How the "Reasonable Care" Obligation of 19 USC 1484(a) can be Used as Leverage by Customs to Force Payment of Duties that have Otherwise Become Final*

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An importer has just received a Notice of Action from US Customs and Border Protection advising that a tariff classification the importer has used for an imported product for a number of years is considered to be incorrect, that the entry covered by the Notice and all entries of the same merchandise that have not yet been liquidated will be reclassified, and that the importer will be billed for additional duties. The Notice states that all future entries of this product must be classified in the correct provision. The Notice goes on to state that the importer should review its import records for the preceding five years, advise Customs of all entries of that merchandise which used the incorrect classification, and tender duties and fees for all of those entries based on the revised classification. Customs cites 19 USC 1592(d) as authority.

After conducting some investigation, the importer agrees that the classification it had been using is indeed incorrect, and that the classification asserted by Customs is the correct one. It ensures that all future shipments are entered as required by Customs, and prepares for payment of the additional duties on unliquidated entries as they liquidate and are billed.

The importer knows, however, that the duty determined on liquidated entries becomes final, even against the government, unless the government voluntarily reliquidates the entries within 90 days of liquidation pursuant to 19 USC 1501 or the entries are Protested by the importer within 180 days of liquidation pursuant to 19 USC 1514. The importer is reluctant to pay substantial additional duties on shipments where liquidation has become final, particularly as it imported the goods using the same classification without inquiry or objection by Customs for many years.

Legal Requirements

19 USC 1592(d) instructs Customs to collect, notwithstanding the finality provided by 19 USC 1514, any duties, taxes or fees of which the US has been deprived as the result of a violation of 19 USC 1592(a) (the basic penalty statute), whether or not any penalty is assessed. 19 USC 1592(a) covers the entry, introduction, or attempted entry or introduction of goods into the US by means of any document

or electronically transmitted data or information which is false and material, or by means of a material omission. Information is material to the transaction if it may influence agency action, including but not limited to the classification, appraisement, or admissibility of the merchandise. When the filing of (or omitting to file) such information is due to negligence, gross negligence, or fraud, a Customs violation exists.

Although the government must demonstrate all elements of a violation for any alleged fraud or gross negligence, for simple negligence the government is only required to show that the information was false and material. The burden of proof (unlike in common law negligence) then shifts to the alleged violator to demonstrate that the filing of the false data was not the result of negligence.[1] Negligence is the failure to exercise the same degree of reasonable care as would a competent person in the same circumstances to ascertain the facts, draw inferences from them, and understand the obligations imposed by the statute, or to communicate that information in a manner understood by the recipient.

Entering goods into the United States requires determining the legal classification of the goods under the Harmonized Tariff Schedules of the United States (HTSUS) and the value of goods pursuant to the provisions of 19 USC 1401a by ascertaining the facts, drawing inferences, and determining whether the applicable requirements of law with respect to these issues are met; and the communicating of that data to Customs. Thus, if an importer (usually through its Customs broker as agent) claims a classification or sets forth a value that is ultimately determined to be incorrect, Customs may well assert a *prima facie* violation of 19 USC 1592(a).[2]

Dilemma

The situation facing the importer described above is that the classification claims filed with its entries for several years are now clearly and admittedly recognized to be wrong, and Customs can assert a *prima facie* violation of 19 USC 1592(a). Customs, without initiating any penalty claim, has demanded under 19 USC 1592(d) that back duties for the past five years (the length of the Statute of Limitations for negligence) be ascertained and paid. The importer must now decide whether to accede to Customs demand for additional duties or risk Customs' initiating a 1592(a) penalty proceeding that could result not only in liability for the duties, taxes, and fees involved, but also a fine of up to two times that amount as well. (Customs could seek larger fines based on culpability at the fraud or gross negligence level, but would have to prove not only the false statement but also all of the other elements of the violation.)

The importer is also unable to resist the demand for additional duties by filing a prior disclosure, as such action involves both admitting the violation, and repaying – with interest – the contested duties and fees, the very result the importer wants to avoid.[3] (Some importers have, with varying degrees of success, attempted to file "contingent" prior disclosures, asserting that the information was not negligently filed, but asking that they be afforded prior disclosure treatment if they are ultimately unable to prove reasonable care was used.) The importer must decide either to pay the amounts based on the revised classification, even though the lost duties are beyond the reach of Customs' ability to recover by reliquidation, or run the risk of a penalty. Even if the importer believes that it can make a

successful showing that reasonable care was used to establish the classification in question, it will still face legal fees, administrative costs, and possible financial disclosure requirements while an investigation takes place. If there is some question as to whether reasonable care can be demonstrated, there is strong pressure to accede to the Customs demand for payment.

Any importer considering relying on its ability to demonstrate that the mis-classification was not a negligent act should carefully review the process by which the incorrect classification decision was originally made. The fact that a decision was wrong does not necessarily make it negligent; lack of reasonable care in reaching the decision, however, will. A legitimate dispute over a classification will not constitute negligence, despite the position taken by Customs ultimately being shown to be correct, so long as the position of the importer is shown to have been reached using reasonable care. [4]

Demonstrating Reasonable Care

Reasonable care can be demonstrated by securing a binding ruling from Customs, or obtaining the written opinion of a Customs "expert" – attorney, licensed Customs broker, recognized consultant – which must be based on full and complete information provided by the importer - and following that advice. Alternatively, it can be demonstrated by having an established internal procedure for making determinations, with knowledgeable personnel with access to the necessary information, including the tariff, Customs publications and rulings, court decisions, product information (drawings, specifications samples, including engineers, designers, etc. as needed to explain), bills of materials, and so forth, and demonstrating that the procedure was actually used. [5]

There are many reasons why an importer may not be able to demonstrate that a determination, even though made in good faith, was reached with the use of reasonable care. A classification decision made by the company in the past may have pre-dated a formal procedure the company now has in place. The original decision may have been made by a customs broker based only on an invoice description, with no investigation and no written opinion. A decision reached through reasonable care may no longer be valid if Customs or the courts have issued intervening rulings or decisions that indicate a change in Customs position and the change was not recognized by the company. Any of these may indicate that it would not be possible to demonstrate reasonable care was used in reaching, or continuing to use, the original decision.

The use of reasonable care is a continuing obligation. Each new entry requires that value, classification, admissibility, and any related material information be ascertained and transmitted correctly, so that changes in the law, new interpretations by Customs, or just greater information on the part of the importer must be taken into account. Good practices include updating databases on an ongoing basis before relying on them for entry data or otherwise verifying the continued validity of that data.

Analysis

Customs does not, for the most part, make demands under 19 USC 1592(d) unless it has some evidence or suspicion of negligence. Such suspicion could be based on importer's changing its port of

entry after some preliminary inquiry was made or issue raised (port shopping), failing to revise its classification after the issuance of some publicized court decision or Customs ruling on similar or identical merchandise, or learning that a competitor was paying higher duties on similar goods and failing to investigate. Although the change in ports could be completely unrelated to the Customs issue involved, the importer could be genuinely unaware of the court or Customs decision, or the information on competitor's duty rates could be sketchy and incomplete, the failure to look into the possible issue, or have a system in place to remain aware of decisions that affect the company could be considered negligent – a failure to use reasonable care.

An importer that has received a demand for duties under 19 USC 1592(d), therefore, should begin its review with the idea that Customs is suspicious of something, and look for the cause. It could be something that the importer has done without recognizing the way it might look to Customs, such as changing ports. It may simply be that there is a body of decisions on similar goods that Customs would expect the importer (or its expert) to be aware of. No intent to fail to pay proper duties is required for a negligence claim. The importer should also review its activities with regard to the product over the past five years to determine if there were any changes in circumstances (such as new rulings), inquiries from Customs or Customs brokers, information received from suppliers or trade associations, or other indications that any question or concern regarding the classification had been raised.

If clear evidence of reasonable care exists, such as a formal opinion from a Customs expert or a documented internal process that had reviewed the relevant information, it can be presented to Customs as a basis for resisting the payment demand. Customs may nevertheless argue that such evidence may show reasonable care was used initially but the continuing obligation was not met due to failure to apply new decisions or rulings. A formal, documented process of continuing review, even if it missed important changes, could still be enough to demonstrate reasonable care, although the process would have to be reviewed/revised to better handle similar future occurrences.

Conclusion

Customs demands for payment of duties pursuant to 19 USC 1592(d) on older entries that have otherwise become "final" through liquidation can be a shock (and potentially large expense) for an importer that has consistently entered goods under the same classification for an extended period, all without any notice from or questions raised by Customs. As there is usually some suspicion by Customs that something more than just being wrong is involved, the importer should investigate carefully to identify any areas of concern. Even if Customs is only acting on the basis that the importer "should have known better," the inability to affirmatively demonstrate that reasonable care was used will expose the importer to significant pressure to comply with the demand.

It is certainly possible (and desirable) to present to Customs any documented evidence indicating that the reasonable care requirement had been met, even if only for a portion of the period covered by the demand for duties. If Customs agrees, some or all of the duty liability may be avoided. Care should be exercised, however, in resisting Customs demands for duty when it is not possible to

demonstrate reasonable care was used, as it could provoke Customs to resort to an actual penalty claim under 19 USC 1592(a) to secure collection of fines as well as back duties.

ENDNOTES

[1] *United States v. Ford Motor Company*, 463 F.3d 1267, 1279 (Fed. Cir. 2006).

[2] See the discussion of Negligent Classification and Reasonable Care in *United States v. Optrex America Inc.*, Slip. Op. 08-63, USCIT June 9, 2008.

[3] 19 U.S.C. 1592(c)(4). US Customs and Border Protection has published an Informed Compliance Publication entitled *The ABCs of Prior Disclosure* on its website, www.cbp.gov.

[4] Importers are required to use "reasonable care" when entering merchandise into the US by 19 USC 1484(e), an amendment made to the Tariff Act of 1930 by the Customs Modernization Act, Title VI of the North American Free Trade Implementation Act, Pub. L. 103-182, effective December 8, 1993. This concept is discussed in more detail in the article "Customs and the Court Indicate What is "Reasonable" in Meeting "Reasonable Care" Obligations", published in *Corporate Counsel's International Adviser, Issue No. 258, November 1, 2006,* also available on the author's website www.swbakerlaw.com.

[5] Customs has indicated the importance it places on formal, documented procedures in the materials published on Focused Assessments on its website, www.cbp.gov. Several exhibits to the materials cover Internal Controls, including a sample Import Control Manual with 72 sections in 12 chapters. See also "Customs and Border Protection: Expectations for Corporate Compliance", *Corporate Counsel's International Adviser,* Issue No. 228, May 1, 2004, also available on the author's website www.swbakerlaw.com.