Changes in prior disclosure rules are more complex than what meets importers’ eyes

On May 28, the U.S. Customs Service introduced the first major revision of the prior disclosure regulations (19 C.F.R. Section 162.74) in years. These regulations are part of the recordkeeping, inspection, search and seizure provisions promulgated pursuant to 19 U.S.C. Section 1592, the penalty statute.

The new regulations became effective on June 29. They were implemented to simplify and understandability of prior disclosure pursuant to the Customs Modernization Act of 1993.

Sec. 1592 permits Customs to assess monetary penalties against parties who make fraudulent, grossly negligent or negligent material false statements, acts or omissions in connection with their importations.

Typical examples of common violations include undervaluation, the wrong description of merchandise, and improper country of origin declarations.

Prior disclosure is a provision in the law that provides reduced penalties to any member of the trade community that advises Customs of its (the member’s) non-compliance with certain import laws and regulations before Customs discovers and notifies the party of such.

In the absence of a filing of a prior disclosure, Customs could take the following actions:
- Assess a penalty amounting up to the domestic value of the merchandise.
- Assess a penalty amounting to the lesser of the following: the domestic value of the merchandise, or four times the duties of which the government was deprived.
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By filing a prior disclosure, the disclosing party can sharply reduce its liability for Customs penalties.

For a fraudulent violation, Customs may only assess a maximum penalty totaling 100% of the duties of which the government was deprived, or, if no duties were assessed, then 20% of the duties of which the government was deprived.

Corollary advantages to filing a prior disclosure include the opportunities that periodic compliance reviews provide in uncovering and correcting current errors; improving future operations and avoiding excessive legal expenses and lengthy Customs proceedings.

The timing of a prior disclosure is at the disclosing party’s discretion. Various factors that may affect such a decision include the following:
- The amounts of money at issue, since de minimis charges may not be worth the cost of filing.
- Whether Customs has contacted the company regarding a violation. However, even if it is currently under investigation, assisting Customs in uncovering violations could result in significant mitigation of any penalties assessed.
- Whether the disclosing party has conducted a self-assessment and compiled all of the information necessary to file.

Normally, a prior disclosure is filed at the port of entry where the disclosed violation occurred. If violation has occurred at more than one port, each port should be listed in the disclosure (with copies sent to each).

Amendments allow for review of duty rulings

The most significant amendment to the regulations is the provision that permits the disclosing party to request a Customs Headquarters review of the field office’s determination of an actual duty loss.

However, in order to gain such a review, several conditions must be met: the loss must exceed $100,000 and must be deposited with Customs, there must be over a year remaining under the statute of limitations for the goods subject to the claimed disclosure and the disclosing party has to be in full compliance with all of the other regulations.

Furthermore, headquarters’ review is limited to determining issues of correct tariff classification, correct rate of duty, elements of dutiable value and the correct application of any special rules (e.g. Generalized System of Preferences, Caribbean Basin Initiative, Harmonized Tariff Schedule 9802, etc.). It is not subject to appeal.

Parties waive right to contest loss of duties

Moreover, parties requesting and obtaining headquarters’ review waive their right to contest, either administratively or judicially, the amount of duties calculated by Customs. Failure to tender the amount finally calculated for actual loss of duties would result in the denial of the prior disclosure.

Other significant changes include:
- The new application of the prior disclosure provisions to the penalty statute for filing drawback claims (19 U.S.C. Sec. 1593a).
- The express allowance fororal prior disclosure, which is now confirmed in writing within 10 days (unless waived by the concerned Finances, Penalties and Forfeitures (FP&F) officers).
- The new authority given to the local FP&F officer to make the initial decision regarding the validity of the prior disclosure.
- The requirement that the commencement of a Customs investigation must now be evidenced by a writing. Such writing must accompany any pre-notice that is issued in a case relating to a prior disclosure that was denied by Customs.
- The existence of a new verification provision in which the FP&F officer has discretion to defer the verification of a prior disclosure until the disclosing party has completed the disclosure of the circumstances of its violation.
- The presumption that the importer has knowledge of the commencement of a formal investigation when it receives a pre-notice that is issued in a case relating to a prior disclosure that was denied by Customs.

When you add it up, importers get hit hard

On balance, the revised regulations are not favorable to the importing public. By only allowing a headquarters’ review of a determination by the Customs field office in cases where the amount at issue exceeds $100,000, Customs excludes a large number of disclosing parties from seeking such review.

More critically, companies that choose this option are forced to forego any further relief beyond the headquarters level.

This contravenes the intent of prior disclosure provisions, which was to encourage companies to come forward in the interest of promoting a free exchange of information between trade and government.

Now, free traders are asked to waive their rights of review for fundamental issues (e.g. tariff classification, appraisement) and agree to grant ultimate decision-making authority to Customs headquarters.

In view of the fact that headquarters is constantly reversing itself (as evidenced by the multiplicity of revocations issued on a regular basis), this waiver is something akin to playing Russian roulette.

Moreover, such review is not merely limited to the revenue loss claims raised by the field office, but could potentially be expanded to include an independent Headquarters determination.

What Customs has ultimately done is present importers with a new dilemma: "Do I continue to be the responsible corporate citizen and forfeit my rights of judicial review under an due process of law to an administrative agency which has a history of arbitrariness, or do I collaborate and let Customs make the discovery?"

By choosing the latter, the importer could potentially subject itself to greater penalties, but would retain its "day in court".

Another important consequence of the revised regulations concerns the decision-making power granted to the local FP&F officers.

In order to ensure complete objectivity, such authority should more appropriately be vested in a Customs official who is further removed from the potential penalty action.

A simplified rule that complicates your life

While the new prior disclosure regulations somewhat simplify the understanding of the concept, they now feature provisions that complicate the practice.

By limiting headquarters’ review of field office decisions and delegating greater authority to more lower-level FP&F officers, Customs again created an environment ripe for the development of a disjointed series of decisions.

Furthermore, the new provision which prohibits an importer from obtaining administrative and judicial relief is of questionable legality. Such a provision is in contradiction to the clear authority of the United States Court of Customs and the United States Court of Appeals for the Federal Circuit for review of any and all Customs decisions.

In its alleged effort to encourage expanded use of the prior disclosure provisions, Customs has effectively placed the importer under duress to evaluate whether it is in its best interest to utilize this option at all.

Thus, in the end, Customs will more likely have thwarted the use of the prior disclosure process, rather than promoted it.

Whether this was the intended result of the promulgators of the revised regulations is a question that remains unanswered.

Customs Update is a weekly column examining critical aspects of the relationship between customs agencies and importers. This column was prepared by Steven S. Weiser and Ari L. Kaplan, partners atWeiser & Kaplan, a New York international trade law firm of Graham & James LLP. N.Y., and reflects the opinion of the writers. Please address any questions in Customs Update, Trade Desk, The Journal of Commerce, Two World Trade Center, Suite 2790, New York, N.Y. 10048.