CUSTOMS-NOTES

Written by George R. Tuttle Law Offices for informational use by the trade and import community on selected topics of general interest concerning Customs and import related matters.

January, 1997

REASONABLE CARE & RECORDKEEPING UNDER THE CUSTOMS MODERNIZATION ACT

by George R. Tuttle and George R. Tuttle, III

The United States Customs Service is preparing to meet the challenge of international trade in the 21st Century. Are you?

Facing predictions of shrinking budgets and a swelling workload, the United States Customs Service, in the early part of this decade, acknowledged that its existing method of processing import transactions, collecting revenue and enforcing trade, consumer and environmental laws could not withstand the expected flood of imports in the 21st Century. To meet this challenge Customs, in an uneasy alliance with the trade community, forged the Customs Modernization and Informed Compliance Act ("the Mod Act"), which was adopted and passed into law as a part of the North American Free Trade Implementation Act (NAFTIA) Public Law 103-182, December 8, 1993.[1] The stated purpose of the Mod Act is to "streamline and automate the commercial operations of the U.S. Customs Service," and "to improve compliance with the customs laws and provide safeguards, uniformity, and due process rights for importers."[2] The Mod Act is premised on the twin tenets of shared responsibility and informed compliance.

Fundamentally, the Mod Act provides Customs with the legal authority to automate previously paper intensive, manually processed commercial operations (movement, clearance of cargo, and collection of revenue). As envisioned, importers will someday interface electronically with Customs throughout all aspects of the import transaction, from manifests and invoices, filing of entry declarations and release of cargo to automated duty payments. The cost for this 21st Century Customs Service, however, is not inexpensive to the importing community.

The Mod Act alters the basic relationship between Customs and the importer by shifting from Customs to the importer the legal responsibility for determining the correct value, classification, and rate of duty applicable to entered merchandise.[3] The responsibility to

---

[1] This article reviews and comments on recent U.S. Customs Service Regulations and proposals on record-keeping and reasonable care requirements mandated by Title VI of North American Free Trade Implementation77s Act (NAFTIA), Public Law 103-182, December 8, 1993. The provisions of the Customs Modernization Act are contained in Title VI of the Act.

[2] House Report 361, 103 Cong., 1st Sess. 1993, page 106.

[3] Samuel. H. Banks, Acting Deputy Commissioner of Customs, *An Overview of*

maintain and produce records is also significantly altered to reflect the new role of the Customs Service in verifying declarations made at entry.[4] As automation becomes the standard, many of the documents and records previously required no longer have to be presented to Customs at the time of entry.[5] Importers, however, must still retain these documents and be prepared to produce them if requested by Customs. Failure to produce a requested document can result in the assessment of significant penalties.[6]

When drafting the Mod Act, Congress recognized that the Customs service has been and continues to be forced by a lack of resources to rely on the accuracy of information provided by importers regarding the tariff classification and value of merchandise. To ensure that Customs would not be misplacing its reliance on the accuracy of an importer's information and entry declaration, Congress determined that importers should be held to a higher level of accountability for the claims they make. Consequently, the Mod Act requires importers to use "reasonable care" when providing Customs with entry information, including classification, value, and duty rate, and for ensuring that all other applicable import requirements have been satisfied.[7] Under the Mod Act, the failure to use reasonable care in discharging this responsibility is tantamount to negligence and, at a minimum, the importer is subject to the possible imposition of a civil penalty under 19 U.S.C. § 1592.[8]

The Customs Service, trade community and other interested government agencies have worked thoughtfully and deliberately since passage of the Mod Act to redesign many processes and procedures, and draft new regulations to implement the various provisions of the Mod Act. Recently, the fruits of these labors have begun to emerge, and the Customs Service has released interim regulations and draft proposals addressing some of the recordkeeping requirements and the "reasonable care" standard.

The balance of this article will review the new recordkeeping regulations, the draft proposal regarding the "reasonable care" standard, and Customs' new importer compliance assessment program.

I. New Recordkeeping Requirements

The Customs Service took a significant step forward in implementing the Mod Act when it published its list of entry records and information required by law to be kept by importers. See T.D. 96-1, dated January 3, 1996. While there has always been a general requirement for importers and their agents to

---

Customs Legislated Modernization, Global Trade Talk, Vol. 4, No. 3 (1994).

[4] *Id.*

[5] As customs reduces entry documentation requirements on importers it expects to increase the use of post-entry reviews and audits as a means of insuring compliance. Samuel. H. Banks, Acting Deputy Commissioner of Customs, *An Overview of Customs Legislated Modernization*, Global Trade Talk, Vol. 4, No. 3 (1994).

[6] House Report 361, 103 Cong., 1st Sess. 1993, page 114.

[7] House Report 361, 103 Cong., 1st Sess. 1993, page 136.

[8] House Report 361, 103 Cong., 1st Sess. 1993, page 120.

maintain records[9], the failure to produce one of the identified records can now result in the imposition of substantial administrative fines.[10]

A. The "(A)(1)(A) List"

Subparagraph (a)(1)(A) was added to section 509 of the Tariff Act of 1930[11], by section 615 of the NAFTIA. It requires the maintenance and production of a record by an importer if "such record is required by law or regulation for the entry of merchandise whether or not the Customs Service required its presentation at the time of entry." In the spirit of what is referred to as "informed compliance," Congress further amended Section 509 by adding subsection (e), which requires the Customs Service to publish a list of records or entry information that is required to be maintained by importers and produced under section 509(a)(1)(A) -- known as "the (a)(1)(A) list."

The records identified in the (a)(1)(A) list, include, but are not limited to, any statement, declaration, document, or electronically generated or machine readable data. It identifies those records required by law or regulation for the entry of merchandise, including documents required by agencies other than the Customs Service. It is expected that the list will be amended as Customs reviews its requirements and continues to implement various aspects of the Customs Modernization Act.

B. Recordkeeping Penalties

Under new subsection 1509(g), the failure to produce a record or information identified on the (a)(1)(A) list within a reasonable (but unspecified) period of time after a written demand (taking into consideration the number, type, and age of the item demanded) may result in a penalty action, loss of any special duty privilege, and the liquidation or reliquidation of the merchandise at a higher rate of duty than entered. Under paragraph (g), the penalty may not exceed $10,000 (or 40% of the value of the merchandise, whichever is less), where there is a finding of negligent conduct associated with maintaining, storing, or retrieving the demanded document or information, or $100,000 (or 75% of the value of the merchandise, whichever is less), if there is a determination that the failure to produce the demanded document or information was willful or intentional. It is to be noted, however, that when a record or information has been previously filed with and retained by Customs, the record is not subject to recordkeeping penalties, although the underlying backup or supporting information from which it is obtained may also be subject to the general record retention regulations and examination or summons procedures of 19 U.S.C. §§ 1508 and 1509.

The (a)(1)(A) list and penalty provisions pertain only to records or information required for the entry of merchandise. An owner, importer, consignee, importer of record, entry filer, or other party who imports merchandise, files a drawback claim, or transports or stores bonded merchandise, any agent of the foregoing, or any person whose activities require them to file a declaration or entry, is **also** required to make, keep and render for

---

[9] 19 U.S.C. § 1508 requires importers, their agents, and other parties involved in an import transaction to make, keep, and render for examination and inspection records which pertain to importations which are kept in the normal course of business.

[10] 19 U.S.C. § 1509(g) as amended (1994).

[11] 19 U.S.C. § 1509. The provision relates to the examination and production of documents and records.

examination and inspection records (including, but not limited to, statements, declarations, documents and electronically generated or machine readable data) which pertain to any such activity or the information contained in the records required by the Tariff Act in connection with any such activity, and are normally kept in the ordinary course of business. While these records are not subject to administrative penalties, they are subject to examination and/or summons by Customs officers. Failure to comply with an administrative summons could result in the imposition of significant judicially imposed penalties and denial of import privileges.

C. Voluntary Recordkeeping Compliance Programs

In an effort to mitigate the severity of the recordkeeping penalties, Congress authorized the establishment of a voluntary recordkeeping compliance program, whereby parties certified by Customs as having a qualifying recordkeeping program would avoid the assessment of a monetary penalty for a first time negligent violation of the (a)(1)(A) list production requirements. Recordkeepers who are certified by Customs may participate in the program if they can demonstrate, among other things: comprehension of legal recordkeeping requirements; employment of procedures for explaining recordkeeping requirements to employees; for making, maintaining and producing records when demanded; and, for notifying Customs of variances to, or violations of, the recordkeeping compliance program, and for taking corrective action when notified by Customs of violations or problems regarding the program.[12]

The Customs Service has already engaged in lengthy consultation with the public regarding the development of its voluntary recordkeeping compliance program, referred to as the "Entry Information Recordkeeping Certification Program," and draft versions of its "Recordkeeping Compliance Handbook," are available to the public.[13]

D. Third Party Recordkeeping

The Customs Service also plans to permit importers and other parties subject to the recordkeeping requirements to designate a third party as their certified recordkeeper, so long as the designated third party is an authorized agent of the importer and otherwise receives certification that its entry recordkeeping system meets all statutory and administrative requirements and standards. Certified recordkeeping agents will be subject to the same responsibilities and penalties as recordkeepers for program violations and failure to produce documents upon demand. Liability of the third party recordkeeper, however, will be limited to the maintenance of only those records specifically designated and identified on the recordkeeper's application documents and by the agreement between the recordkeeper and the agent.

Under the Mod Act, retaining the service of a customs broker to prepare the necessary documents and/or information and to make entry is insufficient to create such a relationship, nor will such a relationship by itself shield an importer from penalties for

[12] House Report 361, 103 Cong., 1st Sess. 1993, page 114.

[13] The most recent revised handbook was released January 22, 1996, and information on how to obtain this handbook may be obtained by contacting your local U.S. Customs Service Office, or on Customs Electronic Bulletin Board under file RCPH0196.EXE.

failure to produce such records when requested. In today's business environment, both large and small companies may find third party recordkeeping an enticing alternative to obtaining certification for themselves. Before doing so, however, importers must carefully consider the risks of establishing such a relationship.

It will be incumbent upon importers contemplating third party recordkeeping relationships to consider the ramifications of such a relationship carefully and to contractually define the scope of the obligations upon each party to ensure that there is a mutual understanding as to each party's obligations and responsibilities, including the nature of the documents to be retained by each party, and any charges and fees for cataloging, archival, retrieval, and production of requested documents. Importers should also be clear as to the disposition or return of documents if and when the recordkeeping relationship terminates, or when the third party recordkeeper ceases business operations.

Under automated entry bypass procedures, Customs will not receive or retain entry documents, invoices, and declarations. Should an importer be required to contest a decision of the Customs Service in connection with the entry, the importer will be expected to produce a true copy of the entry and accompanying documentation. Thus, importers will have to consider how these documents will be produced and the associated costs of doing so, if the recordkeeper is outsourcing its recordkeeping activities to a third party, regardless of whether they are certified or not.

Importers should consider what type of supervision they will exercise over the third party agent maintaining their records and its ability to maintain and produce an importer's records when requested. As a related matter, importers need to clarify with a prospective third party recordkeeper its obligation to notify the importer should the third party recordkeeper be penalized, or its privileges suspended with respect to another account, and what impact, if any, such a penalty or suspension of certification for that account will have on their account. The failure to exercise reasonable care in oversight may result in the loss of protection afforded an importer by the third party recordkeeping relationship.

II. The Reasonable Care Standard For Entry Requirements

Importers have always had an obligation to provide Customs with complete and accurate information regarding a product and its value. Once presented with this information it was the obligation of Customs to classify the product and assess its value for duty collection purposes. Under the Mod Act, however, the importer now has the added responsibility to correctly value and classify merchandise. The responsibility of Customs has been limited to confirming that the entry has been correctly made and that the proper amount of duties have been paid.[14] Under the Mod Act an "importer of record"[15]

---

[14] House Report 361, 103 Cong., 1st Sess. 1993, page 137.

[15] The use of the terminology, "importer of record," has special legal significance. Congress intended to make it clear that the party assuming legal responsibility for making entry is responsible for ensuring that reasonable care has been exercised. Under section 1484, only the owner or purchaser of the imported goods is authorized to make entry. However, for shipments consigned to parties in the U.S., a licensed customs broker may act in their behalf as "importer of record." See 19 USC 1484(a)(2)(b).

must use "reasonable care" when (a) making an entry and providing the information necessary for Customs to determine if the merchandise may be released from custody, and (b) in completing the entry by providing the declared value, classification, and rate of duty applicable to the merchandise, and, for providing other information as necessary to enable Customs to properly assess duties, collect accurate statistics, and determine whether all other requirements of law have been met.[16]

In the post-Mod Act environment, it is expected that importers will be knowledgeable regarding the customs regulations, administrative rulings, interpretations and publications, as well as statutes, tariff schedules (including interpretative or explanatory notes), and judicial decisions which govern their import transaction.[17] If the party is not experienced in customs matters, it is expected that it will turn to Customs for advice regarding the transaction, or retain the services of a licensed customs broker or other acknowledged expert who has the requisite experience and knowledge of customs laws, regulations and procedures.[18] When using a qualified expert, the importer is also responsible for providing the expert with full and complete information sufficient for the expert to make entry or to provide advice as to how to make entry.[19] When such steps are taken, the importer will be presumed to have acted with "reasonable care" in making entry.[20]

The failure to exercise "reasonable care" in making entry will subject the importer of record, at a minimum, to penalties for negligence[21] found under 19 U.S.C. § 1592,[22,23] which may be as much as two times the loss of revenue, or 20 percent of the value of the

---

16 19 USC 1484 (1994)

17 Customs "Discussion Draft on Reasonable Care" released January 22, 1996. Available on Customs Electronic Bulletin Board under file MA-CARE1.TXT dated January 22, 1996.

18 House Report 361, 103 Cong., 1st Sess. 1993, page 120

19 Id.

20 Id.

21 For Customs' purposes, negligence has been defined as: "the failure to exercise the degree of reasonable care and competency expected from a person in the same circumstances in ascertaining the facts or in drawing inferences therefrom, in ascertaining the offender's obligation under the statute, or in communicating information so that it may be understood by the recipient. As a general rule, a violation is determined to be negligent if it results from the offender's failure to exercise reasonable care and competency to ensure that a statement made is correct." House Report 361, 103 Cong., 1st Sess. 1993, page 121.

22 House Report 361, 103 Cong., 1st Sess. 1993, page 121.

23 As a matter of policy, however, Customs may consider alternatives to penalty action, such as counseling or implementation of mandated compliance programs. Customs "Discussion Draft on Reasonable Care" released January 22, 1996. *See also* Proposed Revisions to Section 1592 Penalty Regulations, dated August 8, 1995, wherein it is stated "mitigation may take the form of 'administrative probation,' whereby the violator may eliminate or reduce § 1592 penalty liability by taking actions to correct the problems which led to the violation. Available on Customs Electronic Bulletin Board under file MA950821.TXT dated August 21, 1995.

merchandise, if the violation was non-revenue related.[24] Penalties for gross negligence[25] may be as much as four times the loss of revenue or 40 percent of the value of the merchandise, if the violation was non-revenue related.[26] Using an expert, however, will not insulate an importer from penalties where there is a failure to provide complete disclosure of all relevant information regarding the transaction.

It is also expected that if experts are consulted regarding Customs requirements, importers will satisfy themselves as to the qualifications of the "expert" to handle their specific commodities or specific Customs issues.[27] If the importer discloses all of the relevant information to the "expert" and the expert errs in its advice to the importer, the importer will be excused from liability, but only if the importer has made "complete disclosure" of the applicable facts to the expert, and has exercised due diligence in selecting the appropriate "expert."

It is expected that information provided to the expert be in writing, and that the advice given by the expert also be in writing, stating or restating the relevant facts and circumstances which were considered before arriving at the recommended course of action.[28]

The reasonable care standard will likely present great difficulties and new challenges for many importers and their customs brokers, as the previous norms for classifying merchandise are reexamined. Typically, importers rely almost exclusively on their customs broker to determine the classification of merchandise for them. In the past, Customs brokers often performed this service with little or no factual input from their clients, and with little time between notification of the arrival of merchandise and the filing of the entry and the release of cargo. In most cases, goods are classified solely on a minimal description of the good on the invoice provided by the foreign shipper. This frequently leads to the misclassification of goods. Additionally, many brokers do not inquire with importers as to the existence of additional payments, assists and other financial arrangements which can affect the entered value of the goods. The obligations presented by the Mod Act will require a retooling of this process and importers and brokers alike will need to workout the classification and valuation of merchandise well in advance of its arrival.

When controversies exist over the classification of goods, or there are questions as to whether certain additional payments, assists, or the relationship between the importer and the seller affect the price, the importer must ensure that the appropriate steps are taken to resolve the controversy in a manner consistent with the principles of the Mod Act. If the importer, broker, or customs specialist are uncertain as to the specific

---

[24] 19 U.S.C. § 1592, et. seq.

[25] For Customs' purposes, gross negligence has been defined as: "an act (of commission or omission) done with actual knowledge of or wanton disregard for the relevant facts and with indifference to or disregard of the offender's obligations under the statute." House Report 361, 103 Cong., 1st Sess. 1993, page 121.

[26] Id.

[27] Customs "Discussion Draft on Reasonable Care" released January 22, 1996. Available on Customs Electronic Bulletin Board under file MA-CARE1.TXT dated January 22, 1996.

[28] Customs "Discussion Draft on Reasonable Care." January 22, 1996.

classification or valuation of an article, it is incumbent upon them to bring the matter to the attention of Customs and seek advice as to the preferred method of classification or valuation. When the importer's preferred classification is contrary to the local advice provided by Customs, it may, if the transaction is still prospective in nature, seek a ruling from Customs.[29] When an importer disagrees with the classification or valuation of merchandise which is the subject of current or past importations, the merchandise is to be classified in accordance with the recommendation of Customs, and an administrative protest, in the form and manner prescribed in 19 C.F.R. Part 174,[30] may be filed.[31]

III. The Role Of Regulatory Audit In Ensuring Informed Compliance

A key feature of Customs new approach to achieving informed compliance is the importer compliance assessment program operated by the Regulatory Audit Division of the Office of Strategic Trade.[32]

Under this program, each regional audit division selects importers within their jurisdiction for a compliance assessment based on nationally, or in some cases, regionally developed criteria. The compliance assessment differs initially from a more traditional customs audit of the past in that it looks at procedures or systems employed by the target importer to determine whether the importer provides complete and accurate information and has achieved a level of compliance with the regulations acceptable to Customs. The process of evaluating the importer's system is referred to as a compliance assessment. If the assessment indicates the level of compliance of the importer needs improving, Customs will perform a more detailed audit, and offer guidance and assistance to the importer to improve the company's compliance levels, procedures and systems relating to customs transactions.[33]

Compliance assessments begin by the importer completing a lengthy questionnaire regarding its import activities, corporate structure, relationship with suppliers, importing practices, location and

---

[29] Proposed Section 177.11. Available on Customs Electronic Bulletin Board under file MA-177.EXE dated February 23, 1996.

[30] Part 174 of the Customs Regulations regarding Administrative protests is also undergoing a substantial rewrite. Available on Customs Electronic Bulletin Board under file MA-174.EXE dated February 23, 1996.

[31] The filing of an administrative protest under 19 U.S.C. 1514 and its denial is generally a prerequisite to obtaining judicial review of a matter before the United States Court of International Trade.

[32] The expanded nature of audits of importers received the tacit approval of Congress in the Mod Act's legislative history, wherein it is stated "the Committee expects that in an era of 'informed compliance,' the Customs Service will continue to make expanded use of its Regulatory Audit program." House Report 361, 103 Cong., 1st Sess. 1993, page 115.

[33] *See generally*, Customs' Importer Audit Program--Compliance Assessment Team (CAT)-KIT available on Customs Electronic Bulletin Board under file DIAP1095-EXE.

interrelationship of records, scope of internal controls over entry of merchandise, and processes and procedures employed by the importer concerning the classification and valuation of goods. The Customs compliance assessment team reviews the responses by the importer and develops an audit plan designed to carry out the objectives of the compliance assessment.

The second phase of the assessment will focus on the review of entries and the underlying records supporting the transaction. Using statistical sampling methods, Customs will select sufficient entries from a primary focus group to ensure that the sampling will be statistically representative of the group with an accuracy rate of 95%. The compliance assessment team will then request the importer to provide for examination the customs records which support the valuation and/or classification of the imported articles. Additionally, Customs will, using the company's general ledger accounts, select and examine categories which may disclose unreported assists or additional payments to foreign suppliers. If there are sufficient errors in the sampling of transactions examined, Customs will expand the scope of its audit activities by selecting additional entries and moving deeper into General Ledger transactions.

The Mod Act does, however, provide some protections to the importer and lends certainty to the audit process. Section 615 NAFTIA amends section 509 by adding Subparagraph (b) outlining regulatory audit procedures. These procedures provide an importer with the right to an entry conference during which the purpose of the audit is to be explained and the estimated termination date for the audit set. Additionally, upon completion of the audit, Customs is to provide a closing conference and explain the preliminary results of the audit.[34] Within 90 days of the close of the audit, a formal audit report is to be prepared, which upon application under Freedom of Information Act procedures, is to be made available to the importer.[35] Where serious violations are discovered during the course of an audit, Customs may, however, upon commencement of a formal investigation as described under 19 U.S.C. Section 1592(4)(b), decline to conduct the exit conference and withhold production of the audit report to the extent permitted under 5 U.S.C. § 552.[36]

---

[34] 19 U.S.C. § 1509(b)

[35] Id.

[36] Id.

CONCLUSION

The Mod Act will provide many efficiencies in processing of cargo long sought after by both Customs and the import community. The majority of importers, however, are not yet prepared to face the true impact of this law and the obligations it imposes upon them. The challenge for the trade community will be to educate importers as to their obligations and help them develop the processes and procedures needed to ensure compliance with the Customs laws.

For additional information on this subject or for additional copies of this publication contact:

George R. Tuttle Law Offices
Three Embarcadero Center, Suite 1160
San Francisco, CA 94111 Phone (415)986-8780
Fax (415) 986-0908

Email address: info@tuttlelaw.com