

NBITA

# Evaluating Risks and Exposures In Customs Transactions

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Presented by

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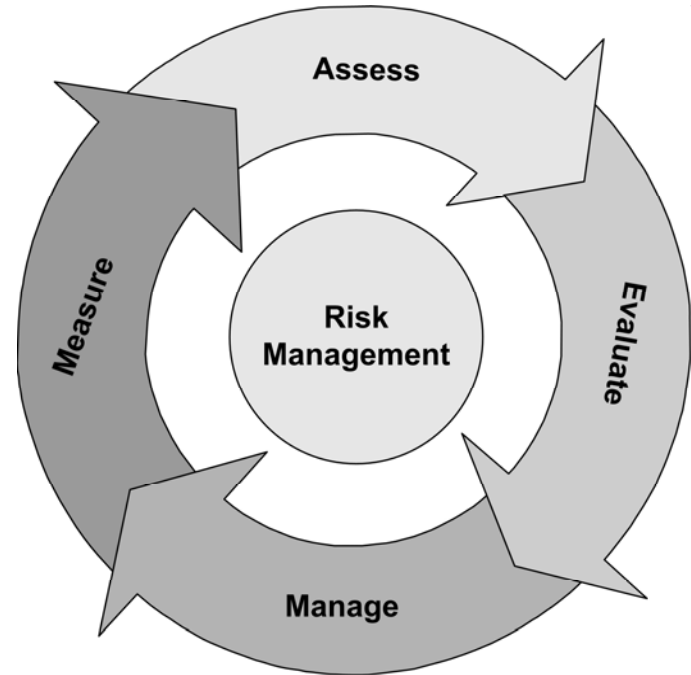
## Evaluating Risks and Exposures In Customs Transactions

- Compliance extends beyond voluntary programs like ISA
- Basic obligation of all importers
- Cost of non-compliance
  - Disruption of business
  - Disruption of supply chain
  - Distraction to employees and management
  - Penalties and Liquidated damages
  - Detention and seizure of goods



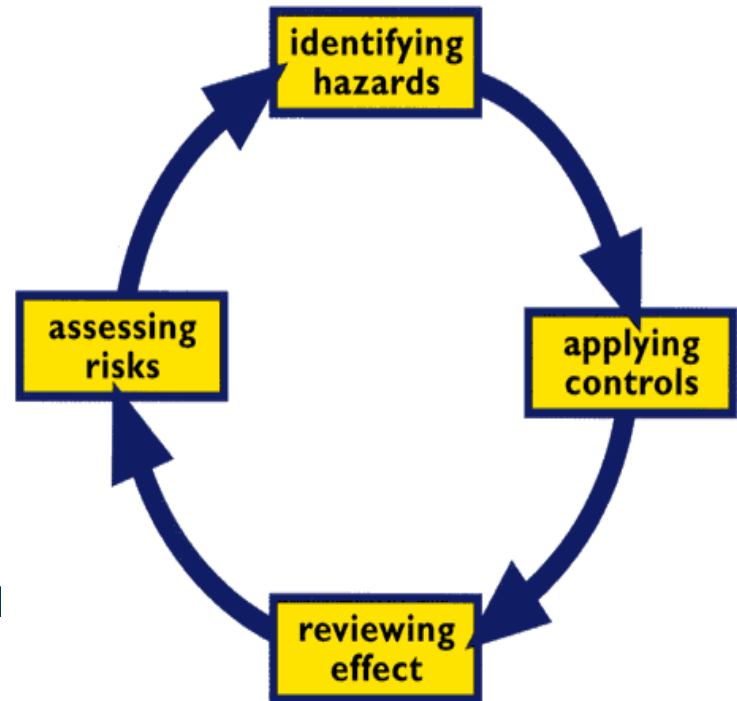
# Evaluating Your Risks and Exposures

- What is a “risk assessment?”
  - Company identifies transactions that are risks to CBP compliance
  - analyzes risks for possible effects, and designs control activities to manage those risks.



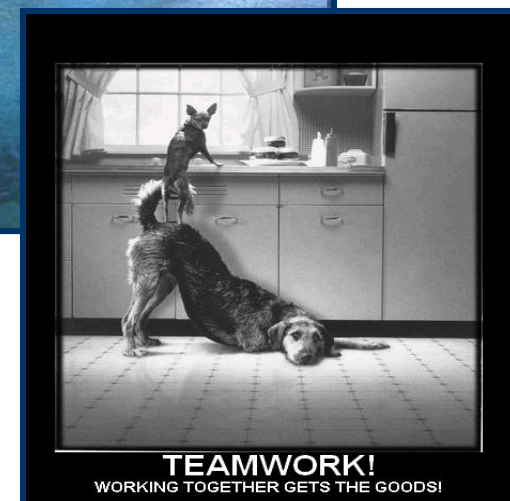
# Evaluating Your Risks and Exposures

- Typical risk areas associated with customs transactions--
  - Classification
  - Special trade areas/ Transshipment
  - Valuation
  - Quantity
  - Recordkeeping
  - Antidumping/ Transshipment
- New “risk” areas include:
  - Product safety—CPSC/ Food/ Medical
  - Trademark / trade names
  - Textiles



# Where to Begin Your Risk Assessment?

- Identify Customs programs use by your company
- Identify persons knowledgeable about products and programs; assemble compliance team
- Review regulations and legal requirements for programs
- Determine what records must be maintained and/or procedures that must be followed



**TEAMWORK!**  
WORKING TOGETHER GETS THE GOODS!

# Where to begin: Data Collection and Analysis



- Obtain copy of importer activity report or ACE reports from Customs
  - Review data for information on
    - Exporters/manufacturers
    - values
    - tariff classifications
    - Special duty /preferences

# Where to begin: Data Collection and Analysis

- ITRAC - Importer Trade Activity
  - ITRAC is company-specific import data placed in an MS-Access 97 database, and provided on CD-Rom for a processing fee.
- Link CBP web page
  - [http://www.customs.gov/xp/cgov/admin/fl/foia/making\\_a\\_request/itrac/itrac.xml](http://www.customs.gov/xp/cgov/admin/fl/foia/making_a_request/itrac/itrac.xml)

# Where to begin: Data Collection and Analysis

- **Available ITRAC information includes:**

- Country of Export
- Est. Tax
- Port of Lading/Unlading
- Country of Origin
- Exams
- Related Party Status
- Discrepancy Types
- Export Date
- Special Program Indicator
- Entered Value
- Filer
- Ultimate Consignee
- Entry Date
- HTS Number/Desc.
- Entry Number
- Liquidation Date
- Entry Type
- Manuf. Id
- Est. Duty/Rate
- Mode of Transport

# ISA Risk Review Process

- Review the company's risk environment, such as:
  - Imports from specific manufacturers or suppliers
  - Imports from countries known for transshipment
  - Imports subject to antidumping, textiles and other sensitive Customs issues
  - Large volumes of imports under special duty provisions or special trade programs
  - Large volumes of imports under complex tariff classifications

# Tariff Classification Risk Reviews

- Review FA Technical Guide 5D related to Classification
- Informed compliance publications: Classification of Sets; Classification of Textile Costumes Under the HTSUS; Footwear
- Does company record tariff classification at the part or SKU level (product/classification matrix)?
- Use PO reports to identify high value or high volume SKUs
- Does company document classifications with technical information and reference to preexisting rulings or HTS classifications and Explanatory Notes
- Identify HTS classifications with unique classification requirements or duty free/ low duty rates

# Tariff Classification Risk Reviews

- Review high value or high volume SKUs against classification requirements
- Examples:
  - Telecom cables– duty free vs. non-telecom 2.4%
  - Power supplies for ADP/ Telecom– duty free vs. non ADP/Telecom
  - Wearing Apparel– water resistant vs. non-water resistant
  - Wearing Apparel-- textile articles worn while participating in sports incorporating guards, pads, evaluated on a case-by-case basis
  - Classification of bicycles– dependent on size of wheels and weight
  - Flashlights– 12% vs. Portable electric Lamps – 3.5%
  - “Parts” classifications vs. specific tariff description for article

# Tariff Classification Risk Reviews

- Use ITRC or ACE report
- Summarize HTS classifications for specific time period; rank by value
- Compare HTS classifications from ITRC/ ACE report to known HTS used by company
- Prepare report of entries with classifications that are not on company data base

# Methods Of Customs Valuation

## 19 USC 1401a

- The Customs Value law provides for the following methods of value, in order of preference:
  - Transaction value
  - Transaction value of identical or similar merchandise
  - Deductive value
  - Computed value
  - a derived (fall-back) method reasonably adjusted to circumstances
- Merchandise may not be appraised on the basis of -
  - Minimum, arbitrary, or fictitious values

# Transaction Value

- What is Transaction Value?
- The term "price actually paid or payable"
  - “the total payment (whether direct or indirect) . . . for merchandise by the buyer to, or for the benefit of, the seller.”
  - Plus certain statutory additions if not otherwise included:
    - packing costs
    - selling commissions
    - assists
    - royalty or license fees paid as a condition of importation
    - Proceeds of a subsequent resale, disposition, or use

# Transaction Value

- When is transaction value appropriate?
  - Must have a sale of the imported goods for export to the United States.
  - No restrictions on disposition or use, except those
    - Imposed by law
    - Geographical resale territory
    - Which do not otherwise substantially affect the value

# PRICE ACTUALLY PAID OR PAYABLE

- Companies are often invoiced separately by vendors / suppliers for:
  - tooling, molds, packaging items
  - Expedited or “hot lot” manufacturing fees
  - Small lot or small quantity surcharges
  - Product modifications
  - NRE or separate tooling charges for startup production costs
  - Testing costs -- 542187 dated Nov. 7, 1980 (TAA No. 11); 543645 dated Feb. 17, 1987.

# Customs Valuation: 1401a(b)(2) The Related Party Rule

- Statute (19 USC 1401a) requires imported goods to be appraised at “transaction value” unless transaction value is found inappropriate
- (b)(2)(A) -- The transaction value of imported merchandise shall be the appraised value of that merchandise for the purposes of this chapter only if -
  - \*\*\* (iv) the buyer and seller are not related, or
  - the buyer and seller are related but the transaction value is acceptable
- Burden is on importer to establish that the relationship does not affect the price
- Customs has published ICP on valuation for related party transactions

## Acceptability of Inter-company Prices Based On “IRS” Transfer Pricing Methodology

- HQ 546979, August 30, 2000
  - “While the goal of both the TAA and section 482 of the Tax Code is to ensure that the transactions between related parties are at arms length, the method of making that determination is different under each law.”
  - “Customs approach to related party transactions differs from the IRS approach . . . the [IRS] methods review profitability on an aggregate basis, not a product by product basis.”
  - “Customs generally analyzes related party transactions at a more detailed product by product level . . .

## Related Party Rule For Customs Valuation

- Use of “Test Values”
  - Comparison of transfer price to:
    - Transaction value of similar goods
    - computed or deductive value of goods
  - Limited to situations where there has been an “appraisement entry”
- “Circumstances of Sale”
  - Documentary Evidence of “arms length negotiations”
  - Evidence of Market value of goods
  - Selling price equals all costs plus profit and general expense for seller

# “All Costs Plus Profit” Method

- An importer may demonstrate that the relationship between the buyer and the seller did not influence the price by establishing that:
  - "the price is adequate to ensure recovery of all costs plus
  - a profit that is equivalent to the firm's overall profit realized over a representative period of time in sales of merchandise of the same class or kind . . ."
- Statement of Administration Action, Id.; see also 19 C.F.R. 152.103 (l)(1)(iii).

# The Generra Rule

- The Generra Presumption
  - All payments made by a buyer to a seller, or a party related to the seller, are part of the price actually paid or payable for the imported merchandise. (Generra Sportswear Co. v. U.S., 8 CAFC 132 (1990))
  - Congress did not intend for CBP to engage in extensive fact-finding to determine whether separate charges, all resulting in payments to the seller in connection with the purchase of imported merchandise, are for the merchandise or for something else.
  - The burden of establishing that payments are unrelated to the imported merchandise rests on the importer. Moss Mfg. Co. v. United States, 896 F. 2d 535, 539 (Fed. Cir. 1990)

# Valuation Checklist

- ❑ Price Actually Paid or Payable
- ❑ Packing
- ❑ Selling Commissions
- ❑ Assists (e.g., Materials/Component Parts, Tools, Dies, Molds, Merchandise Consumed, Engineering, Development, Art Work, Design Work, Plans)
- ❑ Royalties and License Fees
- ❑ Proceeds of Subsequent Resale
- ❑ Transportation Costs (e.g., International Freight, Foreign inland Freight,
- ❑ Transportation Rebates, Insurance)
- ❑ Retroactive Price Adjustments (Periodic and year end transfer price adjustments)

# Valuation Checklist

- ❑ Price Increases
- ❑ Rebates and Allowances
- ❑ Indirect Payments to 3<sup>rd</sup> Parties that benefit seller
- ❑ Payment of Seller's Debt by Buyer (e.g., quota)
- ❑ Price Reductions to Buyer to Settle debts (e.g., Reductions for Defective Merchandise)
- ❑ Purchases on Consignment
- ❑ Quota/Visa
- ❑ Currency Exchange Adjustments

# Where to Begin Your Valuation Risk Assessment?

- Important Resources: Customs Publications
  - Customs Valuation Encyclopedia of Rulings and Decisions
  - Informed Compliance Publications
    - Bona Fide Sales & Sales for Exportation to the United States
    - Buying & Selling Commissions
    - Customs Value
    - Determining the Acceptability of Transaction Value for Related Party Transactions
    - Importation of Commercial Samples
    - Proper Deductions for Freight & Other Costs

# Where to Begin Your Valuation Risk Assessment?

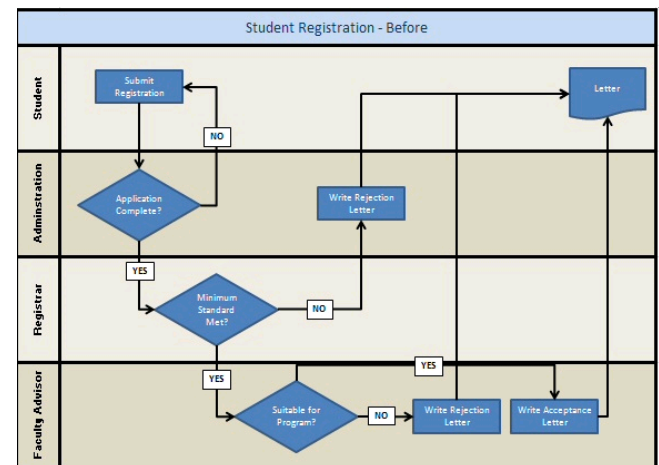
- Exhibit 5B - Transaction Value - Technical Information for Pre-Assessment Survey (TIPS)
- Exhibit 5T - Reconciliation - Technical Information for Pre-Assessment Survey (TIPS)

# Where to Begin: Valuation

- Focus on
  - Purchase pricing adjustments, discounts, rebates, etc.,
  - Accounting: payments, payable, inventory
  - Cost of Goods: assists, foreign R & D, royalties.
  - Finance Dept -- what are key general ledger accounts used to record payments for goods and R & D ?

# Where to Begin Your Valuation Risk Assessment?

- Flow chart product acquisition and payment process:
  - Purchase/ ordering of merchandise
    - Finished goods/ materials/ work in process/ returns/ spares
  - receipt of merchandise
  - recording of inventory
  - payments made to foreign vendors
  - payment made to U.S. vendors
  - Development of new product



# Valuation Where to begin: Data Collection and Analysis

- Obtain financial information related to:
  - Accounts Payable and Vendor reports
  - P & L account descriptions and information for cost of goods and other similar accounts
  - Supply Contracts and Royalty or License agreement
- Vendor Payment Analysis
  - Select a time frame for Analysis
  - Sort ITRAC or ACE entry line by MID code and determine total value for period
  - Sort vendor payments for same period
  - Compare totals and determine reason for discrepancies

# Assists & Supplemental Payments

- Discuss definition of assists with Manufacturing/ Procurement/Purchasing / R & D Groups
- Intercompany Transfers can be assists
- Identify vendors and suppliers— review export data/records from shipping for shipment of tooling and equipment
- Obtain asset report and check location of equipment
- Research new vendors or other shifts in production

# Risk Analysis: Special Trade Programs

- GSP, Free Trade Agreements, U.S. Goods Returned
- Frequent area for errors and unsupported claims
- Customs Publications and FA Guidance
  - [Exhibit 4F - A Guide for Supporting Generalized System of Preferences \(GSP\) Claims](#)
  - [Exhibit 5E - HTSUS 9801.00.10 - U.S. Goods Returned - Technical Information for Pre-Assessment Survey \(TIPS\)](#)
  - [Exhibit 5H - HTSUS 9802.00.80 - U.S. Articles Assembled Abroad - Technical Information for Pre-Assessment Survey \(TIPS\)](#)
  - [Exhibit 5M - Generalized System of Preferences - Technical Information for Pre-Assessment Survey \(TIPS\)](#)
  - [Exhibit 5Q - Israel Free Trade Act \(IFTA\) - Technical Information for Pre-Assessment Survey \(TIPS\)](#)
  - [Exhibit 5R - African Growth and Opportunity Act - Technical Information for Pre-Assessment Survey \(TIPS\)](#)

# Risk Analysis: Special Trade Programs

- Select a time frame for analysis
- Sort ITRAC or ACE entry line data by SPI codes or tariff classifications (9801 or chapter 99)
- Select sample line transactions
- Determine whether appropriate supporting documentation is available

# Risk Analysis: Special Trade Programs

- 9801/9802 claims require (19 CFR 10.1):
  - Foreign Shipper Declarations
  - Evidence of US export
  - U.S. Manufacturer declarations
  - Has company applied for and received waiver from Port?
  - Review HQ H007668, dated June 20, 2007

# Risk Analysis: Special Trade Programs

- Most Special Trade Programs have special documentation requirements
  - Vendor declarations (i.e., gsp) are subject to additional verification
  - The supporting documents may include: trip reports, site visits, quality assurance reports
  - health and safety certificates prepared by government officials, and origin certificates prepared by government officials.

## Risk Analysis: Special Trade Programs

- Articles that are the product or manufacture of the SPI country may require additional evidence to substantiate the manufacturing origin:
- Evidence may include raw materials purchases, proof of factory labor, and support for manufacturing overhead. (Focus on source documents)
- Evidence of Direct Shipment (Singapore Integrated Sourcing Initiative (ISI))

# Risk Analysis: Quantity

- Exhibit 5S - Quantity - Technical Information for Pre-Assessment Survey (TIPS)
  - Unacceptable practices: declaring numbers of containers rather than number of units
  - Document receiving and inventory reconciliation practices
  - Does Receiving report unresolved quantity discrepancies to Trade Compliance?
  - Audit receiving discrepancy reports for accuracy
  - Does Trade Compliance report quantity discrepancies to CBP?

# Prior Disclosure During an FA

- Prior Disclosure can minimize exposure to 1592 penalties-- Even during an FA.
- A PD occurs when party “disclose” evidence of a violation without knowledge of a formal investigation, and tenders, or agrees to tender amount owing.
- During FA or other audit, PD may be “accepted” if matter is fully disclosed prior to receiving a sufficiently documented result sheet. (unless party is otherwise informed of violation).
- Prior disclosure is "violation specific" and disclosure benefits ordinarily are available only for those violations fully disclosed by the prior disclosure.
- Violations may still count towards projection of LOR.

# Treatment of “Gray Areas”

- FA Exhibit 3H - Resolving "Gray Areas" of Harmonized Tariff Schedule (HTS) Classification
- Correct classification of some imports can be difficult.
- Customs, as well as the importer, is negatively affected when costs to achieve compliance are out of proportion to the risks associated with noncompliance.
- In some cases the classification used by importer is a plausible alternative to the Customs classification
- If the classification is a “gray area,” importer’s internal controls will be considered sufficient to provide reasonable assurance that the appropriate classification is used, and the classification will not be counted as an error for the risk opinion.

## *Conducting Your Risk Assessment*

- **Identify risks and compliance goals**
  - Identify legal and regulatory compliance objectives
  - Sample entry and financial transactions
  - Identify errors and causes, and
  - Share results with other affected groups
  - As a group determine how errors can be eliminated
  - develop written procedures that “**reasonably ensure**” compliance objectives are met.

# Are You Ready?

- What does Customs want to see?
  - Demonstrated Management commitment to compliance with customs requirements and expectations
  - Evidence of a **“risk review”** related to import transactions
  - Documented programs & processes with designated responsibilities
  - Interaction between affected company employees and Customs brokers of important Customs related information
  - Periodic checks to verify accuracy of information
  - Evaluation of errors and documentation of “process fixes”
  - Disclose errors and tender any loss of revenue