. § 10.37 (1997).

51. 19 C.F.R. § 10.38 (1997).

52. 19 C.F.R. § 10.39(d)(1) (1997).

product samples and advertising material. The carnet document "allows you to take material to the more than 30 countries that are members of the carnet system."<sup>53</sup> A carnet will serve as both the entry document and bond for the shipment.<sup>54</sup> The original carnet documents are returned to the importer before leaving for the next country, at the next destination the process is repeated using the same documents. This standardizes diverse customs procedures for a sales force.<sup>55</sup>

### c. Foreign Trade Zones and Warehouse Entries

A Foreign Trade Zone (FTZ) is an area located in the United States but is legally outside the nation's customs territory. A shipment is entered into the zone duty free. Duty is paid only when the merchandise is withdrawn from the zone. Components and raw materials are entered into the zone and then processed or assembled into a finished product. When the item is withdrawn duty will be the rate for the finished article or the foreign component parts, whichever is lower.<sup>56</sup> Duty is not paid on material destroyed or turned into scrap in the manufacturing process.

The FTZ is ideal for importers of finished products. The zone can be used as a showroom; "goods may be brought to the threshold of the market, making immediate delivery certain and avoiding the possible cancellation of orders due to shipping delays after a favorable market has closed."<sup>57</sup>

Foreign exporters planning to expand or open up new American outlets may forward their goods to a foreign-trade zone in the United States to be held for an unlimited period while awaiting a favorable market in the United States or nearby countries without being subject to customs entry, payment of duty, taxes or bond.<sup>58</sup>

An importer can use the zone as a showroom and warehouse, however, retail sales from a zone are prohibited.<sup>59</sup>

Strict record keeping requirements insure the importer will track all material that has been entered and withdrawn from the zone.<sup>60</sup> Failure to maintain a secure facility or to adequately follow customs procedures can lead to severe penalties<sup>61</sup> (of up to \$1000 a day for each violation) or sus-

---

53. L. Fargo Wells and Karin B. Dulat, *EXPORTING FROM START TO FINANCE*, at 113.

54. 19 C.F.R. § 114.13(a) (1997).

55. For information on carnets contact the U.S. Council of International Business, 1212 Avenue of the Americas, New York, NY 10036.

56. Routh, *supra* note 21, at 13.

57. *Importing into the United States*, *supra* note 19, at 61.

58. *Importing into the United States*, *supra* note 19, at 60.

59. 19 C.F.R. § 146.14 (1997).

60. 19 C.F.R. § 146 Subpart B (1997).

61. 19 C.F.R. § 146 Subpart G (1997).

pension of zone status.<sup>62</sup>

Duty may also be deferred by entering the merchandise into a bonded warehouse. Payment to Customs will only be made when the merchandise is withdrawn for consumption.<sup>63</sup> Unlike an FTZ, goods in a warehouse cannot be manipulated or manufactured. While merchandise may be sold while in the warehouse,<sup>64</sup> withdrawals from a bonded warehouse may only be made by one primarily liable for the duty.<sup>65</sup>

#### d. Trade Fairs

Trade fairs are an excellent opportunity for businesses to take part in the global marketplace.<sup>66</sup> The U.S. Customs Service has special regulations facilitating entry of goods for a trade fair. The Secretary of Commerce may designate trade fairs in which articles<sup>67</sup> will be entered duty free.<sup>68</sup> The fair operator will file a bond,<sup>69</sup> and be responsible for all fair entries.<sup>70</sup> Exhibits at a trade fair must be segregated into domestic and imported articles.<sup>71</sup> If any item originally declared as an "article for a fair" then enters the stream of commerce, even if lost or stolen,<sup>72</sup> the fair operator must pay any applicable duties and taxes. Marking requirements will not apply to articles entered for a fair unless those items are sold.<sup>73</sup>

#### e. Drawback

Drawback is a refund of duties when imported merchandise is exported. This program began in 1789 as part of the first United States tariff act. The program's purpose is to encourage exports. A refund of duties allows domestic business to compete in foreign markets without the disadvantage of passing duty costs along to purchasers.<sup>74</sup> A refund of duty may also be made if the imported merchandise is destroyed.

The Customs Modernization Act, part of the NAFTA Implementa-

62. For information regarding Foreign Trade Zones inside the United States contact the Foreign Trade Zones Board, Department of Commerce, Washington, D.C. 20230.

63. 19 C.F.R. § 144.12 (1997).

64. 19 C.F.R. § 144.21 (1997).

65. 19 C.F.R. § 144.31 (1997).

66. For information regarding Trade Fairs contact the American Association of Exporters and Importers, 11 W. 42nd St., New York, NY 10036, 212-944-2230.

67. 19 C.F.R. § 147.1(f) (1997). "Articles for a fair includes but is not limited to: (1) Actual exhibit items; (2) Pamphlets, brochures, and explanatory material in reasonable quantities relating to foreign exhibits at a fair; Material for use in constructing, installing, or maintaining foreign exhibits at a fair." *Id.*

68. 19 C.F.R. § 147.0 (1997).

69. 19 C.F.R. § 147.3 (1997).

70. 19 C.F.R. § 147.11(a) (1997).

71. 19 C.F.R. § 147.31 (1997).

72. 19 C.F.R. § 147.41 (1997).

73. 19 C.F.R. § 147.21 (1997).

74. DEPT. OF THE TREASURY, *supra* note 19, at 30.

tion Act, has made extensive changes to the drawback law. "The statute authorized a 'drawback compliance program' as well as specific monetary penalties for false drawback claims. The drawback compliance program is aimed at allowing Customs to review claims in a post audit mode on an account basis, as opposed to a transaction-by-transaction basis."<sup>75</sup>

#### D. Marking Requirements

Any import into the United States must be marked clearly, legibly and permanently with the English name of where it was manufactured or produced.<sup>76</sup> Marking must be in a conspicuous place so the ultimate purchaser<sup>77</sup> in the United States will know where a good was made.

##### 1. Exceptions to Marking

Many items are incapable of being marked, such as; raw materials in bulk form, ball bearings, or wire.<sup>78</sup> These items are exempt from marking.<sup>79</sup> When an importer brings in these "J-List" items, already packaged for sale to the ultimate purchaser, the package must be marked. If a finished product is imported in bulk, the container in which they are repackaged must show the country of manufacture.<sup>80</sup>

Marking exemptions extend to items produced more than twenty years prior to importation,<sup>81</sup> or any goods being imported that were originally made in the United States.<sup>82</sup>

Articles imported for use by the importer and not intended for resale are also free from marking requirements.<sup>83</sup> Items may also be exempt from marking if economically impractical.<sup>84</sup>

75. *Customs Publishes Proposed Rules to Revise Drawback Regulations*, 14 INT'L TRADE REP. 211 (1997).

76. 19 C.F.R. § 134.11 (1997).

77. 19 C.F.R. § 134.1(d) (1997), "The 'ultimate purchaser' is generally the last person in the United States who will receive the article in the form in which it was imported." *Id.*; If the article is sold at retail in its imported form, the purchaser at retail is the 'ultimate purchaser.' 19 C.F.R. § 134.1(d)(3) (1997); 19 C.F.R. § 134.1(d)(2) (1997). A manufacturer may be the 'ultimate purchaser' if the imported article is subjected to a process which results in a substantial transformation of the article. 19 C.F.R. § 134.1(4)(2) (1997). An "ultimate purchaser" can even be one who receives the imported article as a gift.

78. 19 C.F.R. § 134.33 (1997) "J-List exceptions. Articles of a class or kind listed below are excepted for the requirements of country of origin marking in accordance with the provisions of section 304(a)(3)(J), Tariff Act of 1930, as amended (19 U.S.C. § 1304(a)(3)(J))." *Id.*

79. 19 C.F.R. § 134.31 (1997).

80. 19 C.F.R. § 134.34(1) (1997) "The containers in which the articles are repacked will indicate the origin of the articles to an ultimate purchaser in the United States." *Id.*

81. 19 C.F.R. § 134.32(i) (1997).

82. 19 C.F.R. § 134.32(m) (1997).

83. 19 C.F.R. § 134.32(f) (1997).

84. 19 C.F.R. § 134.32(c) (1997). For a better understanding of marking exemptions see generally 19 C.F.R. § 134.31 (1997).

## 2. Geographic names

Many consumer items are identified with a particular locality. Imported products marketed with the intent to capitalize on a geographic name must clearly show where the good was manufactured. The country of origin must appear on the imported article "legibly, permanently and in close proximity" to any geographic name that may appear on the item or its container. The country of origin must be in comparable size to the geographic name and be "preceded by 'Made in,' 'Product of ,' or other words of similar meaning."<sup>85</sup>

## 3. Special Marking Requirements.

Many items are controlled by specific agencies, such as the Food and Drug Administration. The marking requirements of 19 C.F.R. § 134 are "separate and apart from any special marking or labeling required on specific products by other agencies. It is recommended that each specific agency be contacted for any special marking or labeling requirements."<sup>86</sup>

Certain articles have special marking requirements. Items made of iron or steel must be marked by one of five methods: die-stamped, cast-in-mold lettering, etching, engraving, or by means of metal plates, attached by welding, screws, or rivets, bearing the country of origin.<sup>87</sup>

## 4. Clocks and Watches

Clocks and watches must have very specific markings. In addition to the standard marking restrictions, "[c]lock movements shall be marked on the most visible part of the back cover to show the name of the country of manufacture, and the name of the manufacturer or purchaser."<sup>88</sup> "Watch cases shall be marked on the inside or outside of the back cover to show the name of the country of manufacture, and the name of the manufacturer or purchaser."<sup>89</sup> Customs considers the country of origin for watches to be where the movement was manufactured.<sup>90</sup>

### *E. Other Government Agency Requirements*

Various classes of merchandise are subject to import requirements of other government agencies. Many imported products will be of a type regulated by Congress. Whatever agency has responsibility for a particular class of domestic products will also be responsible for regulating imports of those same products.

---

85. 19 C.F.R. § 134.46 (1997).

86. DEPT. OF THE TREASURY, *supra* note 19, at 43.

87. 19 C.F.R. § 134.43(a) (1997).

88. 19 C.F.R. § 11.11(b) (1997). In this context 'purchaser' refers to importer of record.

89. DEPT. OF THE TREASURY, *supra* note 19, at 44.

90. DEPT. OF THE TREASURY, *supra* note 19, at 43.

### 1. Food and Drug Administration

The Food and Drug Administration monitors a wide range of imports.<sup>91</sup> The F.D.A. must approve all shipments of food items and any items that come into contact with food such as dishes, eating utensils, cups and glasses. The F.D.A. also controls imports of all cosmetic products, even tooth brushes, hair brushes and combs. Eyeglasses and sunglasses must also be shown to meet certain safety specifications.

The F.D.A. requires extensive reporting for medical products; an importer must file forms documenting the product, the factory where it was made, and information on the domestic importer.<sup>92</sup> Radiation emitting products may be subject to performance standards. These standards certify a product meets the maximum radiation emission standards at the time it was manufactured. These products may only come into the country if an importer's F.D.A. entry notice and electronic product declaration are filed in conjunction with the Customs information.<sup>93</sup> This is required for all microwave ovens, computer monitors, televisions, picture tubes, and even some CD-ROMS. Domestic radiation emitting products are subject to the same standards.<sup>94</sup>

Anyone wishing to import alcoholic beverages must obtain an importer's basic permit from the Bureau of Alcohol, Tobacco and Firearms.<sup>95</sup> Alcoholic beverages are also subject to strict Customs and F.D.A. requirements.

### 2. Federal Communications Commission

Any radio frequency device, such as televisions, tape recorders, or stereos are subject to the radio emission standards of the Federal Communications Commission. The entry documents of these products must have an FCC declaration (FCC form 740).<sup>96</sup>

### 3. Motor Vehicles

Any imported automobile or motor vehicle equipment must comply with all applicable motor vehicle safety standards in effect when these vehicles or items were manufactured. However, "certain temporary importations are exempt from the requirements of certification and conformance ...."<sup>97</sup> When the vehicle is imported for permanent use a bond

---

91. 19 C.F.R. § 12.1 (1997).

92. For information regarding import requirements contact: Food and Drug Administration of the Department of Health and Human Services, Rockville, Md. 20857.

93. DEPT. OF THE TREASURY, *supra* note 19, at 48.

94. These forms are issued by the Food and Drug Administration, National Center for Devices and Radiological Health, 1390 Piccard Drive, Rockville, MD 20850.

95. A.T.F., Department of the Treasury, Washington, D.C. 20226. (202)-927-8110.

96. Federal Communications Commission, Washington, D.C. 20554. (202)-632-6345.

97. DEPT. OF THE TREASURY, *supra* note 19, at 56.



must be posted for 150% of the dutiable value. This is to insure nonconforming vehicles are brought into compliance. Extensive modifications are required for nonconforming vehicles. Often it may be so costly that it is often impractical and even impossible to achieve compliance.<sup>98</sup> The Clean Air Act prohibits imports of all engines not conforming with emission standards of the Environmental Protection Agency.<sup>99</sup>

#### 4. Toxic Substances Control Act

All shipments of any chemical substance must comply with TSCA, the Toxic Substances Control Act.<sup>100</sup> To certify compliance an importer must submit a TSCA statement with the entry documents before the shipment can be released.<sup>101</sup>

#### *F. Liquidation*

Liquidation occurs when an entry is finally closed. The duty rate and amount become final for most purposes. Customs audits all entry documents, classifications and valuation information after the merchandise has been released. The reviewing officer will certify the information transmitted to Customs against the entry invoice and supporting documentation. Customs may question the classification or valuation of the merchandise. If the entry is accepted without any changes it will be deemed liquidated. Liquidation is only official after it is posted in the customhouse.<sup>102</sup> An entry not liquidated within one year from when the shipment was released will be deemed liquidated by "operation of law" at the rate and amount of duty asserted by the importer.<sup>103</sup>

The one year limit can be suspended by Customs or the importer if there is a question regarding the entry information. If the importer has information that could lead to a lower valuation or a change in tariff classification, he or she may request an extension of the time for liquidation. Customs may suspend liquidation when more information is needed to verify the entry information. If Customs advances the rate of duty the importer may file a protest within 90 days of liquidation.

#### *G. Penalties*

##### 1. False Entry Information

Incorrect classification, valuation or presenting false entry informa-

---

98. For information regarding vehicle import requirements contact the U.S. Department of Transportation, National Highway Traffic Safety Administration, Director of the Office of Vehicle Safety Compliance, 400 Seventh Street, S.W., Washington, D.C. 20590.

99. Environmental Protection Agency, Investigations/Imports Section, Washington, D.C. 20460. (202) 260-2504.

100. 19 C.F.R. § 12.118 (1997).

101. 19 C.F.R. § 12.121(a) (1997).

102. 19 C.F.R. § 159.9(c)(1) (1997).

103. 19 C.F.R. § 159.11(a) (1997).

tion is a failure to use reasonable care. The Customs Service may impose a penalty commensurate with the level of culpability under 19 U.S.C. § 1592.

a. Negligence

“As a general rule, a violation is determined to be negligent if it results from the offender’s failure to exercise reasonable care and competence to ensure that a statement made is correct.”<sup>104</sup> Negligent conduct is anything that causes incorrect information to be filed with Customs, such as, repetitive clerical errors, misinterpretation of the statute or even failure to communicate information to those entering the data.<sup>105</sup>

[A]n initial clerical error may be repeated several times over by entry level clerks or typists whose job it is to prepare documents using a model format as their source guide as to what should be repeated. In such circumstances multiple repetitions of an initial clerical error may not constitute a pattern of negligent conduct. The Customs Service will be expected to examine the nature of the data transcription in issue, and the element of time and the number of importations involved . . . . With increased reliance on electronic systems, it is entirely possible that transposition of amounts, insertion of basic entry data, or other form of clerical error will be repeated many times over once incorporated into the system. [A determination of negligence] shall be based on the existence and operation of quality control procedures, nature of the data transmission, number of importations handled, and the degree of time involved in the action creating the error. The failure to use reasonable care, as required by 19 U.S.C. 1484, resulting in repetitive errors, whether repeated by computers or humans, shall constitute a pattern of negligent conduct.<sup>106</sup>

A negligent violation is punishable by a penalty for the value of the merchandise or double the loss of duty, whichever is less. If the violation did not affect the duty payment the penalty will be 20 percent of the merchandise value.<sup>107</sup>

b. Gross Negligence

“A violation is determined to be grossly negligent if it results from an act or acts (of commission or omission) done with actual knowledge of or wanton disregard for the relevant facts and with indifference to or disregard for the offender’s obligations under the statute.”<sup>108</sup>

---

104. H.R. REP. NO.103-361(I), *supra* note 3, at 121.

105. *Id.*

106. *Id.*

107. 19 U.S.C. § 1592 (c)(3)(A)(I)(ii), (B) (1997).

108. H.R. REP. NO.103-361(I), *supra* note 3, at 121.

Gross Negligence is punishable by a penalty for the lessor of the domestic value of the merchandise or four times the amount of revenue the Customs Service would be deprived. If the duty amount was not affected the penalty is 40 percent of the dutiable value of the merchandise.<sup>109</sup>

### c. Fraud

A violation is when the act was done voluntarily and intentionally, with an intent to deceive, to mislead, or to convey a false impression, as established by clear and convincing evidence.<sup>110</sup> Fraud is punished by a fine not more than the domestic value of the merchandise.

## 2. Liquidated Damages

Most Customs entries require the importer post a bond that guarantees the payment of duties, fees, taxes and penalties. If any bond condition is breached the surety will become liable for all damages.<sup>111</sup>

Liquidated Damages arise when Customs has issued a Notice for Redelivery and the merchandise is not returned. The notice will be issued most often for incorrect country of origin marking, copyright violations, requests for samples, problems with import documents or other government agency requirements. If the goods are not redelivered within the time allowed,<sup>112</sup> Customs will issue a claim for liquidated damages for the value of the merchandise.<sup>113</sup>

If the merchandise is not redelivered, the importer will receive a claim for liquidated damages, Customs Form 5955-A. The claim is generally for the value of the merchandise or three times the value if the merchandise is restricted.<sup>114</sup> Customs does allow the right to petition for relief that can substantially reduce the claim.<sup>115</sup>

## 3. Mitigation of Penalties

### a. Prior Disclosure

Penalties can be avoided if an importer corrects a mistake that has resulted in the underpayment of duties. The importer must make a written disclosure along with a tender of unpaid duty. The disclosure and voluntary tender must be made "before, or without knowledge of, the commencement of a formal investigation of such violation. . . ."<sup>116</sup> A formal investigation will be considered as "the date recorded in writing by the

---

109. 19 U.S.C. § 1592 (c)(2)(A)(I)(ii), (B) (1997).

110. H.R. REP. NO.103-361(I), *supra* note 3, at 121.

111. 19 C.F.R. § 172.1(a) (1997).

112. 19 C.F.R. § 141.113(a) (1997).

113. 19 C.F.R. § 141.113(g) (1997).

114. 19 C.F.R. § 141.113(g) (1997).

115. 19 C.F.R. § 172 (1997).

116. 19 U.S.C.S. § 1592(c)(4)(a) (1997).

Customs Service as the date on which facts and circumstances were discovered or information was received which caused the Customs Service to believe that a possibility of a violation of subsection (a) existed."<sup>117</sup> "In addition, in accordance with the Mod Act, the proposed regulation indicates that a writing evidencing the "commencement" shall accompany any required prepenalty notice issued in connection with a case initiated relating to a prior disclosure denied by Customs ...."<sup>118</sup>

### III. THE CUSTOMS MODERNIZATION ACT

The Customs Service is faced with regulation of a rapidly increasing volume of imports with a static level of resources. To ensure U.S. trade laws are followed Customs has begun a major redesign of the Trade Compliance process. In 1993, the Mod Act was passed as Title VI of the North American Free Trade Agreement Implementation Act.<sup>119</sup>

These provisions amended many sections of the Tariff Act of 1930 and related laws. Two new concepts which emerge from the Mod Act are 'informed compliance' and 'shared responsibility.' These concepts are premised on the idea that in order to maximize voluntary compliance with Customs law and regulations, the trade community needs to be clearly and completely informed of its legal obligations.<sup>120</sup>

#### A. *Informed Compliance and Shared Responsibility*

These concepts of informed compliance and shared responsibility are premised on the idea that in order to maximize voluntary compliance with Customs laws and regulations, the trade community needs to be clearly and completely informed of its legal obligations. Accordingly, the Mod Act imposes a greater obligation on Customs to provide the public with relevant information concerning the trade community's responsibilities and rights under the Customs and related laws."<sup>121</sup> Greater responsibility is placed on the trade to while Customs must work to make compliance information readily available.<sup>122</sup> Informed compliance is "a shared responsibility wherein the Customs Service effectively communicates its require-

---

117. 19 U.S.C.S. § 1592 (c)(4)(B) (1997).

118. Adrienne Braumiller, *supra* note 18.

119. Pub. L 103-182, 107 Stat. 2057 (1993).

120. Stuart P. Seidel, *Customs Informed Compliance Strategy*, (visited Oct. 18, 1997) <<http://www.customs.ustreas.gov/imp-exp/rulings/comply/ma-incmp.htm>>.

121. *Id.*

122. Matthew T. McGrath, et al., *International Legal Developments in Review: 1996, Customs Law*, 31 INT'L LAW. 379 (1997). "[R]easonable care places some burden on the Customs Service to inform the trade community of the requirements for compliance." *Id.*

ments to the trade, and the people and businesses subject to those requirements conduct their regulated activities in conformance with U.S. laws and regulations.<sup>123</sup>

### 1. Reasonable Care

The Mod Act shifts the burden of compliance to the importer, all importers must now show 'reasonable care' in their Customs transactions. "It is now the importer's responsibility to value and classify merchandise" under the reasonable care standard.<sup>124</sup> Customs has drafted checklist as to what is reasonable care.<sup>125</sup> In formulating the standard Customs is

123. Stuart P. Seidel, *supra* note 120.

124. Special Report: 1996 Trade Outlook, 13 INT'L. TRADE REP. at 144 (1996).

125. George Wiese, *Customs Informed Compliance Strategy*, (visited Oct. 18, 1997) <<http://www.customs.ustreas.gov/imp-exp/rulings/comply/ma-incmp.htm>>.

#### Draft Reasonable Care Checklists:

##### Merchandise Description & Tariff Classification

1. Did you properly describe your merchandise to Customs in accordance with 19 U.S.C. 1481?
2. Did you properly classify your merchandise in accordance with 19 U.S.C. 1484?
3. Has Customs issued a "ruling" regarding the description of the merchandise or its tariff classification, and if so, has the ruling been followed?
4. Have you consulted the tariff schedules, court cases and Customs rulings to assist you in describing and classifying the merchandise?
5. Have you consulted with a Customs "expert" to assist in the description and/or classification of the merchandise?
6. Is the nature of your merchandise such that a laboratory analysis is suggested to assist in proper description and classification?

##### Valuation

1. Did you provide Customs with a proper declared value for your merchandise in accordance with 19 U.S.C. 1484 and 19 U.S.C. 1401a?
2. Has Customs issued a "ruling" regarding the valuation of the merchandise, and if so, has the ruling been followed?
3. Have you consulted the Customs valuation laws, Customs Valuation Encyclopedia, court cases and Customs rulings to assist you in valuing merchandise?
4. Have you consulted with a Customs "expert" to assist in the valuation of the merchandise?
5. If you purchased the merchandise from a "related" seller, have you reported that fact upon entry and taken measures to ensure that value reported to customs is a correct "related party" value for the goods?
6. Have you taken measures to ensure that all of the legally required costs or payments associated with the imported merchandise have been reported to Customs (e.g., assists, commissions, indirect payments or rebates, royalties, etc.)?

##### Some Major Reasonable Care Questions

1. Have you taken measures to ensure that the merchandise complies with other agency requirements prior to or upon entry (e.g., FDA, EPA/DOT, CPSC, FTC, Agriculture, etc.)?
2. Is the merchandise subject to an antidumping or countervailing duty order and if so, have you complied with Customs reporting requirements upon entry?
3. Have you taken measures to verify the country of origin of the imported merchandise?
4. Have you taken measures to ensure that the merchandise is properly marked upon entry with the correct country of origin (if required) in accordance with 19 U.S.C. 1304?
5. Is the merchandise subject to quota/visa requirements, and if so, have you

forcing importers to seek help from an expert in Customs regulations. "Reliance solely on the general information in [Customs Service] publications may not be considered reasonable care."<sup>126</sup> "A party will be presumed to have acted with reasonable care if 1) the 'party requests advice, prior to importation, from a Customs expert,' and 2) receives advice from the expert prior to importation; and 3) the party relies of the advice in filing entry for the subject merchandise."<sup>127</sup>

An importer might have exhibited reasonable care even if Customs later disagrees with their actions. The new operational environment requires an importer to exhibit a good faith effort to comply with all regulations, and the reasonable care standard must be interpreted flexibly.<sup>128</sup>

## 2. Enforcement Strategy

Customs enforcement will shift from transaction based processing to account<sup>129</sup> based interaction with the trade community. An account based focus can efficiently reach the top 1000 importers responsible for bringing in over 60 percent of all import value.<sup>130</sup> Not all high volume merchandise is equally significant in Customs enforcement. Three factors contribute to a commodity being designated for emphasis in the trade enforcement plan; 1) The commodity's strategic impact on the nation's security or economic well-being, 2) its current compliance rate, and 3) the volume of importation.<sup>131</sup> Customs will concentrate on 'Primary Focus' industries that are involved with automobiles and auto parts, advanced displays, telecommunications equipment, textiles and footwear, steel, production equipment, certain agricultural goods, and critical components (such as ball bearings.) Priority areas that Customs will be looking at in-

---

provided a correct visa for the goods upon entry? *Id.*

126. Stuart P. Seidel, *Reasonable Care and Informed Compliance*, (visited Nov. 9, 1997), <<http://www.customs.ustras.gov/imp-exp/rulings/icpframe/htm>>.

127. *ABA Views International Issues in Harmonization, Customs, IP*, 14 INT'L. TRADE REP. at 1443 (1997).

128. H.R. REP. NO.103-361(I), *supra* note 3, at 120.

The following are two examples of how the reasonable care standard should be interpreted by Customs: (a) the failure to follow a binding ruling is a lack of reasonable care; and (b) an honest, good faith professional disagreement as to correct classification of a technical matter shall not be lack of reasonable care unless such disagreement has no reasonable basis (e.g., snow skis are entered as water skis). *Id.*

129. George Wiese, *Informed, Voluntary and Enforced Compliance*, (visited Oct. 18, 1997), <<http://www.customs.ustras.gov/imp-exp/rulings/complyk/ma-incmp.htm>>. (Accounts are defined as every person or firm with whom Customs does business, or in whom Customs has an interest related to trade compliance; this includes all relevant business entities such as importers, carriers, brokers, manufacturers, warehouse proprietors, and sureties).

130. Stuart P. Seidel, *supra* note 125.

131. *Id.*

clude classification, valuation, claims for special preference, payment of antidumping duties, trade statistics, and origin claims.<sup>132</sup>

### 3. Customs Audits

#### a. Compliance Assessment

As part of the primary focus evaluation Customs will form Compliance Assessment Teams. These teams will strategically review defined areas of importer records and processes. "At the conclusion of the CAT review, Customs will develop performance improvement plans making recommendations for improvement. It will then be the importer's responsibility to fix the problems identified."<sup>133</sup> Customs will follow up to see that the reforms have been implemented. A CAT review may turn into a full blown Customs audit if serious problems are discovered.

At a minimum this first level of review is a useful for Customs to identify specific areas of noncompliance. Customs will conduct 200 audits<sup>134</sup> a year and major importers can expect to have some kind of agency review. Specific "red flags" that will pique Customs attention. Such as, notations on the invoice such as "For Customs Purposes Only," or crossed out (and "whited out") information on the invoice, prices that are lower or higher than usual. Customs will also pay special attention to related party transactions, transfer pricing and assists or if the goods are shipped from a different country than where it was manufactured.<sup>135</sup>

Customs has increasingly used statistical models to compare an importer to others in the same industry. The data gathered from entries can show inconsistencies in the trade patterns of a particular importer. "In 1995, Customs conducted a "baseline" analysis on compliance with trade laws."<sup>136</sup> This baseline information is used in trend analysis and gives a much more accurate picture of compliance than the hit or miss method of examinations.

#### b. Audit Procedure

When Customs initiates an audit it must contact the party to advise them of the impending audit, describe what records will be examined, and schedule an "entry conference."<sup>137</sup> During the conference Customs will explain the purpose of the audit and set an estimated termination date.<sup>138</sup>

---

132. *Attorneys Get Tips on Audit Readiness as Agency Gears up to Begin CAT*, 12 INT'L. TRADE REP. at 1357 (1995).

133. *Id.*

134. Mark K. Neville, Jr., *IRS and Customs Work Together Through Information Sharing*, 5 J. INT'L. TAX'N. 372 (1994).

135. Sandra Smith, *Legal Aspects of Importing*, INT'L. SMALL BUS. DEVELOPMENT CTR., (1997).

136. *Special Report: 1996 Trade Outlook*, 13 INT'L. TRADE REP. at 144 (1996).

137. Smith, *supra* note 135.

138. 19 U.S.C § 1509(b)(2) (1997).

At the end of the on-site audit Customs will arrange a closing conference to explain the preliminary results.<sup>139</sup> Customs will issue a formal report of the findings within 90 days of the closing conference.<sup>140</sup> The final report will be delayed if the audit has revealed serious violations and a formal investigation has begun.<sup>141</sup>

### *B. Recordkeeping Requirements*

The Mod Act has new recordkeeping requirements for all members of the import process. These new requirements are part of the increased burden born by the trade under informed compliance. "These amendments will clarify the recordkeeping requirements for the importing community, close existing loopholes, and update the statute by bringing records made or retained by electronic means within the purview of the recordkeeping requirements."<sup>142</sup> As Customs moves to an audit based enforcement strategy emphasis is placed on production of records upon demand. Customs now has five-year retention period for most records that can extend to eight years for drawback claims.<sup>143</sup> To ensure compliance congress passed tougher penalties for failing to produce records and expanded the scope of Customs summons power.<sup>144</sup> Customs has placed such emphasis on this area that the agency has created a new part to Chapter 19 C.F.R. to just handle recordkeeping. "Because of the enhanced importance of recordkeeping, Customs believes that a new part devoted solely to this subject is appropriate. Accordingly, Customs is proposing to create a new Part 163 regarding recordkeeping."<sup>145</sup> The recordkeeping requirements now extend to any party that is a part of the import process.<sup>146</sup>

---

139. *Id.*

140. 19 U.S.C. § 1509(b)(3) (1997).

141. 19 U.S.C. §1509(b)(5) (1997).

142. *Id.* at 112.

143. *Id.*

Finally, section 614 provides that records pertaining to drawback claims shall be kept for three years from the date the claim is paid; all other records required to be kept by this section, including those pertaining to exportations to Canada, shall be retained for five years from the date of importation or exportation (to Canada), as appropriate. *Id.*

144. 19 U.S.C. § 1509(a)(1)(B)(2)(iv)(C) (1997).

145. Recordkeeping Requirements, 62 Fed. Reg. 19704 (1997) (to be codified at 19 C.F.R. pt. 163).

146. 19 U.S.C. § 1508(a)(1) (1997) requires any party who is:

Owner, importer, consignee, importer of record, entry filer, or other party who—

(A) imports merchandise into the customs territory of the United States, files a drawback claim, or transports or stores merchandise carried or held under bond, or

(B) knowingly causes the importation or transportation or storage of merchandise carried or held under bond into or from the customs territory of the United States;



### 1. Increased Importer Burden

Faster processing of Customs entries is a direct Mod Act benefit to the importer. This is offset by the more burdensome recordkeeping requirements.<sup>147</sup> This marks the shift to an audit based regulatory scheme.

Customs must be able to use a post-entry record demand to ensure that an importer's claims on entry were valid. In order to expedite the release of merchandise, Customs may initially waive production of certain required records and then verify them at a later date. This is especially true in the case of records not affecting admissibility. This fact is recognized in the law, which refers to a record which is required by law or regulation for the entry of the merchandise whether or not the Customs Service required its presentation at the time of entry.<sup>148</sup>

### 2. Protection for Importers

Congress intended the new requirements to allow Customs thorough access to information while protecting the importer from agency abuse.

It is the Committee's intent that Custom's recordkeeping requirement and examination authority is limited to those records which are referenced in the statute. The Committee emphasizes that Customs is not authorized to exceed its statutory authority in making 'fishing expeditions' when requiring importers to maintain records and produce them for audit or inspection. It is the Committee's belief that the stipulation in section 615 of those records required to be produced for Customs upon request should restrict significantly potential for abuse.<sup>149</sup>

The recordkeeping requirements give Customs broad new powers to demand information and punish importers who do not comply. However, that power should be used with discretion. Any demand for records must be complied with in a reasonable time.<sup>150</sup> In determining what is reasonable Customs must consider how factors such as the quality, type and age of the documents demanded will impact the obligation to produce.

- 
- (2) agent of any party described in paragraph (1); or  
 (3) person whose activities require the filing of a declaration or entry. *Id.*

147. For a complete list of (a)(1)(A) information see the Customs Service Web Page. Howard Plofker, *Interim List of Records Required to be Maintained and Produced Pursuant to 19 U.S.C. 1509(a)(1)(A)* (visited Oct. 18, 1997) <<http://www.customs.ustreas.gov/imp-exp/finala1a.htm>>.

148. *Id.* (Customs response to an importer comment regarding the proposed (a)(1)(A) list.)

149. H.R. REP. NO.103-361(1), *supra* note 3, at 113.

150. 19 U.S.C. § 1509(a)(1)(A) (1997).

A single request for a single page document associated with a six-month old entry should be produced within a matter of days. In contrast, the production of 50 commercial invoices from an equal number of entries that were filed more than two years preceding the date of the demand obviously will take longer to produce, and may take as much as two to four weeks, depending on whether the records had to be retrieved from storage and the method of storage.<sup>151</sup>

The concepts of "shared responsibility and informed compliance" intend that Customs Service and the importing community develop document production schedules that are not an overwhelming burden, but at the same time permit the Customs Service to verify the accuracy of import transactions.

### 3. The (a)(1)(A) List of Required Records

The Mod Act requires Customs to publish the documents to be kept by the import community.<sup>152</sup> The list is required by 19 U.S.C. 1509(a)(1)(A), and is commonly referred to as the "(a)(1)(A) list." The list is divided into four sections.

These sections include:

I. General list or records required for most entries;

II. Records or information required on Customs Form 3461, 7533.

III. Records or items of information, required by law and regulation for the entry of merchandise and are presently required to be produced by the importer of record at the time the form 7501 is filed and

IV Documents/ Records or Information required for entry of special categories of merchandise.

All other 'records' that pertain to any import activity, drawback claim, the transporting or storing of bonded merchandise must also be kept, and rendered for inspection upon demand. 'Records' is defined broadly and includes information and data maintained in the form of electronically generated or machine readable data.<sup>153</sup>

### 4. Information Sharing with the IRS and Department of Commerce a. Internal Revenue Service

The North American Free Trade Agreement Implementation Act added the Customs Service to the list of agencies allowed to receive information from the IRS. Section 522 of NAFTA added section 6103 (1)(14) to the Internal Revenue Code and regulations controlling the release of tax return information to Customs have recently been issued.<sup>154</sup>

---

151. H.R. REP. NO.103-361(I), *supra* note 3, at 113.

152. 19 U.S.C. § 1509(e) (1997).

153. Adrienne Braumiller, *supra* note 18.

154. 26 C.F.R. § 301 (1996).

Customs will be most concerned with verification of dutiable value for imported merchandise. Information concerning payments to exporters not included on the import documents may be uncovered during an IRS audit. "For example, an importer's own accounts payable records are especially useful in finding undeclared amounts in the nature of royalties or dutiable assists. For this reason Customs auditors can be expected to do a thorough job of reviewing all the importer's journal entries."<sup>155</sup>

Questions will arise when inconsistent information is reported with the two agencies. If an importer is purchasing from a related party the relationship must be indicated on the Customs entry and a Form 5472 must be filed with the importer's federal income tax return. The same value for the shipment must be reflected in any information filed with either agency.

Routine transfer of IRS information is prohibited under the confidentiality statutes.

Only in cases where the Customs Service has a Customs Regulatory Audit planned or in progress, can Customs request certain specific information from the IRS and only in cases when the importer has refused to provide the information voluntarily. The existing provisions for these transfers are contained in Public Law 103-182 passed December 8, 1993.<sup>156</sup>

Customs may forward information on to the Internal Revenue Service with no such restrictions. "There is no prohibition similar to that in Section 6103 on this information flow, and Customs has been able to forward information on importer's inconsistent entries to the IRS."<sup>157</sup>

#### b. Department of Commerce

The Customs Service and the Department of Commerce are both responsible for enforcement of export regulations. "Both Commerce and Customs can be involved in the conduct of inspections and the investigation of suspected export control violations."<sup>158</sup> The Commerce Department is primarily concerned with enforcement of the export licensing system and Customs considers import licenses as part of dutiable value. Congress recognized the need for a smooth exchange of information.

To ensure their effective cooperation in export control, Commerce and Customs will routinely and promptly exchange licensing and enforcement information, including advising as to the opening and closing of investigations and

---

155. Mark K. Neville, *supra* note 134.

156. Providing Customs with IRS Form 5472, 60 Fed. Reg. 46,141 (1995).

157. Mark K. Neville, Jr., *supra* note 134, at 373.

158. Enforcement Responsibilities of Commerce and Customs Under the Export Administration Act, 50 Fed. Reg. 41,545 (1985).

the referral of cases to the Department of Justice for criminal prosecution .... Customs shall be responsible for supplying information and evidence developed in Customs investigations to Commerce so as to facilitate timely and coordinated pursuit by Commerce of civil penalties, administrative sanctions or temporarily denial orders, Commerce shall be responsible for supplying Customs information so as to facilitate appropriate action on forfeitures.<sup>159</sup>

## 5. Penalties

### a. Penalty for Failure to Produce the Required Records

The Customs Modernization Act introduces stiff penalties for failure to produce any required document. The penalty is based on the amount of culpability. If the failure to produce the information is a result of negligence in recordkeeping the penalty will \$10,000 or 40 percent of the value of the shipment.<sup>160</sup> If the importer cannot supply the documents because of a willful failure to comply the penalty will be not more than \$100,000 or 75 percent of the appraised value of the merchandise, whichever amount is less.<sup>161</sup> The penalties will be assessed on each entry for which the importer cannot provide documentation. Further, the above penalties are not exclusive, they are in addition to any other penalty provided by law.<sup>162</sup>

Often Customs will demand documents related to a special duty program. If the importer is unable to provide information regarding the preferential duty treatment the special rate can be denied. Customs can liquidate, or reliquidate, the entry at the general rate of duty in addition to is-

---

<sup>159.</sup> *Id.*

<sup>160.</sup> 19 U.S.C.S. § 1509(g)(2)(B) (1997).

If the failure to comply is a result of the negligence of the person in maintaining, storing, or retrieving the demanded information, such person shall be subject to a penalty, for each release of merchandise, not to exceed \$10,000, or an amount equal to 40 percent of the appraised value of the merchandise, whichever amount is less. *Id.*

<sup>161.</sup> 19 U.S.C.S. § 1509(g)(2)(A) (1997).

If the failure to comply is a result of the negligence of the person in maintaining, storing, or retrieving the demanded information, such person shall be subject to a penalty, for each release of merchandise, not to exceed \$100,000, or an amount equal to 75 percent of the appraised value of the merchandise, whichever amount is less. *Id.*

<sup>162.</sup> 19 U.S.C.S. § 1509(g)(4) (1997).

Penalties are not exclusive. Any penalty imposed under this subsection shall be in addition to any other penalty provided by law except for— (A) a penalty imposed under section 592 (19 USCS § 1592) for a material omission of the demanded information, or (B) disciplinary action taken under section 641 (19 USCS § 1618). *Id.*

suing a penalty.<sup>163</sup>

#### b. Mitigation of Penalties

The penalties may be severe for recordkeeping failures, however, they can be offset by a showing of good faith or inability to perform.

No penalty shall be issued if the demand is substantially complied with by the production of other evidence satisfactory to the Customs Service, if an act of God or other natural casualty or disaster prevents compliance with a lawful demand, or if demanded information was presented to, and retained by, Customs at time of entry or submitted in response to an earlier demand.<sup>164</sup>

Congress intended for the agency to use restraint in issuing the new, stiff penalties under the Mod Act. Agency headquarters in Washington "should exercise tight control over the imposition of recordkeeping penalties, and until the Customs Service gains some experience in administering this penalty, no such penalty should be issued without prior headquarters review and approval."<sup>165</sup>

#### 6. Certified Recordkeeping Compliance Program

A voluntary recordkeeping compliance program is available to all parties who are required to maintain and produce records and are in compliance with Customs laws and regulations. "Participants in the program are eligible for alternatives to penalties and may be entitled to greater mitigation of any recordkeeping penalty the party might be assessed should he be unable to produce a requested record."<sup>166</sup> "Applicants to the program may have Customs review their recordkeeping procedures and methods. If Customs determines that the party meets the program requirements, Customs may certify that fact and permit him to participate in the program."<sup>167</sup> Customs has prepared a Recordkeeping Compliance Handbook to assist the public in meeting recordkeeping requirements.<sup>168</sup>

For certification an importer must show: (a) they understand the legal requirements, time periods, and nature of the records involved, (b) have procedures to educate employees in preparation, maintenance, and production of required records, (c) procedures in place for the preparation, maintenance and production of required records, (d) dependable individual(s), who are familiar with recordkeeping requirements, to be responsi-

---

163. H.R. REP. NO.103-361(I), *supra* note 3, at 113.

164. *Id.*

165. Recordkeeping Requirements, 62 Fed. Reg. 19,704, 19,706 (1997).

166. *Id.*

167. *Id.*

168. U.S. Customs Service, Field Director, Regulatory Audit Division, 9090 S.E. First Street, Miami, Florida 33131.

ble for the records, (e) record maintenance procedure approved by Customs for original documents and other formats (such as microfiche), (f) procedures to notify the Customs Service of recordkeeping failure and programs to take corrective action when the system has failed.<sup>169</sup>

Thorough compliance review of an importer's operations can offer significant cost savings in both duty and by avoiding any possible Customs penalty. "Despite the very high duties (which may be higher than the corporate tax rate), few importers or their attorneys give "Customs law questions the same thought spent on tax planning or other issues."<sup>170</sup> Not being audit ready will extend the Customs review and possibly lead to stiff fines.

### *C. National Customs Automation Program (NCAP)*

Customs is working to move away from a paper based entry system. The system is now only on-line for entry information and transfer of duty payments. Entries are now released through ABI,<sup>171</sup> the Automated Broker Interface. Electronic transfer of funds to Customs is made through ACH, Automated Clearinghouse.<sup>172</sup> However, the broker or importer must be located at the port of entry and submit paperwork for any entry selected for Customs review. NCAP will automate other Customs transactions such as filing of bonds, drawback claims, electronic penalty process and remote entry filing from any location.<sup>173</sup> Large importers, like Nortel (Northern Telecom), are eager to embrace NCAP. They recently began "filing Customs entries for 40 percent of (their) shipments . . . and as a result the company reduced its brokerage fees by 75 percent at its major ports of entry."<sup>174</sup> The legislation also permits importers to cut costs through submission of information in batch form. Duty can be paid semi-monthly (with interest) as opposed to an individual payment for each shipment.<sup>175</sup>

#### 1. Remote Entry Filing

Under current law, Customs entry processing must take place at the same port where the goods are imported. This means that an importer needs to have a physical presence, usually in the form of a broker, in

---

169. See generally 19 U.S.C.S. 1509(f) (1997).

170. Routh, *supra* note 21.

171. 19 C.F.R. § 24.25 (a) (1997).

172. 19 C.F.R. § 24.25(b)(2) (1997).

173. H.R. Rep. No. 103-361(I) (1993).

174. Barbara Kevles, *Small Importers Face Maze of Revised Regulations*, DALLAS BUS. J. (Aug. 23, 1996).

175. Announcement of National Customs Automation Program Test of Account-Based Declaration Prototype, 62 Fed Reg. 14,731, 14,735 (1997). "For each shipment released during a calendar month, the entry filer must electronically transmit complete entry summary data to Customs on or before the filing deadline for that month." *Id.*

every port where they do business. Remote filing would allow goods to enter in one port, Customs processing to be handled in the importer's home city "and the goods could be delivered to another destination."<sup>176</sup> Remote filing fulfills Customs' objective of uniform entry treatment by confining entry processing to the importers home port. Entries will be consistently handled by the same brokers and processed at the same Customs office.

Among customs brokers remote filing has caused the greatest controversy. "Small brokers generally fear that it would hurt their business since it would eliminate the need to have a customs broker at the port of entry."<sup>177</sup>

Remote filing also leads to changes in the trading infrastructure. When U.S. Customs entries are removed the merchandise, ports, freight lines, the merchant marine, banks and other concerned private sector variables change. Customs manpower can be centralized into major business centers and most services can be performed remotely. U.S. Customs saves money by not maintaining a significant presence in as many cities. The less the presence, the lessening of the port activity.<sup>178</sup>

#### *D. Conclusion*

As business begins to globalize the import environment must change. To keep pace with an increasing level of imports, the Customs Service has become more streamlined and has shifted the burden of compliance squarely on the shoulders of the importer.

---

<sup>176</sup>. *Senate Finance Committee Attaches Revival of Super 301 to NAFTA Proposals*, 13 DAILY REPORT FOR EXECUTIVES at d17 (Oct. 22, 1993).

<sup>177</sup>. *Id.*

<sup>178</sup>. *Customs Modernization and Informed Compliance Act: Hearings on H.R. 3935 Before the Subcomm. on Trade of the House Comm. on Ways and Means*, 102d Cong., (1993).