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CBP Special Enforcement Initiative

By Susan Kohn Ross

Noncompliance Headaches Continue

It has long been understood that achieving 100% trade compliance with textile and wearing apparel imports has been challenging for both Customs and the trade community. In a recent presentation,

Janet Labuda, the U.S. Customs and Border Protection (CBP) Director of Textile Enforcement, reminded the audience just how daunting that challenge remains. Textiles (including wearing apparel) still account for approximately 40% of all duties collected and about 22% of all import entries filed. Customs' focus is on preference claims where a 45% rate of noncompliance has been found, but CBP is also examining short-supply fabric claims, which recently resulted in \$2 million in denied claims.

Under Ms. Labuda's direction, CBP has assembled a cross-functional team to review textile and wearing apparel imports from China. Over a relatively short period of time, the team visited 60 companies in Los Angeles, another 60 in Manhattan, and another 61 throughout the rest of the country. The result confirmed CBP's worst fears. In one example, goods worth \$33 million were imported by one company, but the person acting as importer was getting paid just 1¢ per garment. In other words, this person did not qualify to act as importer of record, and the value being declared at time of entry was significantly underreported. In other examples, a shipment was originally offered for entry with a value of \$200,000. When Customs refused the entry, the corrected entry reflected a value of \$1.7 million. Another entry originally submitted at \$250,000 was ultimately revised to \$1.5 million. According to Ms. Labuda, more than half of the importers interviewed did not have the right to make entry. They had no knowledge about the goods and also had no interest in those goods.

While these CBP efforts may be focused on importers, it is clear that CBP considers the customs brokers to be the "linchpin" and recognizes that freight forwarders are also involved. As a result, CBP and the Federal Maritime Commission are cooperating as these investigations continue.

For Customs, the issue is supply-chain security. Who are the real parties to the transaction? Without knowing that fact, risk at all levels cannot be properly measured or addressed. From the trade's perspective, many honest importers are getting stuck in the middle. They file an entry; it is refused on the grounds the value is too low, despite proof of payment. A significantly higher value is then arbitrarily set by CBP. Do you challenge CBP; or do you pay the duty, get your goods, and argue about it later? Not surprisingly, most choose to secure the goods and argue about valuation later. Should the fact there are some dishonest importers mean that everyone who imports from China is being treated with the same heightened skepticism and close scrutiny?

One last word of warning - if you are purchasing branded merchandise on a DDP or LDP basis, do not think you are off the hook. From CBP's perspective, you may well have some form of liability if the seller does not make proper entry. Does this mean that as the DDP or LDP buyer, you should demand to get a copy of the 7501 from your seller? CBP says yes, but is that realistic? Even if you elect to do so, does it mean the document you are given is authentic? How are you supposed to make that determination? Each company will have to answer these questions for itself. What do your SOPs require?

What Income?

It is no secret that the federal government is seriously upside down in terms of the current recession and resulting deficit. It is also well known that Customs is responsible for enforcing regulations that protect the revenue. However, going after taxes on phantom income is going too far.

It has become commonplace for Customs to issue a 1099-C debt cancellation form in circumstances that have tax lawyers shaking their heads in disbelief. Here is the scenario using a liquidated damages case as the example, although this is being done across the board with various categories of monetary penalty that have been issued and forgiven. It is also being applied whether the matter gets resolved through the reduction of the fine via the mitigation process or pursuant to an Offer in Compromise.

We will presume the Notice of Liquidated Damages involves a late-filed entry. The amount of the claim will typically be issued for the face amount of the bond, say \$100,000. Because this is such a routine violation, Customs issues the Notice with the Option 1 calculation right on it, which will be \$100 plus an interest amount. Of course, Option 1 only applies if the entry has been filed and all the duties and user fees were already paid. For purposes of this illustration, we will presume the Option 1 amount totals \$125. The importer pays the fine and that ends the penalty case, but now a 1099-C is issued for \$99,875, the supposed amount of the forgiven debt!

A 1099-C is issued pursuant to IRS regulations (see IRC 6050P and Treasury Regulation 1.6050P-1) when a debt in excess of \$600 is involved and it is forgiven. The sort of debt envisioned by these laws and regulations is something like a student loan or mortgage; in other words, a situation where there is a fixed and final amount agreed to by the parties. The CBP mitigation process clearly does not fit this criteria. If you receive a 1099-C, you should immediately give it to your CPA so that it accompanies your tax return, and the IRS should be notified that Customs was in error when it issued the 1099-C. As a result, the amount purportedly forgiven is not being declared as income, only reported. Just as when the IRS reduces or cancels a penalty, no debt forgiveness results, no debt forgiveness results when Customs reduces or cancels a fine.

The issuance of a Form 1099-C has become so widespread that we have approached Customs upper management and requested that Customs put a stop to this action or, failing that, explain the legal thinking behind it, since the tax law experts with whom we have consulted are stumped.

False Patent Marking Becomes Costly

The Texas district court has ruled in *Forest Group v Bon Tool Co.*, 2010 U.S. Dist. LEXIS 41291 (S.D. Tex. Apr. 27, 2010) that if a party places a false patent marking on a product, the fine will be based on the maximum price at which the product was sold rather than the profit margin or economic benefit the company derived. The decision was seen to be in accord with the deterrent goal of the patent law. While the fine in this case totaled only \$6,840, its ripple effect is expected to be far more significant, especially in cases where hundreds of thousands or millions of products are mass-produced and falsely labeled.

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