

Chapter 38

Specific Corporate Compliance Challenges by Practice Area: Customs

Author: Marian E. Ladner

Editor: Carole Basri

Synopsis

PART I: OVERVIEW

§ 38.01 Introduction

PART II: ANALYSIS

§ 38.02 Customs Compliance—A U.S. Perspective

§ 38.03 Fundamental Risk Areas

- [1] Classification
- [2] Value
- [3] Origin
- [4] Recordkeeping
- [5] Audit and Monitoring
- [6] Training

PART III: RESOURCES

§ 38.04 Accounting Procedures

§ 38.05 Customs Broker Evaluation Table

§ 38.06 Customs Broker Evaluation Form

§ 38.07 Customs Release Reporting

§ 38.08 Import File Audit Checklist

§ 38.09 Basics of Foreign Trade Zones

PART I: OVERVIEW

§ 38.01 Introduction

Corporations spend hundreds of thousands of dollars, if not millions, on understanding the tax consequences of doing business in various global jurisdictions. What they fail miserably in doing is understanding the practical implications associated with running afoul of what in many countries is the single largest revenue producing agency (i.e., Customs), and what in the United States is the second largest revenue producing agency after the Internal Revenue Service (“IRS”), U.S. Customs and Border Protection (“CBP”).

Sophistication in the area of global Customs compliance and its impact on complex supply chains is a must. Never forget that importing is a privilege, not a right and consider for a moment what would happen to your business revenues if you were not permitted to cross borders with components, parts and finished products. Customs formalities are anything but perfunctory. They require importers to comply with a myriad of complex laws and regulations. Running afoul of these often seemingly contradictory rules can lead to dramatic decreases in profitability, supply chain interruptions and in the most egregious cases, fines, penalties and incarceration.

PART II: ANALYSIS

§ 38.02 Customs Compliance—A U.S. Perspective

Corporate executives tend to be woefully ignorant as to precisely how their products get to market. They don't truly understand their supply chains or the landed cost, invariably believing that the unit cost established by the buying/purchasing group represents the landed cost. All too often that is not the case. Reason being: failure to understand and properly execute Customs regulatory requirements which result in unprojected increases to the landed cost calculations.

Consider for a moment that with the increased number of Free Trade Agreements ("FTA") the United States has entered into, duty rates are going down year after year. Why is it then that revenue collections, \$32.5 billion in 2008, have been consistently going up? [with only slight exception, as 2007's were \$33 billion, but 2008 also saw a slight drop in the number of entries filed with CBP. Over the prior five years, both numbers have grown steadily.] The government is collecting its pound of flesh, not from duties but from dummies. It is catching company errors and penalizing aggressively. This fact is supported by the 2008 seizures statistics which reflected an increase in excess of 10 percent. One final statistic of note here is that CBP's entire workforce increased by 11% in 2008. What do you suspect the effect of CBP's expanded resources will be? More officers equate to more enforcement but compliance vigilance can prevent CBP from dipping into your profits. [http://www.cbp.gov/xp/cgov/newsroom/highlights/08year_review.xml]

Not only can noncompliance with legal and regulatory requirements wipe out entire profit margins, the seizure and forfeiture process can result in significant product losses. Although this occurs time and time again, why is it CEOs and CFOs continue to remain uninformed relative to the cost/benefit analysis associated with a strong import compliance program? And why is it top executives feel comforted when hiding behind meaningless statements such as "We've never had a problem so everything is just fine." I liken this argument to prophylactic health care. If you have been healthy all your life, does that mean nothing will go wrong with your body when you are 40, 50, 60, etc.? Intuitively grown-ups understand that it is beneficial to invest both the time and money it takes to validate ones health through testing, examination and consultation with a professional. Ask yourself why insurance companies support "well person check-ups"? Do you think these corporations truly care about your health/life span or do you suppose it is because their bean counters understand that preventative health care is cheaper than waiting for, and dealing with, a problem identified later in the process, such as stage four cancer? It's about cost savings! The same is absolutely true relative to proactive customs compliance initiatives.

☒ Strategic Point: It is simply more cost effective for any company to establish, maintain and monitor a robust import compliance program than it is to wait for a

(Rel.2009-10/2009 Pub.1542)

problem.

As with so many other things, communication, education, policies, procedures, processes and yes, resources and commitment are what is all too often lacking.

§ 38.03 Fundamental Risk Areas

In December 2003, the North American Free Trade Agreement was passed (“NAFTA”) and along with that legislation, came the Customs Modernization and Informed Compliance Act (“ModAct”). The ModAct required importers to exercise reasonable care over their import transactions. The challenge for a company then is, just how does one successfully demonstrate the exercise or execution of reasonable care?

“Well, that is the job of my import department; that’s what they’re supposed to be doing!” This is an all too often heard refrain. Corporations need to understand that the import compliance team is not the creator of most of the corporation’s import compliance information. The import team is much like the hub or center of a wheel. The other departments, divisions or stakeholders are the spokes, responsible for providing structure, filtering content and generating communication. Processes must exist to effectively funnel information to the compliance hub. The compliance group is charged with interfacing with the government and ensuring that corporate reporting is comprehensive, accurate and timely in its presentation. The import group is rarely the party responsible for creating or generating the needed information. They are merely the gatekeeper charged with searching for missed information relative to process gaps or failures. To do so successfully, they must be familiar with all of the moving pieces of the organization. An inquisitive nature and a healthy dose of paranoia will serve these sleuths well, as they protect and report the company’s imports.

The following critical import entry information should be of concern to every importer.

[1] Classification

The United States and the majority of developed and many underdeveloped countries are party to international agreements that establish a common nomenclature and rules of interpretation as to Product definition. In the United States, merchandise is classifiable under the Harmonized Tariff Schedule of the United States (“HTSUS”) in accordance with the General Rules of Interpretation (“GRIs”). The systematic detail of the HTSUS is such that virtually all goods are classified by application of GRI 1, that is, according to the terms of the headings of the tariff schedule and any relative Section or Chapter Notes. In the event that the goods cannot be classified solely on the basis of GRI 1, and if the headings and legal notes do not otherwise require, the remaining GRIs may then be applied. In understanding the language of the HTSUS, the Harmonized Commodity Description and Code System Explanatory Notes may be utilized. The Explanatory Notes (“ENs”), although not dispositive or legally binding, provide a commentary on the scope of each heading of the HTSUS, and are generally indicative of the proper interpretation of these headings. *See* T.D. 89-80, 54 Fed. Reg. 35127, 35128 (Aug. 23, 1989).

(Rel.2009–10/2009 Pub.1542)

From a practical perspective, what happens when these rules are applied is that reasonable humans differ on the interpretation, meaning and ultimately the application of these tariffs. Not only do importers disagree with the U.S. government, but with potentially other signatory countries interpretations of this tariff as well. Establishing as much certainty as possible around these anticipated tariffs is critical if true landed costs are to be arrived at. A corporation must determine how best to capture and ensure the proper classification and declaration of its merchandise. Examine whether building an excel spreadsheet will provide the necessary information, by product, by country? Consider whether classification information can be housed in your global financial reporting system, such as SAP or Oracle. Note, you must still be concerned with how, who and how often this information will be communicated to key service providers, such as customs brokers, freight forwarders and suppliers/vendors.

☒ **Strategic Point:** Practice Tips include:

- Understand the product, part, component, chemical make-up, essential character and use. Identify the proper working group within your organization and expertise needed to arrive at the proper classification. Research CBP's database (www.dhs.gov or www.cbp.gov, more specifically "CROSS") research whether any Informed Compliance publications are relevant. Work with engineering if you need a Material Data Safety Sheet ("MSDS"), drawings or sketches or to understand same. Document your findings, rationale and conclusions. Date and make reference to the employee concluding same.
- Create a Product Master/Master Spreadsheet to capture all assets as well as expensed items.
- Special Program Indicators and Qualifying for Preference Programs - ensure bill of materials ("BOM") and origin determinations are accurate. Common pitfalls occur when dual sourced materials are not tracked by their country of origin thus having unanticipated downstream preference qualifications results. Other examples are when sourcing changes occur which alter the country of origin but are not accurately captured within the bill of materials. This too can devastate a landed cost analysis when a product no longer qualifies for duty free treatment due to an origin shift within the BOM.

[2] Value

Title 19 of the United States Code, section 1401a (19 U.S.C. § 1401a) addresses the appraisalment of imported merchandise. The primary method of appraisalment is transaction value. In essence, transaction value is the price actually paid or payable for merchandise when sold for exportation to the destination country. To the extent not already included in the price, additions for certain packing costs; selling commissions; assists (materials component parts, tools, dies, molds or catalysts used or incorporated into the imported merchandise; non-U.S. research and development ("R&D"));

(Rel.2009-10/2009 Pub.1542)

royalties and license fees; and proceeds of any subsequent resale, disposal or use of the imported merchandise that inure to the benefit of the seller. Said one final way, P.A.P.P.+C.R.A.P.P.=T.V.

⚠ Warning: These additions represent critical noncompliance obstacles for companies, made only thornier when complicated by the overlay of intercompany transfer pricing practices.

Global supply chains are continually shifting as they seek competitive advantages and cost reductions. Often these tectonic shifts result in entire production lines moving across borders, tooling being designed, engineered, created or sourced from one location and provided to another location, operation or division. The subsequent result: manufacturing, distribution or order fulfillment creates an importation into the U.S. that fails to appropriately capture all of the various components necessary to properly value the merchandise for CBP appraisal purposes. If capturing these cost factors isn't difficult enough, it certainly doesn't help that the Internal Revenue Code ("IRC") defines intercompany transfer pricing and the cost of goods sold as something dramatically different than the price actually paid or payable found in CBP's regulations. [IRC §§ 1059a and 482 do not result in the same "price or cost" for taxing purposes as what must be arrived at to satisfy 19 CFR § 152.103 for duty appraisal purposes.]

⚠ Warning: Costs that are properly excluded from the price determination for the IRS are required for inclusion in the appraised value for CBP's duties due. This fact alone underscores the importance of understanding the subtleties of both of these revenue hungry goliaths.

🔍 Strategic Point: Practice Tips:

- Communicate across multifunctional groups within the business - examples include sourcing/vendor management, engineering, order fulfillment, R&D, finance, manufacturing, etc.
- Product or project launches, testing, R&D, returns, supply chain (when plant or production equipment move, etc.) should interact with the gatekeeper for compliance - the import group.
- Utilization of existing institutional processes to notify all parties affected, such as a Management of Change ("MOC") process, project team meetings, supply-chain: shipping and receiving department's email notifications.
- Prototypes, samples, testing equipment and returns can potentially be coordinated with a serialized Return Authorization Form or process

(Rel.2009-10/2009 Pub.1542)

ensuring updated and accurate information is captured before borders are crossed.

[3] Origin

Determining the proper country of origin for a part, component, material or finished good can be a difficult, if not daunting challenge for importers. In addition to simply understanding the rules of product “origin” there are alternative sets of rules governing “origin” determinations under the various FTAs. Further, you must consider what the applicable definition for “country of origin” is. This is critical when Global corporations attempt to “qualify” goods. Not only must these issues be addressed within an import compliance program, but considerable attention must also be paid to the rules of product marking. (19 U.S.C. § 1304.) In other words, a determination as to the proper “country of origin” of a particular product may differ from the determination as to how that product must be marked. (19 CFR § 134.) And, if that isn’t bad enough, the markings required on a product can differ from the country of export to the country of import. [Note: currently several countries do not have marking requirements—Brazil, Colombia, Malaysia, Mexico, Singapore—and many do, both comprehensively and selectively - Austria, Argentina, Australia, Canada, Korea, Philippines, PRC, Russia, United Kingdom, Venezuela and Vietnam - to name a few.] Each country has its own requirements, which might not, at the end of the day, be compatible with the other country!

✘ **Strategic Point:** Finally, consider whether to build requirements and/or indemnities into purchase orders (“PO”) and procurement contracts that will mandate proper country of origin determinations and markings. Do not be fooled into believing that because you sourced an item from a “domestic supplier” that means it is of U.S. origin. In truth, many of these products are produced/sourced from outside of the U.S. Domestically-sourced goods are often incorrectly presumed to be of U.S. origin creating downstream errors, particularly relative to claims for duty preference. Another equally painful error is when these non-U.S. origin items are subsequently either marked as U.S. origin or are placed in containers or outer boxes that label them as U.S. origin or manufacture. Markings must follow the requirements of CLIP - conspicuous, legible, indelible and permanent. For entry into the U.S., it must also be in English and must indicate to the “ultimate purchaser” the article’s country of origin.

✘ **Strategic Point:** Practice Tips:

- Ensure traceability within the inventory of proper country of origin determinations for items by part number, lot number or other identifier.
- Ensure multi-sourced parts (i.e., the same part sourced from various

(Rel.2009–10/2009 Pub.1542)

vendors or countries) can be tracked throughout your production or BOM, whichever is at issue.

- Review parts, materials, components or finished products and material masters to insure that items procured from suppliers, whether domestic or other, properly reflect the true country of origin.
- Understand if a country requires a certificate of origin (examples include the NAFTA signatories, Spain, Taiwan and many of the FTAs).
- Review the rules governing “substantial transformation” and its impact through the production process. Understand whether you have a new and different article; understand the essential characteristics of your product; whether there is a significant process of manufacture.



Core Case: (*U.S. v. Gibson-Thomsen Co., Inc.*, 27 C.C.P.A. 267 (1940))

- Determine the country where the last “substantial transformation” took place or perhaps what country added the most value, or where a key change or “shift” in the tariff took place.

! Trap: If you are relying on supplier/vendor or seller’s Certificates of Origin (“C/O”) for preference claims, be sure to have the C/O in your possession at time of importation (such as is required when claiming NAFTA). It is often not acceptable to make a duty preference claim on the theory that you “can get it later if you need to” (i.e., when audited or asked by Customs). (*See* NAFTA, 19 CFR § 181.)

- Understand if the article is incapable of being marked, either physically or economically; whether the commodity or substance is a liquid, such as crude oil, or is a gas. Determine if an exception to marking exists but be sure to mark the outside container, if required.
- Determine if a global marking program is desirable and workable for your company. Consider incorporating global marking requirements into a special shipping procedure or guide.
- Consider embedding origin and marking requirements in supplier POs.
- Consider whether adopting the most stringent marking requirement you have globally, could or should be adopted as a global standard.

[4] Recordkeeping

Recordkeeping and record retention timeframes, generally vary around the world. In the U.S., most records are required to be maintained for a minimum of five years. Ask yourself or your compliance department if they are certain as to precisely what records

(Rel.2009–10/2009 Pub.1542)

must be kept? Is it just the entry documents themselves? Are transactional emails required to be kept, notes of phone calls, purchaser or customer correspondence, etc.? CBP's regulations contain a list of records to be maintained. While not an exhaustive list it does set a minimum threshold for companies. (19 U.S.C. § 1509(a)(1)(A), with the list at 19 CFR § 163 app.)

Consider whether your company has a document retention policy or not, and assuming it does, how long are records to be maintained?

🕒 Timing: Depending upon what CBP programs you are participating in, for example duty drawback which allows an importer to pay duties at time of import and then if merchandise is exported within three years, “draw back” up to 99 percent of duties paid, you may be required to keep records for eight years. A Foreign Trade Zone (“FTZ”), bonded warehouse or other regulatory scheme could require varied timeframes as high as a 12-year retention cycle. So, assuming you are not pulling an Enron and destroying records purposely so as not to comply, familiarize yourself with your document retention policy and validate your compliance.

📌 Strategic Point: Another critical consideration is whether your company could benefit from alternative storage methods, such as scanned or PDF'd copies or other electronic media?

⚠ Warning: If so, you might need CBP's permission before adopting them. Another area of concern for internal compliance is the requirement that records be “readily retrievable”. This is generally interpreted by CBP's Office of Regulatory Audit (“Reg Audit”) to mean within 30 days. Test whether or not documents could be retrieved within 30 days for an importation that occurred, for example, on December 17, 2004. Any software changes that would prevent this; storage at an Iron Mountain type location that might have difficulties meeting the timeframes; lost or misplaced documents, etc.? Many companies cannot fully comply with the recordkeeping requirement. Are you aware that CBP's regulations provide that if you cannot locate a single required document or piece of paper, this could result in a penalty of up to \$100,000 - per document?! (19 CFR § 163.6(b)(1)(i)-(ii).)

📌 Strategic Point: Practice Tips:

- Create a recordkeeping checklist that accounts for all needed records and timeframes associated with retaining same.

(Rel.2009–10/2009 Pub.1542)

- Determine if necessary import records should be maintained in one location or in multiple locations, by one party or multiple parties.
- The import group should perform file reviews at time of importation and post-importation (monthly, quarterly and annually) to ensure all required documents are available.
- Develop a random or judgmental sampling of file records to be reviewed over the minimum five-year required timeframe.
- Consider alternative recordkeeping methods and determine if governmental approval is required.
- Consider engaging the Internal Audit group to perform reviews and audits to verify whether all records are in the files.

[5] Audit and Monitoring

It is often said that the first step in any auditing or monitoring program is the “self-assessment”. This can be likened to the full work-up that a new physician or health care provider might perform - do you have high blood pressure, anemia, or coronary artery disease?

The key factors in making any self-assessment a success is corporate support (i.e., the proverbial tone from the top). Another necessity is support from the critical stakeholders. Departments such as: traffic/logistics and distribution, shipping and receiving, accounting/finance, international sales, supply chain, information technology, engineering, purchasing/procurement, materials management, internal audit, and legal. You must possess an appropriate reviewer or team to conduct the review. Reviewer criteria include technical expertise and experience, resources, budget, sufficient time, objectivity and access to the proper parties. The appropriate scope of the review must also be considered. Major areas can include: general import compliance, Foreign Trade Zones (“FTZs”), and other areas such as duty drawback or participation in preference claim programs, such as NAFTA.

☒ Strategic Point: Practical Tips:

- Import Audit areas include - classification, value, country of origin and origin marking, quantity declarations, recordkeeping, Special Trade Programs, Internal Controls, policies, procedures, import manual, and IRS Section 1059a concerns (transfer pricing/cost of goods sold), participation in the reconciliation program for classification, value or NAFTA, temporary imports under bond (“TIB”), transshipment etc.
- FTZ audit areas include the above, as well as a review of admissions, withdrawals, inventory reconciliation, adjustments/cycle counts, waste, scrap and destruction, procedures manual, approvals, FTZ formalities, document filings and payments, annual board reporting, etc.
- Develop self-assessment tools, such as a Questionnaire; evaluate re-

(Rel.2009-10/2009 Pub.1542)

sponses; assess the adequacy of existing documented internal controls; meet with respective process owners to discuss their processes and work flow, develop a work plan, and review/audit procedures. Consider including both internal and external process owners (i.e., customs brokers, freight forwarders, third party consultants).

- Consider the adequacy of existing resources, for numbers, expertise and turnover; consider the import compliance team's budget.
- Consider the adequacy of internal or external training that has been performed.
- Consider the adequacy of communications between divisions and departments.
- Identify process gaps, internal control weaknesses and any areas of particular risk.
- Identify and document any opportunities for process improvements, enhancements or revenue recovery.
- Review favorite hiding places such as the general ledger, chart of accounts, cash disbursements. Look for royalties, license fees, commissions, sourcing payments, miscellaneous intercompany transactions, over-ages and shortage accounts, molds, tooling and other manufacturing accounts, fixed asset accounts, freight payments, surcharges, miscellaneous freight charge accounts, etc.
- Perform transactional testing - judgmental and random sampling; document procedures and findings; issue a final report, create and implement any necessary corrective actions, and monitor the successful resolution of the actions taken.

[6] Training

Training is a non-negotiable if a company is to maintain an effective import compliance program.

✘ **Strategic Point:** Training can take many forms, however. Many employees segued into their compliance roles through Supply Chain or the traffic department, often learning the old-fashioned way through On-the-Job-Training (“OJT”).

⚠ **Warning:** Unfortunately, OJT without real training can lead to significant gaps in regulatory compliance. Regardless of how employees arrived into the orbit of compliance, companies should offer internal and external training programs. This can vary from live training, computer based training (“CBT”), pre-recorded class-room oriented training, mentoring programs or other, one-on-one training.

(Rel.2009–10/2009 Pub.1542)

Some companies opt for train-the-trainer type scenarios where one member of the team is responsible for absorbing all of the relevant information and then bringing it back to the others to understand, process and implement. Still others find membership in particular trade associations and attendance at various conferences to be beneficial, as well as participation in certain government outreach sessions that train on new import requirements, such as was offered after the passage and implementation of provisions under the Lacey Act or the new Importer Security Filing (“ISF” more commonly referred to as “10+2”). The absolute bottom line, however, is that training is a must. Laws and regulations are not static. Therefore, your import compliance team must have an opportunity for meaningful and productive training to insure that the compliance program remains robust and compliant.

☒ **Strategic Point:** Practical Tips:

- Document all training received by employees through sign-in sheets, e-sign in, or certificates of completion. Capture and record training by subject area, date and retain relevant handout materials/training aids provided and/or Agendas.
 - Assess whether gaps in training have occurred and a timeframe for rectifying same.
 - Provide targeted training sessions on relevant compliance topics to all effected internal stakeholders. This should not be limited to the import compliance team. Consider including both internal cross-disciplinary stakeholders as well as external service partners. Create a monthly, quarterly, yearly schedule/calendar for training. Use both internal and external expertise, as may be needed.
 - Combine any computer based training with live, interactive training. In many ways, it is impossible to monitor whether training has been effectively received if presented entirely in an electronic format.
 - Beware of continual and exclusive reliance on just a train-the-trainer type of approach. Although attractive from a cost perspective, this method can have appreciable shortcomings when communicating necessary information and process changes.
-

PART III: RESOURCES**§ 38.04 Accounting Procedures****Accounting Procedures**

Accounting System	Response	Dates	Contact Person
1. Do you have a procedures manual? Provide a copy.			
2. Have any changes been made to the manual in the last year?			
3. Do you have an accounting flow-chart? Provide a copy.			
4. What payment methods are used (e.g., checks, L/C, W/T)?			
5. What triggers a payment? (Invoice, Packing List, Separate Billing Invoice, Other)			
6. How are inter-company purchases paid for?			
7. How are credits accounted for?			
8. What internal controls are in place to account for "free" or "n/c" invoices?			
9. Do we have supplier discounts and are they taken?			

Accounting System	Response	Dates	Contact Person
10. If you deduct early payment discounts from the Customs value, are there means of determining if those early payment discounts are actually taken? Who is notified?			
11. Are early payment discounts deducted at time of import?			
12. Are freight charges deducted from the value for the duty when the supplier's shipping terms are FOB your location? Are freight charges realistic and verifiable?			
13. Are you informed of material input deductions (assists, royalties, agreements, etc.)?			
14. Are invoices tracked back to purchase orders? What happens if there is a discrepancy between the P.O. and the invoice?			
15. Is there a record of supplier adjustments (quantity discrepancy, value discrepancy, inferior quality, etc.)?			
16. What steps are taken if there is discrepancy between a receiving report, purchasing order and invoice for quantity or price?			

Accounting System	Response	Dates	Contact Person
17. Where is the correspondence regarding imports stored?			
18. What is the retention period for documentation?			
19. Do you give cash advances to vendors? How are those advances factored into the final payment?			

§ 38.05 Customs Broker Evaluation Table

Customs Broker Evaluation Table

Broker Name:							
Objectives:							
1. No broker-incurred penalties from late filing of duty.							
2. Entry copies received monthly via CD-ROM.							
3. Classification requests sent at least prior to shipment arrival.							
4. CL notified within 24 hours of all examinations (FDA, US-CBP, etc.).							
5. Correction of entries as a result of broker error must be made via PEA within 2 weeks of discovery.							
6. CBP 28/29 notices from Customs forwarded within 2 working days of receipt.							
7. Broker to provide org. chart for administrators and managers, changes must be advised within 30 days.							
8. Update parts database with HTS #s and, if applicable, OGA information within 24 hours of receipt.							
Service from _____ to _____.							
Entry #	Entry Date	Violation	Discovery Date	Disposition	Completion	Adverse effect on Bussmann	Refund due to Bussmann

§ 38.06 Customs Broker Evaluation Form

CUSTOMS BROKER EVALUATION FORM

Name of Broker:

Completed by:

Date of Evaluation:

Time Period Covered by Evaluation:

Objective Criteria:

- a) Number of known late entry filings by broker during evaluation period:
- b) Receipt of Entry Records:
 - Of 20 entries selected from ACE, for how many have we received entry records?
- c) Accuracy of Classification:
 - Of 20 parts selected from 20 different entries, on how many did the broker classify per the classification database in existence at the time? If not in the database, did the broker request a classification?
- d) Accuracy of Origin:
 - Of 20 parts selected from 20 different entries, on how many did the broker correctly declare the country of origin? If the origin was not shown on the commercial invoice, did the broker request guidance?
- e) Accuracy of Value:
 - Of 20 entries selected from ACE, on how many did the broker correctly declare the valuation shown on the commercial documents?

Subjective Criteria: (Rate: Strong / Average / Weak):

- a) Degree to which broker follows the standard operating procedures;
- b) Level of knowledge of broker representatives;
- c) Responsiveness of broker to special interests;
- d) Degree to which broker effectively applies technology.

§ 38.07 Customs Release Reporting

Customs Release Reporting

Customs Release/ Reporting	Response	Dates	Contact Person
1. Do you have a procedure manual? Provide a copy.			
2. Have any changes been made to the manual in the last year?			
3. Who is the primary contact for Customs matters?			
4. Do you maintain a separate system for Customs purposes?			

(Rel.2009-10/2009 Pub.1542)

Customs Release/ Reporting	Response	Dates	Contact Person
5. What are your procedures for clearing foreign goods?			
6. Do you prepare Customs entries based on the actual goods shipped as confirmed by receiving records and account payable records?			
7. Do you amend entries when a shipping discrepancy occurs? How?			
8. Can all purchase orders for imported products be matched to a Customs entry?			
9. Do you have the purchase order number on Customs entries?			
10. Do you have a list of approved suppliers and shipping terms?			
11. Explain the services or arrangement of WMS and Burton?			
12. Do you have a current Harmonized Tariff Schedule?			
13. Who determines the following:			
a. Tariff classification			
b. Value for duty			
c. Tariff treatment			
14. Where are the certificates or other proof of origin kept?			

Customs Release/ Reporting	Response	Dates	Contact Person
15. How do you determine country of export?			
16. Do you claim GSP on any entries?			
17. Do you claim NAFTA on any entries?			
18. How do you verify your goods qualify for GSP?			
19. Do you have a country of origin certificates on file?			
20. Do you have imports of U.S. goods returned? Or repaired and returned?			
21. Do you receive shipments from foreign sources which are "no charge"? If so, how are they account for Customs purposes? How is their value for duty determined?			
22. Do you have imports of U.S. goods returned? Or repaired and returned?			
a. How are they handled for Customs purposes?			
b. How is their value for duty determined?			
23. What procedures are in place to report retroactive price changes on imported goods to Customs after the initial accounting?			

(Rel.2009-10/2009 Pub.1542)

Customs Release/ Reporting	Response	Dates	Contact Person
24. What steps are taken if there is discrepancy between a receiving report, purchase order and invoice for quantity or price?			
25. How do you know that the value declare to Customs is actually what accounting pays vendor?			
26. How do you know assists are involved? How do you track those goods with assists?			

§ 38.08 Import File Audit Checklist

IMPORT FILE AUDIT CHECKLIST

Customs Entry Number: _____ Date: _____/_____/_____.

Vessel Name: _____ Voyage/Flight # _____ Broker File #: _____

Entry / Immediate Delivery (CBP form 3461)

Entry Summary (CBP Form 7501)

Verify

Check

- Entry Number against CBP Form 3461 _____
- Exporting Country against Commercial Invoice _____
- Country of Origin against Commercial Invoice _____
- Invoice Value against Commercial Invoice _____
- Quantity reported against Bill of Lading/AWB _____
- "Related Party" statement against Broker Instruction Letter _____
- Harmonized Tariff Code against Broker Instruction Letter _____
- Duty calculated correctly _____
- MPF / HMF calculated correctly _____
- Total calculated correctly _____

(Rel.2009-10/2009 Pub.1542)

- Modified CBP Form 7501**
 - Attach documentation if applicable
 - Commercial Invoice**
 - Payment Invoice**
 - Verify against Commercial Invoice
 - Check
 - Quantities _____
 - Unit Values _____
 - Total Value _____
 - Packing List**
 - Bill of Lading or Air Waybill**
 - Certificate of Origin**
 - Importer’s Declaration**
 - Shipper’s Declaration**
 - Manufacturer’s Declaration**
 - P.O. / Contract and Amendments**
- Follow-up Actions/Comments:**
Audited By: _____ **Date:** _____/_____/_____

§ 38.09 Basics of Foreign Trade Zones

Basics of Foreign Trade Zones

By Marian E. Ladner

A Foreign Trade Zone (“FTZ”) is an area within the United States that for most practical purposes the government considers outside the Customs territory of the United States. As a result, most merchandise can be brought/imported into an FTZ without going through formal Customs entry procedures or paying import duties.

Companies can undergo a complete cost benefit analysis or they can answer a dozen or so basic questions involving a fairly limited diversion of resources to arrive at a quick analysis of possible zone benefits from which a fairly easy decision may be made.

What is the total annual volume of imports?

What percentage is then exported (exclusive of waste, scrap or defective)?

What percentage of goods in your facility/warehouse annually are foreign?

What was the total annual duty paid on importations?

What import duty paid can be associated with later exports?

What is your average duty rate?

How much in duties do you pay annually?

How many entries to you file annually?

(Rel.2009–10/2009 Pub.1542)

Number of inventory turns per year?

Do you further manufacture or produce sets in your warehouse?

What are the duty rate differences for same?

What is the average Merchandise Processing Fee (“MPF”) paid per entry?

What is the total value of goods annually in your facility?

What is the total inventory tax rate?

What percentage of your inventory is considered waste, scrap or defective merchandise?

Some of the FTZ benefits are obvious. It can help you defer paying duties, lower costs not only to Customs, but to your bank, insurance company and other vendors. Cash flow is improved by lowering inventory costs, deferring or reducing/eliminating Customs duties, distribution savings and the election of preferential duty rates. Merchandise entering a zone may be assembled, tested, sampled, relabeled, manufactured, repackaged, destroyed, mixed, manipulated, cleaned, stored, salvaged or processed. Remember, duties are not owed on labor, overhead, or profit attributed to FTZ production operations.

Duty Deferral - Maintaining imported product inventory in an FTZ enhances the user’s cash flow by delaying the time that duty must be paid.

No Duty on Re-Exports - Unlike the drawback program where you pay duties, wait, and then apply for 99% of those duties to be returned, goods held in a zone and subsequently re-exported are not subject to duty at all, whether goods are in their original form as imported or as components of finished products.

Avoid Inverted Tariffs - The Harmonized Tariff Schedule (“HTSUS”) generally assesses higher tariffs on finished products than on raw materials or component parts (although not always). An importer into a zone may generally chose privileged or non-privileged status when merchandise enters a zone, thus locking in the most advantageous rate of duty relative to its processes. When electing non-privileged (i.e., you pay duty at the rate of the finished product), excluded from the dutiable value calculation are: 1) the cost of processing in the zone (including labor); 2) the general expenses and profit attributable to zone operations; 3) expenses incurred in the zone that are incidental to placing the merchandise packed ready for transfer into U.S. custody; and 4) freight, insurance and similar costs incurred after packed. So, duty is really the cost of the component part times the duty rate applicable to the finished product.

Ad Valorem Tax Exemption - State and local governments are preempted from assessing personal property tax on inventory that has either been imported into an FTZ or is being held in an FTZ for export. The exemption applies only to inventory, and not to equipment used in manufacturing process or to other furniture or fixtures located in a zone. (This is separate from and not coterminous with the Texas “free port” exemption.) The free port exemption exempts goods warehoused in Texas for less than 175 days that then leave the state. Note, many taxing authorities in Texas have elected

(Rel.2009–10/2009 Pub.1542)

NOT to allow the free port exemption and as a result, an FTZ is often the only option to avoid the Texas inventory tax.

Quotas and VRAs - Import quotas are generally not applicable to goods stored in zones and so if quota limits are reached, over quota merchandise may be stored in a zone rather than re-exported and then brought in during the next quota period.

Origin Marking - Foreign components substantially transformed within a zone lose their identity as foreign for marking purposes and the finished product may be treated as a U.S. product.

Fixing Inadmissibility Issues - Goods not allowed entry may in some instances be brought into an FTZ for the deficiency to be rectified. Examples include goods improperly marked or packaged for the U.S. market. Some food and drug products that do not meet the requirements of the Federal Food, Drug and Cosmetics Act may also be reconditioned and subsequently entered.

Avoiding State Regulation - The FTZ Act does not specifically reference any preemption of state law, but the Act has found some to be preempted. Example: a cosmetic company brought non-conforming product into an FTZ warehouse in Florida, which was destined for the Caribbean and the court found that the State of Florida's licensing requirements did not apply to these cosmetics.

Lost product - Loss or shrinkage of product that has undergone processing or storage is generally measured as goods leave. So the volume of product leaving, on which duties are paid, can be less than the volume brought in. Similarly, defective components can be replaced or destroyed without incurring duty on the value of the defective components.

Spare parts - Spare parts may be stored, returned or destroyed without duty payment.

Scrap or Waste - If the scrap or waste is a result of the manufacturing process, it generally escapes duty since most scrap is duty free. (Scrap becomes non-privileged foreign merchandise, and only the amount of privileged (from which the scrap was created) becomes part of the finished product that is dutiable.

Insurance - For insurance purposes, the insurable value of foreign goods in inventory includes the amount of duty paid. By storing in an FTZ, insurance is reduced by reducing the insured value by the amount of duty that would have been paid, and you realize premium savings.

Flexibility - Direct delivery is often permitted by the local Customs head. Direct delivery delays processing back-up at the port of arrival and can be a key element in just-in-time inventory delivery systems. Weekly entry summaries not only reduced broker fees charged per entry, but allow a single entry document combining FTZ activity over a week's period, which can also result insignificant merchandise processing fees ("MPF").

Real Property Tax Exemption - There is an exemption from ad valorem taxation of real property located in an FTZ in very limited circumstances. Tax free treatment is given to leased facilities located in the FTZ grant of the DFW International Airport FTZ. Businesses at the DFW Zone qualify for this exemption and pay no property tax on the

(Rel.2009-10/2009 Pub.1542)

land they lease or buildings they occupy within the zone. Businesses which lease property from the City of Fort Worth adjacent to the Alliance Airport and which is part of a zone are also exempt from property taxes.

A company can become eligible for FTZ benefits by either locating at an existing general purpose zone or obtaining subzone designation for existing facilities. A subzone is a site ancillary to a general purpose zone which is given FTZ status for the benefit of a particular user that cannot be accommodated in existing zone space. Subzone status is granted by the FTZ Board on application from an existing zone and the board approves manufacturing or processing operations to be conducted in a zone, transformation of a foreign article, and processing means an activity other than manufacturing which results in a change in the Customs classification or entry eligibility of an article for consumption.

Having said that . . . I hope the above adds some clarity to the FTZ picture and issues, savings and opportunities it affords.

If you are interested in discussing this further, please contact me.

(Rel.2009-10/2009 Pub.1542)