

JOINT INDUSTRY GROUP

1620 I Street, NW
Suite 615
Washington, DC 20006
☎ (202) 466-5490 📠 (202) 463-8498 ✉ jig@moinc.com

Chairman
Joseph A. Vicario, Jr.
Texas Instruments, Inc.

Vice-Chairman
Ronald Schoof
Caterpillar Inc.

Secretariat
James B. Clawson
JBC International

Treasurer
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Baker & McKenzie

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Director, Regulatory Audit Division
Office of Strategic Trade
U.S. Customs Service
Ronald Reagan Building
1300 Pennsylvania Avenue, NW
Washington, DC 20229

Re: Comments on Proposed Refinements to Compliance Assessment Process

Dear Sir/Madame:

The Joint Industry Group (“JIG”) is pleased to provide comments on Customs proposed refinements to the Compliance Assessment (CA) process that were made available on the U.S. Customs Service web site. JIG is a coalition of more than one hundred and fifty members representing Fortune 500 companies, brokers, importers, exporters, trade associations, and law firms actively involved in international trade, that is acutely concerned with Customs’ policies and practices. JIG membership represents over \$350 billion in annual trade.

In 1996, when Customs initiated the CA process, JIG members responded positively to the initiative, which was seen as wholly consistent with the Informed Compliance concept. Now, however, after several years of experience with the process, our members and many other importers (the Trade) have expressed dissatisfaction with it, both from philosophical and operational standpoints.

JIG is pleased that Customs has responded to concerns of the Trade by proposing various refinements to the CA process, but we are disappointed that Customs chose to limit its process improvement only to post-audit issues. Most of the proposed CA process refinements decrease a company’s chances of being labeled a “high risk” importer, which is laudable. Certainly, every company wants to “pass” a CA and does not want to be categorized as “high risk,” a categorization that subjects it to frequent cargo inspections or additional audits. But from a broader perspective, the basic philosophy and approach of the CA and the process itself needs to be reexamined, and that has not been done. We submit that such a reexamination is essential and offer some thoughts on the subject.

1. Customs Approach to Determining An Importer's Compliance

Part of the Trade's dissatisfaction with the CA program stems from its philosophical disagreement over the Customs Service's notion of customs compliance. To Customs, customs compliance means an importer must achieve a nearly "error-free" import transaction environment. To the Trade, customs compliance means exercising reasonable care in handling import transactions; an "error-free" environment (as Customs defines "error") is a worthy but unrealistic goal. These different philosophies are difficult to reconcile inasmuch as Customs seeks perfection and the Trade believes that the concept of "reasonable care" accepts the possibility of some errors.

From the Trade's perspective, a CA should examine (1) whether a company has internal systems and controls, (2) whether those systems and controls are adequate to achieve compliance with the customs laws, and (3) whether those systems and controls are applied consistently. The Trade believes that sampling a small number of import transactions provides essential information for testing those system and controls and determining how they are being applied. The results should then be used to identify systemic weaknesses and to assist a company in remedying deficiencies.

We do not believe that Customs' current "Pass/Fail" 95% compliance rate, based as it is on the results of a detailed audit of the minutia of a large sample of import transactions, is satisfactory or achieves the desired goal. There is something clearly wrong with a compliance test that few if any importers "pass," even though the companies tested are generally the largest, most sophisticated importers, and frequently employ numerous people, including former Customs officials either in-house or as advisors, to oversee their import/export activity. Labeling such importers as "non-compliant" or "high risk" even though they are aware of and attentive to their customs responsibilities and otherwise exercise reasonable care, places Customs' notion of customs compliance into question. Is Customs' objective to find minor, inconsequential errors or to insure that importers are aware of their obligations under law and have systems that ensure fulfillment of those obligations? We urge you to re-examine and re-think this concept.

2. Level of Compliance + Errors

Under the CA process, a company's level of compliance is directly related to the number of "errors" found by the CA team when it audits a statistically valid sample of entries and other documents in certain specified areas. The JIG submits that Customs over-emphasizes error detection and tabulation in judging the level of a company's customs compliance. Even though Customs draws a distinction between the Letter of the Law (LOL) compliance rate and the Materiality compliance rate, it does not really distinguish between types of errors + clerical errors; procedural errors; broker errors; differences over the interpretation of the law; errors that were discovered by the company, disclosed to Customs and corrected + and does not "weight" the errors based on type. Thus, more frequently than not, a company's compliance rate and assigned "risk" category reveals little about whether a company is truly exercising reasonable care in its customs transactions.

a. clerical errors and procedural errors + these sorts of errors + numbers are transposed

or omitted, documents are misfiled, a receiving report is lost + creep into the best operations and are difficult to prevent or detect without doing a detailed audit of the customs activity frequently. These types of errors should be noted, but not considered in determining whether a company is exercising reasonable care or in calculating a company's compliance rate. We recognize, however, that an unusual number of such errors may suggest a systemic or employee weakness that should be corrected.

b. broker errors + this type of error should be reported separately and further subdivided based on the nature of the error. Many companies, especially smaller companies, do not have in-house customs expertise and rely heavily on their customs brokers. Their reliance is not unjustified inasmuch as brokers are licensed by Customs and the legislative history of the Mod Act indicates that they are "experts" in "customs business." Thus, *broker errors that do not result from information provided by the importer* should be identified and categorized separately and should not be treated as an importer error. Adopting this approach would have a salutary benefit. First, it would place the responsibility where it belongs. More important, by alerting the importer of broker errors, the importer would better be able to compel improvements from its broker, and customs brokers, for their part, would be motivated to monitor their own activities, exercise greater supervision and control over their customs business, and reduce errors rates.

c. differences over the interpretation of the law + A good faith disagreement between an importer and Customs over the correct interpretation of the law should not be treated as an error. This issue most frequently arises during a CA review of classifications. In this area, the focus of the CA should be the system for determining the correct classification because in many instances there is a bona fide disagreement over the applicable HTSUS subheading. We do believe, however, that incorrect classifications should be treated as errors in the following instances:

- ⊖ an importer has obtained an administrative ruling that is not followed;
- ⊖ an administrative ruling or court decision (that is readily available through Customs web site or other electronic means) has established the classification of the product;
- ⊖ the classification has no basis in fact (e.g., water skis are classified as snow skis; classification is dependent on laboratory tests that were not performed).

If these situations exists, it suggests that a company's systems and internal controls are deficient. Otherwise, differences of opinion between the CA team and an importer with respect to plausible, competing legal interpretations involving the classification of goods should be disregarded. We believe it would be sufficient for the CA team to identify specific classifications that it believes are incorrect, along with a recommendation that a ruling be obtained. By eliminating, these differences from the "error" category, and focusing on a company's system for classifying goods, a company's error rate would decline significantly and its classification procedures would improve.

d. prior disclosures + Mistakes are made by even the most vigilant importers, but if they have been corrected prior to a CA, they should not be counted as errors. The CA should focus on whether systems are in place to detect and correct those errors. When information is provided to Customs through reconciliation, SIL, prior disclosure, or any other method, that corrects an entry prior to the commencement of the CA process, the original information provided on the entry should not be treated as an error. Otherwise, the compliance rate can be distorted badly and give a false picture of a company's customs compliance.

e. sample weighting + Although Customs uses an accepted, unbiased method for selecting its sample line items, it is not uncommon to find that a single error appears repeatedly and skews the results. Also, for some industries, Customs has excluded specific products from the CA. In these instances, the sample should be weighted to reflect the compliance rate accurately.

3. **Materiality of Errors**

As suggested by our prior comments, JIG submits that examining transactions for LOL compliance and reporting a compliance rate based on LOL is counterproductive because it distorts a company's compliance record and is not accepted by the Trade as having any validity. We support a compliance rate based on a materiality standard, but believe that the materiality policy could be improved. This means that the types of errors discussed above should not be treated as material, nor included in calculating the compliance rate. In addition, the following situations should not be treated as material errors:

a. small value variances + particularly in non-revenue loss situations, e.g., the precise value of merchandise is not known until after entry and is not reported to Customs when known, but the merchandise is subject to a specific rate of duty and is not subject to the mpf or hmf.

b. conscious decisions to overpay + where a company makes the conscious decision to enter goods at a higher rate or value and pay higher duties, rather than incur the costs of establishing the correctness of a claim because of the cost and/or difficulty of obtaining the correct information.

c. quantity differences + frequently, small quantity variances are not reported to Customs because the reporting costs far exceed the *de minimis* loss or gain of revenue to the Government.

4. **Overpayments and Underpayments of Duties, Fees and Taxes**

The CA process, as originally announced, was intended to provide an evaluation of a company's level of customs compliance. A secondary consideration, although never officially stated in Customs CA policy, was the recovery of any underpaid duties, fees and taxes. Now, however, the recovery of lost revenue appears to have become the major goal of the CA. This is clearly demonstrated by Customs' public announcements of the amount of revenue recovered as a result of CA, and the proposed refinements to the Compliance Risk Categories, in which non-payment of lost revenue results in a company being assigned to the Moderate Risk category. JIG is concerned about how this policy can be reconciled with 19 U.S.C. 1514 and the finality of liquidation; Customs' policy on netting underpayments and overpayments; and the sometime veiled, sometimes explicit, threat of a 1592 penalty action by the CA teams in "recommending" payment of lost revenue.

a. finality of liquidation + most companies do not object to paying what should have been paid in the first place, but in many instances, the CA team's findings of lost revenue results from a disputed classification or, perhaps, a company's inability to produce a receiving report or an accounting record. In other words, the liability of the company for any additional revenue is not clearly established by the CA team. In such instances, the finality of liquidation should not be disturbed, and there should be no adverse consequences arising out of a company's decision not to pay the CA team's "recommended" amount, especially since there is no Congressionally authorized way in which to challenge the CA team's conclusions.

b. "netting" + In a CA, Customs often finds that a company overpaid duties, fees and taxes, but if the entries have been liquidated, it is Customs' position that the finality of liquidation prevents Customs from refunding the overpayment (although as noted above, the finality of liquidation is not rigidly observed if underpayments are at issue). Similarly, where a companies errors cause both overpayments and underpayments, Customs does not permit companies to offset the one against the other, and insists upon collecting the underpayments. JIG understands the legal basis for Customs' position that it does not have the authority to refund monies after the liquidation of an entry becomes final. We suggest, however, that where the handling of underpayments and overpayments are at issue, there is enough flexibility in the law to allow Customs to determine whether all the errors taken together, those involving underpayments and overpayments, have deprived the Government of any duties, fees or taxes. Under this approach, Customs would not refund overpayments, but request an importer to pay only underpayments in excess of overpayments. If Customs does not believe it has the authority to do this, we urge Customs to join with JIG to seek such authority from Congress.

c. threat of 19 U.S.C. § 1592 + related to the finality of liquidation and Customs position on "netting" is the use by the CA teams of the veiled, and sometime explicit, threat of § 1592 to compel payment of alleged duties, fees and taxes. CA has been promoted by Customs as a part of Informed Compliance, as contrasted with Enforced Compliance. If a company's errors

are so egregious that they warrant a civil penalty, the matter should be referred to the appropriate FP&F office, but short of that, even though § 1592(d) authorizes the collection of duties arising out a violation of that section, it should not be invoked. JIG would welcome a clear statement of such a policy from Customs.

5. Remedial Activities

JIG submits that the current and proposed Customs' actions to assist and encourage compliance are not in the spirit of Informed Compliance. The effect of being assigned to a standard, moderate or high-risk category is primarily punitive, not remedial. Increasing the number of cargo selectivity exams and audits do not address a company's underlying problems.

We suggest that more positive, helpful activities related to the identified deficiencies be considered. For example, Customs has worked with the automobile industry to improve the classification of auto parts by participating in the industry-organized Customs Automotive Round Table. We urge Customs to be proactive and organize similar industry groups for the purpose of addressing common deficiencies identified through the CA process. In this regard, recently, Customs sent a letter to importers of machine tools that identified some common errors. We think this is a good start that should be followed up by an industry meeting in which importers and Customs could exchange information and ideas. Only if Customs finds that these positive, remedial steps are not effective, should Customs revert to enforcement-type actions that delay shipments and create other hardships and costs for business.

6. Compliance Risk Categories

JIG supports the proposed "conditional" period, but believes that Customs should clearly define the period during which a company remains in the "standard" risk category. This time period should be agreed upon between Customs and the company before the CA report is finalized. We suggest that the conditional period not be less than one-year from the date of the closing conference of the CA unless the company agrees to a shorter period. The length of the period should be related to the nature of system deficiencies and the agreed upon remedial steps, some of which may take longer than others to complete.

7. Appeal Process

Even though a CA report often is based on conclusions of fact and law that may be disputed by the company, and the report may recommend the payment of allegedly lost revenue which if not paid could have adverse consequences for the company, there is no clear appeal process at which issues in

dispute may be aired, considered and decided. This deficiency is contrary to the Administrative Procedures Act and should be corrected as soon as possible by an amendment to the Customs Regulations. In the interim, we encourage Customs to develop and issue a temporary appeal procedure.

Conclusion

JIG believes the proposed refinements to the CA process are a step in the right direction and should be adopted, but in certain respects the refinements are somewhat cosmetic; that is, the statistics improve as more companies “pass” and avoid more frequent cargo examinations and audits, but the underlying CA process deficiencies remain, at least from the perspective of the Trade. We have suggested both policy and operational changes that JIG believes would vastly improve the CA process.

As always, JIG would welcome the opportunity to meet with Customs to discuss these and such other modifications to the CA process that Customs may be considering.

Sincerely,

Richard H. Abbey
Chair, Import Programs and
Informed Compliance Committee