

CORPORATE RESPONSIBILITIES FOR COMPLIANCE AND RECORD KEEPING UNDER THE CUSTOMS MODERNIZATION ACT AND OTHER STATUTES

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This Memorandum provides an overview of the requirements which importers must observe under laws and regulations enforced by the United States Customs Service ("Customs"), and suggests a compliance and record keeping plan of action which an importing company (the "Company") may wish to consider in order to insure that it discharges its legal obligations.

Informed Compliance

The commercial enforcement process which Customs has used for so many years changed dramatically recently when Customs embarked upon an "informed compliance" program as a consequence of the enactment of the **Customs Modernization Act**, part of the NAFTA Implementation Act of December 8, 1993 (Pub.L. 103-182), and popularly known as the "Mod Act". Under this program, U.S. Customs is committed to less intrusion in and interruption of the import process, but as the *quid pro quo* for this forbearance, the importer of record must now assume nearly total responsibility for compliance with customs laws and regulations, as well as with the extensive record keeping requirements which have been proposed by Customs, but not yet finally adopted.

The Mod Act significantly alters the relationship between Customs and the importer by shifting to the latter responsibility for declaring the proper value of imported goods, asserting their correct classifications and duty rates, and providing all other required or pertinent information and documentation. While the informed compliance program holds the promise of greater flexibility with respect to filing entry for imported goods, and greater speed with respect to their physical clearance, it also imposes upon the importer the burden of knowing which laws and regulations apply and the obligation to implement a satisfactory program for compliance. Whereas Customs previously assumed the primary responsibility for import compliance by examining import transactions regularly, albeit not always comprehensively, under the Mod Act Customs will perform transactional reviews on a less frequent, but more exhaustive basis, generally in the form of intensive shipment inspections and extensive importer audits.

Under the informed compliance process, the importer of record must use reasonable care in providing Customs with accurate and complete information for purposes of entry, classification, duty assessment, and valuation. The importer can no longer rely on Customs to make inquiry and elicit the information and documentation it requires. While Customs has announced that it will "assist" importers in this process, the ultimate responsibility and liability rests with the importer. Thus, for example, if an importer pays a 5% royalty to a third party upon the resale in the United States of the imported merchandise it has purchased from a foreign seller, it is the obligation of the importer to determine whether that royalty payment is within the ambit of the valuation law as a dutiable charge, to declare the royalty payment to Customs, and to tender applicable duties thereon. A reasonably careful importer must examine its transactions carefully and make appropriate determinations as to the values which must be declared, whether additional duties must be paid, and

whether it is necessary or appropriate to disclose such information to Customs. Even in those cases where the importer concludes that no additional declaration or duty payment is required, the principle of reasonable care may require that Customs be informed and/or that a binding ruling letter be requested.

The penalties imposed for failure to exercise reasonable care in providing appropriate information to and filing proper declarations with Customs are substantial. First, Customs will assess and collect any unpaid duties. Second, whether or not additional revenue is collected, any importer which fails to declare or mis-declares the applicable value or classification of imported merchandise is subject to the imposition of monetary penalties pursuant to section 1592 of Title 19, U.S. Code. A negligent violation is punishable by a civil penalty in an amount equal to the domestic value of the merchandise or up to two times the revenue loss, whichever is less, or 20% of the dutiable value of the merchandise if the violation does not affect the assessment of duties. A grossly negligent violation subjects the violator to a civil penalty in an amount equal to the domestic value of the merchandise or up to four times the revenue loss, whichever is less, or 40% of the dutiable value of the merchandise if unpaid duties are not at issue.*

There are other sanctions which an importer will face as a consequence of the failure to comply with customs laws and regulations. In addition to the assessment of monetary penalties, a violator will find that shipments are made the subject of more frequent intensive physical examinations by Customs officials. Such examinations are both costly and time-consuming, and always at the expense of the importer. Further, the violator may expect to receive more requests for information and experience more frequent audits by Customs officials than the importer which establishes that it is in compliance. This will expose the importer to the assessment of monetary penalties whenever additional violations are uncovered.

Record Keeping Requirements

The Mod Act not only expands the responsibilities of importers for legal compliance, but also imposes substantial record keeping requirements so as to insure that the documentation necessary to substantiate such compliance will be available to Customs for audit and review. Under section 1508 of Title 19, U.S. Code, importers must make, retain, and make available for examination and inspection those records which pertain to the importation of merchandise, or to the information contained in the records which importers must maintain in connection with such importation, and are kept in the ordinary course of business. All these records must be maintained for a period of five years after the date of entry and made available to Customs upon notice.

With respect to the specific records which importers must maintain in connection with importation, the Mod Act charges Customs with identifying those records. Accordingly, Customs has

*A fraudulent violation is punishable by a fine in an amount of up to the domestic value of the imported merchandise.

proposed a list which identifies such records, the co-called “(a)(1)(A)” list.” Unlike the records described only in general terms as *pertaining to importation*, the (a)(1)(A) list of records must be supplied to Customs within a reasonable time after a demand for their production or severe monetary penalties may be assessed. For example, the statute provides for the assessment of monetary penalties of up to \$100,000 for the deliberate failure to maintain and furnish required records requested by Customs auditors, and \$10,000 for the negligent failure to provide the required documents.” The aforementioned fines apply to each entry of merchandise for which records are required. Moreover, such fines are in addition to any penalties which may be assessed under the customs civil fraud/negligence statute, 19 U.S.C. §1592.

It is important to recognize that the (a)(1)(A) list does not identify all the records which an importer must maintain. As noted above, section 1508 also requires that importers maintain records *which pertain to the importation of merchandise or to the information contained in the records which importers must maintain in connection with such importation*.

Customs has identified specific records which an importer must keep for entry purposes, subject to the assessment of monetary penalties with respect to each entry for which records are not otherwise filed. However, and more significantly, the agency has not identified any of the other import-related records an importer must retain for the requisite five-year period, except to state that they include (among others) statements, declarations, documents and electronically generated or machine readable data “which pertain to any such activity” and “are normally kept in the ordinary course of business”. These may include many of the documents and correspondence which the Company generates and, admittedly, retains in the ordinary course of business, including letters, fax documents, e-mail messages, purchase orders, and others which relate to import shipments.

Each importer must conduct a review its import activities and, after identifying the import-related records which it maintains in the ordinary course of business, establish a comprehensive record keeping program which makes such documents readily retrievable and available for Customs examination and review. Absent the implementation of such a program, the monetary penalties which the law provides may be assessed for each and every failure to comply, that is, each shipment for which the records are not available.

Corporate Customs Compliance Management

The Customs Modernization Act mandate that importers exercise reasonable care in providing Customs with accurate and complete information and documentation for purposes of entry, classification, duty assessment, and valuation. Under the Act’s record keeping requirements, importers are compelled to maintain specific records for purposes of entry and any additional records which are pertinent to the import process and are kept in the ordinary course of business. These obligations are in addition to the many others which the importer must face, including the proper

** The (a)(1)(A) identification is derived from the statutory section which authorizes the promulgation of the records list, 19 U.S.C. §1509(a)(1)(A). Should you require a copy of the proposed (a)(1)(A) list, we will be pleased to provide it to you.

*** 19 U.S.C. §1509(g).

classification and valuation of its goods, the deposit of the proper amount of duties, timely responses to Customs requests for information, and conformity with all other import laws and regulations, whether administered under customs laws or under the laws and regulations within the legal ambit of other federal agencies. Moreover, the importer of merchandise of any significant volume and value faces a greater likelihood of being the subject of inquiry and audit by Customs officials. The liabilities which face the importer which fails to comply, as described above, are potentially devastating.

In light of the great responsibilities placed upon the importer, made even more far-reaching under the Mod Act, it is imperative that the Company develop and implement an effective and comprehensive import compliance and record keeping program. A successful program requires the implementation of several elements which, together, represent an organized approach to the establishment of import compliance procedures and record maintenance protocols.

● **Product Identification**

As a first step, the Company must identify its corporate import components and those employees and managers who are involved in the procurement and importation of merchandise. Using these individuals as a source of information, the next step is to identify the products which the Company imports and the ports of entry through which they are entered. (This is an ongoing process. As new products are imported, they must be identified and made part of the import database). Establishing an import product database will not only insure proper classification and duty assessment, but also make it possible for the Company to recognize the specific legal requirements which apply to individual products, including those requirements which may be enforced by other federal agencies. Product identification will also include price and cost data, so as to establish that the merchandise in question is entered at the proper value and that the proper amount of duties are being deposited with Customs. Complete product review will also enable responsible Company personnel to identify other legal issues which may apply, such as country of origin marking, duty abatement entitlement, and admissibility. The creation of an effective product database will insure that the Company's declaration are accurate, thorough, and the result of due diligence and the exercise of reasonable care.

● **Record Identification**

As part of the compliance process, the Company will also identify the import-related records which it maintains. In so doing, the Company will be in a position to comply with any demand by Customs for such records, whether the specific records required for entry purposes or those maintained in the ordinary course of business. The (a)(1)(A) list of records, when finalized, will be specific. More difficult will be the identification of other records which are "pertinent" to the import process and maintained in the ordinary course of business. It is helpful to review the Company's import process and "paper trail" in order to identify the documents which the Company must be able to retrieve and submit for examination and inspection in the event of a Customs inquiry or audit. Necessarily, such reviews are often company-specific due to variations in record keeping protocols.

Nevertheless, certain types of documents are customary, including purchase orders, confirmations, letters of credit, bank receipts or payment summaries, wire transfer records, product

specifications, price and payment correspondence, invoices, and receiving records. However, whether other types of records should be maintained require individual determinations by the Company. For example, if so-called "e-mail" transmissions are related directly to the import process and are kept in the ordinary course of business, they may be disclosable in response to the Customs inquiry or audit. An e-mail record which establishes pricing information for an import shipment would certainly fall into this category. Unfortunately, Customs has not identified specifically the "pertinent" records which it expects to be maintained, relying instead on a case by case approach.

- **Present Compliance - "Pre-Audit"**

Another aspect of developing an effective import compliance and record keeping program is to determine the present compliance level of the importer. This is accomplished by performing a Customs "pre-audit." A pre-audit involves the conduct of an audit of selected entries, using the methods which a Customs audit team would utilize in an actual audit. The entries selected would be at random and would cover a period of up to five years prior to the date of the audit. The pre-audit would be comprehensive and would disclose both record keeping shortcomings and entry declaration omissions or errors in value, classification and duty payment. The pre-audit provides the benefit of actual audit techniques and may uncover actual compliance lapses and record keeping deficiencies. By identifying these deficiencies, the Company is in a better position to devise a compliance program and avoid violations in the future.

- **Corporate Procedures**

Whatever procedures the Company decides to put into place, it is necessary to incorporate the procedures in a corporate manual or memorandum to which all employees who are even marginally involved in the import process will have access. This will assist in the effort to maintain corporate compliance with import laws and demonstrate that the Company has undertaken a diligent effort to exercise reasonable care.

- **Customs Compliance Personnel**

As a final, but most important step in any effective compliance and record keeping program, the importer should designate a key employee or employees who will coordinate import compliance and record keeping tasks. For most major corporate importers, that position is held by a management employee charged solely with maintaining Customs compliance and identified as a Customs Compliance Manager, or by a similar title.^{****} While corporate or outside counsel are effective in providing assistance when new regulations and policies are promulgated, when existing laws and regulations are the subject of novel interpretations by administrative rulings and court decisions, or when serious audit, investigation or duty assessment issues arise, operational personnel are vital to maintaining daily compliance and record keeping routines. Clearly, the

**** In certain corporate environments, this position is held by a designated corporate counsel. However, this is the exception, rather than the rule, and in most cases, the position is held by a management official involved in everyday operations. Smaller companies may require that an "import manager" supervise traffic functions together with compliance, however, this is far less desirable as traffic/transportation issues are rarely related to Customs compliance issues.

centralization of the Customs compliance management function will insure consistency and avoid mis-communication (or non-communication) with Customs officials by Company employees who are not aware of all the information necessary to provide accurate responses or who fail to understand the significance thereof. Moreover, the establishment of a Customs Compliance Manager will avoid situations wherein Company officials unwittingly provide responses to Customs which are not only incorrect, but potentially damaging to the Company.

A Customs Compliance Manager will not only insure that compliance and record keeping requirements are met and that proper and complete responses are made on the Company's behalf to Customs requests for such records, but will also act as a clearing point for inquiries from other Company personnel with respect to questions concerning Customs matters. By handling most routine inquiries, and relying on counsel where more complex and potentially critical matters arise, the Company will succeed in implementing both an effective and efficient compliance program. On the other hand, the absence of a Customs Compliance Manager will inevitably cause compliance efforts and record keeping maintenance to deteriorate, particularly as corporate personnel change. Without the presence of a central management official to oversee the process and insure that compliance and record keeping procedures are followed, adherence to those procedures will be inconsistent at best, non-existent at worst. The requirement to exercise reasonable care cannot be satisfied without the designation of appropriate corporate personnel who will monitor and maintain corporate compliance.

Conclusion

A company seeking to stay out of difficulty in the Customs area should review its present Customs compliance and record keeping efforts in light of the new and significant responsibilities which importers are expected to meet. Unless a concerted effort is made to establish a program which satisfies the Company's legal obligations, the potential for incurring substantial monetary liabilities is great. Moreover, any such effort requires not only assessing the Company's present procedures, but also considering the establishment of an centralized management function which will continue the Company's goal of exercising reasonable care, the minimum level of conduct expected by Customs under the informed compliance and record keeping provisions of the Customs Modernization Act.