Canadian Customs

Advisory

Bulletin

August 2003

Living With "AMPS" The New Customs Penalty System

1. Why Should Auto Parts Manufacturers/Suppliers Care About AMPS?

Effective October 7, 2002, Canada Customs and Revenue Agency ("**CCRA**") introduced the Administrative Monetary Penalty System ("**AMPS**") for hundreds of different kinds of customs infractions for commercial shipments to or from Canada. During the ten-month "grace-period" leading up to full implementation of AMPS, CCRA issued notices of AMPS infractions which, if AMPS had then been implemented, would have resulted in millions of dollars of penalties. The notices were intended to warn importers and exporters so that they had the opportunity to correct their errors on future shipments. During this grace-period, the CCRA found an error rate of 20% to 40% in the transactions reviewed, irrespective of the industry. In the first six months of AMPS implementation, CCRA found over 8,100 customs infractions, generating over $5 million in potential penalties under AMPS.

In today's intense cost cutting environment, auto parts manufacturers/suppliers cannot afford to absorb the costs of a significant AMPS assessment. Yet, as the above statistics indicate, many auto parts manufacturers/suppliers may not have adequately prepared for AMPS. It is imperative that you do so, if you want to protect and preserve your margins.

Beyond the monetary penalties, AMPS can also mean the loss of certain import and export privileges, such as expedited customs clearance of goods at the border and streamlined customs reporting and accounting under the Customs Self-Assessment ("**CSA**") program. Once an importer/exporter has a history of non-compliance, CCRA may increase the scrutiny of that importer's/exporter's shipments at the border and generally increase audit activity directed at the importer/exporter. Increased scrutiny and audit activity, as well as the potential for more penalties under AMPS, will eventually increase your costs of doing business.

2. What is AMPS?

AMPS levies monetary penalties on hundreds of different kinds of customs-related infractions, even ones resulting in no revenue loss to CCRA. The penalty levied depends on the type, frequency and severity of the infraction and can rise to $25,000 per infraction.

As an example, an importer has an obligation to amend an incorrect import declaration of origin, tariff classification or customs valuation within 90 days of having "**reason to believe**" that the declaration was incorrect. With the amended entry, the importer pays the "duties", including any GST owing, plus interest at

the prescribed rate (approximately the rate for three-month Government of Canada Treasury Bills issued in the previous calendar quarter).

If an importer were to fail to rectify an incorrect customs valuation within the permitted 90-day grace-period, CCRA could impose penalties under AMPS, in addition to any duties and GST owing, plus interest at the punitive, specified rate. The specified rate of interest is 6% per annum higher than the prescribed rate. The graduated levels of penalties under AMPS for this type of infraction are as follows:

(a) $100 penalty for each error identified in a reassessment period (and not previously identified in an earlier audit by CCRA) to a maximum of $25,000 for the reassessment period;

(b) $200 penalty for each error identified in a reassessment period (if previously identified in an earlier audit conducted within the last three years) to a maximum of $25,000 for the reassessment period; and

(c) $400 penalty for each error in a reassessment period (if previously identified in at least two earlier audits conducted within the last three years) to a maximum of $25,000 for the reassessment period.

What is meant by "**reason to believe**"? This point is key because it starts the 90-day grace-period running. In its policy statements, CCRA gives specific examples of what might constitute "reason to believe" but the list is not intended to be exhaustive. One example given by CCRA is if an importer/exporter is aware that a declaration is contrary to CCRA's written advice, precedent decisions, or published directives and policies. However, what if an importer/exporter genuinely disagrees with CCRA's advice or policies, and even has legal advice to suggest a contrary view is correct? Would the importer/exporter have "reason to believe" its declaration is incorrect in those circumstances? There is no clear answer and ultimately, the courts will likely have to decide the issue and interpret the meaning of "reason to believe".

There is one other important point to keep in mind. Where an error is repeated after being assessed in an earlier audit, CCRA may choose to resort to more severe measures than AMPS to enforce customs compliance, specifically seizure of imported goods and/or other property of the importer/exporter.

3. What Can You Do to Avoid Penalties Under AMPS?

You can self-audit and self-test for customs compliance and put proper compliance procedures in place. You need to establish systems and quality controls for key import and/or export requirements, such as:

(a) marking;

(b) origin;

(c) valuation;

(d) tariff classification;

(e) quantity; and

(f) import/export permits.

You should establish multiple layers of checks and audits for import and export transactions, both internally and through your customs broker. These checks and audits can form part of your standard operating procedures ("**SOPs**").

The SOPs should assign and co-ordinate the various responsibilities for import and export compliance so that quality control and accountability are built into them. Everybody should know his or her role in the system, whether in purchasing, shipping and receiving, accounting, sales, production control, logistics, etc. A policy and procedures manual (the "**Manual**") should set out the SOPs for everybody on the "export team" or "import team" so that everybody is familiar with his or her role and is accountable. The Manual should be continually updated as needs and roles change. The SOPs should welcome forthright declarations of any error, trace the source of the error, check all similar transactions and implement corrective procedures.

It is very important that you have good lines of communication on a continual, "real time" basis with your customs broker to ensure customs compliance. The broker should have the ability to recognize when items are incorrect, the authority and ability to delay customs

clearance and accounting until the items are corrected, and clear lines of communications with your organization so as to facilitate rectifying any identified errors. There should be an established line of authority within your organization to approve clearance of shipments where concerns by the broker have arisen. You should keep your broker informed of such things as any unusual transactions or changes in trade terms, with sufficient lead time to allow the broker to incorporate the information into the preparation of customs documentation.

4. What if an Importer/Exporter Detects Errors in Customs Compliance?

As discussed above, in the case of an incorrect import declaration of origin, tariff classification or customs valuation, the importer should voluntarily amend the entry within 90 days of having "reason to believe" that the error has occurred to avoid penalties under AMPS and interest assessed at the specified rate. Furthermore, even beyond the 90-day grace-period, the importer can make a voluntary disclosure to CCRA to amend the import declaration and pay the duties, GST and interest at the prescribed rate, thereby avoiding potential assessment of AMPS penalties and interest at the higher specified rate. A voluntary disclosure may be the best way to avoid AMPS penalties in the case of many customs infractions. Before doing so, however, you should consult with experienced legal counsel who can advise on how best to proceed and represent you in your disclosure to, and subsequent dealings with, CCRA.

5. What if CCRA Detects the Errors in Customs Compliance and Assesses AMPS Penalties?

Built into AMPS is an appeal and redress process. In the case of obvious errors on an AMPS assessment, such as calculation errors, the assessed party has 30 days within which to make a request for a correction to the CCRA office which issued the AMPS assessment. To appeal contentious issues, the assessed party has 90 days within which to initiate an appeal that must be filed at the CCRA office which issued the assessment.

As an alternative to appealing an assessment, the assessed party can enter into a Penalty Reduction Agreement ("**PRA**") with CCRA. The purpose of the PRA is to give the assessed party an incentive to correct any systemic errors which gave rise to the penalties under AMPS. The PRA identifies the nature of the problem, the action plan to correct the problem, the time-frame within which to implement the action plan and correct the problem, and CCRA's criteria for validating the correction. For a PRA to be available, the total AMPS assessment(s) must be $5,000 or more. The penalties may be reduced or eliminated under the PRA. CCRA sets off certain costs invested under a PRA in systems corrections against the penalties. According to CCRA's PRA "External Guidelines" published in June 2003: "For successful PRAs, presented from October 7, 2002 to October 6, 2003, penalties may be reduced by $1.00 for each dollar spent to apply corrective actions to the underlying errors(s) and become compliant; after October 6, 2003, penalties may be reduced by $0.50 for each dollar spent."

Under a PRA, an assessed party is committed to fulfilling certain corrective measures and obligations. Failure to do so can result in the cancellation of the PRA and the application of AMPS penalties with interest. It is important to note that, as a condition to the PRA becoming effective, the assessed party must forego any rights of appeal. In considering whether to proceed with a PRA, an assessed party needs to consider whether the costs of making the necessary systems changes will ultimately exceed the potential benefits of better customs compliance. Before entering into a PRA, it is recommended that the assessed party consult with legal counsel experienced in customs matters. Fortunately, the costs of legal advice and services in negotiating the terms of the PRA and in implementing the PRA are the types of costs that can be set off against AMPS penalties.

6. Recommendations

As we have explained above, AMPS can have consequences beyond high monetary penalties. Failure to comply with AMPS can make your business

vulnerable to loss of importing/exporting privileges and consequent disruptions. If you have not adequately invested in ensuring your customs compliance, it is critical that you begin to address potential customs problems up front rather than engage in costly after-the-fact damage control. As previously mentioned, pro-active measures may include self-testing and self-auditing for customs compliance, preparing a Manual with SOPs and clearly defined roles for every member on the import and export teams, amending and rectifying incorrect customs entries that have been identified, and maintaining good lines of communication with your customs broker.

Experienced customs legal counsel can assist in co-ordinating this effort, and if CCRA should take enforcement action and impose AMPS, can help you to evaluate the options which you have available to respond to the assessment(s) in order to mitigate or even eliminate the imposition of penalties under AMPS. Sensitive information and discussions with your lawyer are protected by solicitor-client privilege.

Jamie Wilks is a lawyer with McMillan Binch LLP, specializing in commodity tax, customs and trade law, and a member of its Automotive Group. Jamie can be reached by telephone at: 416.865.7804; and by e-mail at: jamie.wilks@mcmillanbinch.com

---

McMillan Binch LLP

Telephone: 416.865.7000
Facsimile: 416.865.7048
Web: www.mcmillanbinch.com

BCE Place, Suite 4400, Bay Wellington Tower, 181 Bay Street, Toronto, Ontario, Canada M5J 2T3