

August 17, 2017

President Trump  
The White House  
1600 Pennsylvania Avenue NW  
Washington, DC 20500

**RE: Continued Failure to Collect Appropriate Duties, Penalties, and Interest**

Dear President Trump:

The Project On Government Oversight (POGO) is an independent nonprofit that investigates and exposes corruption and other misconduct in order to achieve a more effective, accountable, open, and ethical federal government. In our efforts to further this mission, we want to bring to your attention the potentially massive loss of revenue resulting from mismanagement at U.S. Customs and Border Protection (CBP). CBP may be losing billions of dollars due to its unwillingness to collect the required duties, penalties, and interest from non-compliant importers, many of whom are located in China and other foreign countries.

Based on your stated commitments to eliminate waste and fraud in government spending, protect American workers and businesses, and make sure the U.S. gets the most out of its trade deals, we believe the following information will be of great interest to you.

This is not the first time POGO has raised this issue, however. In May 2016, POGO sent a letter to Department of Homeland Security Inspector General (DHS IG) John Roth describing how CBP was losing millions of dollars each year solely from lax enforcement of importation laws.<sup>1</sup> While we were only able to provide the specific example of watch imports, POGO found evidence that suggests such revenue collection issues may also affect the collection of textile, apparel, computer part, and jewelry imports.<sup>2</sup> The DHS IG's office responded, stating that the Government Accountability Office (GAO) had already begun work on the issues we raised, and that the IG's office was working closely with them.

---

<sup>1</sup> Project On Government Oversight, *POGO's Letter to Homeland Security Inspector General To Address Long-standing Revenue Collection Issues at Customs and Border Protection*, May 10, 2016.

[http://www.pogoarchives.org/m/ga/pogo\\_ltr\\_dhs\\_cbp\\_revenue\\_collection\\_20160510.pdf](http://www.pogoarchives.org/m/ga/pogo_ltr_dhs_cbp_revenue_collection_20160510.pdf)

<sup>2</sup> "Through Customs own investigations . . . it has become increasingly clear that a large number of importers are deliberately undervaluing textile and apparel imports from China." National Council of Textile Organizations, *Enforcing America's Trade Laws in the Face of Customs Fraud and Duty Evasion*, May 5, 2011.

<https://www.finance.senate.gov/imo/media/doc/74204.pdf> (Downloaded July 8, 2017); "A number of recent [False Claims Act] lawsuits have alleged that importers fraudulently undervalued goods in order to reduce ad valorem duties . . . [:] *United States ex rel. Tu v. Kuo*, 3:12-cv-04166 (N.D. Ca.) . . . computer cables; women's apparel . . . *United States ex rel. Krigstein v. Siouni and Zarr Corporation*, 1:11-cv-04247 (S.D.N.Y.); jewelry . . . *United States ex rel. Karlin v. Noble Jewelry*, 1:08-cv-07826 (S.D.N.Y.)." Kirsten Mayer and Timothy Cahill, "False Claims Act Enforcement of Customs Duties—Emerging Trends," *International Trade Reporter*, Vol. 31, Issue 41, October 16, 2014, p. 1. <https://www.ropesgray.com/~media/Files/articles/2014/October/International-Trade-Reporter.ashx> (Downloaded July 8, 2017)

The GAO recently released a report that touches upon those issues, but it does not directly address the problems we highlighted.<sup>3</sup> The report seems to accept at face value the success of CBP's programs to ensure trade compliance, but it does not perform any substantive reviews of their effectiveness (except for citing a lack of performance targets and failure to meet legally required staffing levels). Furthermore, the GAO report does not address any of the concerns in Sen. Charles Grassley's (R-IA) 2009 letter to DHS about management failures at CBP, and it glosses over some key indicators of problems.<sup>4</sup>

Most disturbingly, the report states that CBP assessed over \$237 million dollars in penalties in fiscal year 2015, yet only collected \$3.5 million in penalties in that same period.<sup>5</sup> While GAO acknowledges that penalties take time to collect, there is no indication that the assessment of penalties in 2015 was an aberration. It appears CBP routinely assesses hundreds of millions of dollars in penalties each year, but only collects around 1-2 percent of that. Additionally, the word "interest" is never mentioned in the report, and, as we discussed in our 2016 letter, CBP's failure to collect interest from non-compliant importers not only results in lost revenue for the government, it also puts compliant importers at a financial disadvantage and American jobs at risk.

Clearly, the problem of weak revenue collection enforcement needs to be addressed. CBP keeps terrorists and their weapons out of the United States while facilitating lawful international travel and trade.<sup>6</sup> It is also one of the largest revenue producers for the government: in fiscal year 2016 alone, it processed more than \$2.4 trillion in trade and collected more than \$44 billion in revenue.<sup>7</sup> CBP sends all the duty, tax, and fee revenues it collects to various general fund accounts maintained by the Departments of Treasury and Agriculture, and the Army Corps of Engineers.<sup>8</sup> Treasury further distributes the revenues to federal agencies in accordance with various laws and regulations.<sup>9</sup> CBP handles revenue obtained from fines, penalties, and interest in the same manner.<sup>10</sup> Thus, CBP's failure to collect revenue could result in anything from less funding for government agencies to an increase in the federal deficit.

POGO believes that your stated intention to focus on the elimination of waste, fraud, and abuse in the federal government aligns closely with a careful study of the issues we raised in our May

---

<sup>3</sup> Government Accountability Office, *Improved Planning Needed to Strengthen Trade Enforcement*, June 2017. <http://www.gao.gov/assets/690/685215.pdf> (Downloaded August 1, 2017) (Hereinafter "GAO's Trade Enforcement Report")

<sup>4</sup> Letter from Charles E. Grassley, Ranking Member of the Committee on Finance, to the Honorable Janet A. Napolitano, Secretary of the Department of Homeland Security, about CBP revenue collection issues, November 3, 2009.

<sup>5</sup> GAO's Trade Enforcement Report, Report p. 32, pdf p. 38.

<sup>6</sup> Customs and Border Protection, "About CBP." <http://www.cbp.gov/about> (Downloaded June 18, 2015)

<sup>7</sup> Customs and Border Protection, *Performance and Accountability Report: Fiscal Year 2016*, Report p. 78, pdf p. 82. <https://www.cbp.gov/sites/default/files/assets/documents/2017-Mar/FY-2016-CBP-PAR-508C.pdf> (Downloaded June 17, 2017)

<sup>8</sup> Customs and Border Protection, *Performance and Accountability Report: Fiscal Year 2014*, Report p. 89, pdf p. 93. [http://www.cbp.gov/sites/default/files/documents/CBP\\_DHS\\_2014%20PAR\\_508C.PDF](http://www.cbp.gov/sites/default/files/documents/CBP_DHS_2014%20PAR_508C.PDF) (Downloaded June 17, 2017) CBP transfers the remaining revenue, generally less than 1 percent of revenues collected, directly to other federal agencies, the government of Puerto Rico, and the U.S. Virgin Islands.

<sup>9</sup> CBP PAR 2014, Report p. 89, pdf p. 93.

<sup>10</sup> CBP PAR 2014, Report p. 94, pdf p. 97. Non-entity revenue includes fines and penalties, and is distributed substantially the same as other revenue.

2016 letter. We have attached that letter and urge you to closely investigate this loss of revenue at CBP.

If you have any questions or need additional information, please contact me ([danielle@pogo.org](mailto:danielle@pogo.org)) or my colleague Nicholas Pacifico ([npacifico@pogo.org](mailto:npacifico@pogo.org)) via email, or at (202) 347-1122.

Thank you for your time and consideration of this matter.

Sincerely,



Danielle Brian  
Executive Director

encl. Letter from the Project On Government Oversight to the Department of Homeland Security Inspector General regarding lost revenue, dated May 10, 2016.

cc: Department of Homeland Security Inspector General John Roth  
Customs and Border Protection Acting Commissioner Kevin K. McAleenan  
Senate Committee on Homeland Security & Government Affairs Chairman Ron Johnson and Ranking Member Claire McCaskill  
House Committee on Homeland Security Chairman Michael McCaul and Ranking Member Bennie Thompson  
Senate Committee on Finance Chairman Orin Hatch and Ranking Member Ron Wyden  
Senate Committee on Finance's Subcommittee on International Trade, Customs, and Global Competitiveness Chairman John Cornyn and Ranking Member Robert P. Casey, Jr.  
Senator Charles Grassley

# **ATTACHMENT A**



May 10, 2016

Inspector General John Roth  
Department of Homeland Security  
Office of Inspector General  
245 Murray Drive, SW, Bldg 410  
Washington, DC 20538

Re: CBP Potentially Losing Millions of Dollars Annually Due to Its Unwillingness to Focus on Revenue Collection

Dear Inspector General Roth:

The Project On Government Oversight (POGO) is an independent nonprofit that investigates and exposes corruption and other misconduct in order to achieve a more effective, accountable, open, and ethical federal government. In our efforts to further this mission, we want to bring your attention to the potentially staggering loss of revenue resulting from mismanagement at Customs and Border Protection (CBP), formerly the Customs Service. CBP has potentially lost billions of dollars due to its unwillingness to collect appropriate duties, penalties, and interest from non-compliant importers.

CBP keeps terrorists and their weapons out of the United States while facilitating lawful international travel and trade.<sup>1</sup> It is also one of the largest revenue producers for the United States: in fiscal year 2015 alone, it processed more than \$2.4 trillion in trade and collected more than \$46 billion in revenue.<sup>2</sup> CBP sends all the duty, tax, and fee revenues it collects to various general fund accounts maintained by the Department of the Treasury, Department of Agriculture, and Army Corps of Engineers.<sup>3</sup> The Treasury further distributes the revenues it receives from CBP to federal agencies in accordance with various laws and regulations.<sup>4</sup> CBP handles revenue obtained from fines, penalties, and interest in the same manner.<sup>5</sup> Thus, CBP's failure to collect revenue could result in anything from less funding for government agencies to increasing the federal deficit.

---

<sup>1</sup> Customs and Border Protection, "About CBP." <http://www.cbp.gov/about> (Downloaded June 18, 2015)

<sup>2</sup> Sandler, Travis & Rosenberg, P.A., "CBP Commissioner Highlights 2015 Trade and Enforcement Statistics." <http://www.strtrade.com/news-publications-CBP-trade-enforcement-statistics-2015-022316.html> (Downloaded March 1, 2016)

<sup>3</sup> Customs and Border Protection, *Performance and Accountability Report: Fiscal Year 2014*, Report p. 89, pdf p. 93. [http://www.cbp.gov/sites/default/files/documents/CBP\\_DHS\\_2014%20PAR\\_508C.PDF](http://www.cbp.gov/sites/default/files/documents/CBP_DHS_2014%20PAR_508C.PDF) (Downloaded June 17, 2015) (Hereinafter "CBP PAR 2014") CBP transfers the remaining revenue, generally less than 1 percent of revenues collected, directly to other federal agencies, the government of Puerto Rico, and the U.S. Virgin Islands.

<sup>4</sup> CBP PAR 2014, Report p. 89, pdf p. 93.

<sup>5</sup> CBP PAR 2014, Report p. 94, pdf p. 97. Non-entity revenue includes fines and penalties, and is distributed substantially the same as other revenue.

In 2009, Senator Charles Grassley (R-IA) asked the Department of Homeland Security (DHS) to investigate CBP's failure to collect large amounts of duties, penalties, and interest from importers, prompting DHS's Office of Inspector General (OIG) to conduct four audits of CBP.<sup>6</sup> Most of these audits focused on problems with CBP's bonding process, statutes of limitations, and Importer Self-Assessment Program rather than CBP's failures in revenue collection or in preventing undue influence from the trade community.<sup>7</sup> The one audit that actually focused on CBP's auditing practices investigated only technical violations of audit standards rather than broader management deficiencies, thus also failing to adequately address CBP's organizationally pervasive revenue collection problems.<sup>8</sup> Upon review, Senator Grassley found that the OIG audits, while suggestive of "gross mismanagement" in the CBP programs they did investigate, failed to address CBP's revenue collection issues and management problems.<sup>9</sup>

The Government Accountability Office (GAO) has also found CBP's internal revenue controls lacking. GAO reports in 2007 and 2009 that analyzed CBP's revenue functions found that CBP had not been maintaining its legally required levels of audit staff, and that previously reported trade enforcement issues continued to present long-term challenges with significant revenue implications for the government.<sup>10</sup>

Ultimately, little has been done to remedy these issues. It is not only time for a complete audit of CBP's revenue collection practices, but also for investigations into specific schemes to avoid paying lawful duties and into the creation of systems to prevent duty underpayment.

## **I. CBP's Lost Revenue**

POGO has learned that CBP lost millions of dollars between 2008 and 2013 by failing to correct watch importers' wrongful allocation of component costs in the calculation of duties.

---

<sup>6</sup> Letter from Charles E. Grassley, Ranking Member of the Committee on Finance, to the Honorable Janet A. Napolitano, Secretary of the Department of Homeland Security, about CBP revenue collection issues, November 3, 2009; Department of Homeland Security Office of Inspector General, *Customs and Border Protection's Importer Self-Assessment Program*, August 2010. [https://www.oig.dhs.gov/assets/Mgmt/OIG\\_10-113\\_Aug10.pdf](https://www.oig.dhs.gov/assets/Mgmt/OIG_10-113_Aug10.pdf) (Downloaded May 27, 2015) (Hereinafter "ISA Audit"); Department of Homeland Security Office of Inspector General, *Efficacy of Customs and Border Protection's Bonding Process*, June 2011. [https://www.oig.dhs.gov/assets/Mgmt/OIG\\_11-92\\_Jun11.pdf](https://www.oig.dhs.gov/assets/Mgmt/OIG_11-92_Jun11.pdf) (Downloaded June 5, 2015) (Hereinafter "Bonding Process Audit"); Department of Homeland Security Office of Inspector General, *Customs and Border Protection's Office of Regulatory Audit*, September 2012. [https://www.oig.dhs.gov/assets/Mgmt/2012/OIG\\_12-117\\_Sep12.pdf](https://www.oig.dhs.gov/assets/Mgmt/2012/OIG_12-117_Sep12.pdf) (Downloaded May 27, 2015) (Hereinafter "ORA Audit"); Department of Homeland Security Office of Inspector General, *U.S. Customs and Border Protection's Penalty Process – Statute of Limitations*, September 2012. [https://www.oig.dhs.gov/assets/Mgmt/2012/OIG\\_12-131\\_Sep12.pdf](https://www.oig.dhs.gov/assets/Mgmt/2012/OIG_12-131_Sep12.pdf) (Downloaded June 3, 2015) (Hereinafter "Penalty Process Audit")

<sup>7</sup> ISA Audit; Bonding Process Audit; Penalty Process Audit.

<sup>8</sup> ORA Audit.

<sup>9</sup> Letter from Charles E. Grassley, Ranking Member of the Committee on the Judiciary, to Thomas S. Winkowski, Deputy Commissioner of Customs and Border Protection, about CBP audit shortcomings, July 31, 2013.

<sup>10</sup> Government Accountability Office, *Customs and Border Protection Needs to Improve Workforce Planning and Accountability*, April 2007. <http://www.gao.gov/assets/260/259093.pdf> (Downloaded June 15, 2015); Government Accountability Office, *Observations on U.S. Government Efforts to Address Textile Transshipment*, June 18, 2009. <http://www.gao.gov/new.items/d09813t.pdf> (Downloaded July 27, 2015)

Importers are supposed to accurately break down the cost of the watch by component (case, band, battery, and movement) for duty calculations.<sup>11</sup> Different duty rates apply depending on the type of watch, but generally the duty rate for a watch's movement is a flat cent (\$0.01) value while the duty rates for the other components are percentages of the component's average cost.<sup>12</sup> Thus, if an importer allocates more of a watch's cost to the movement than to the other components, duties owed decrease drastically. The following CBP tables, obtained by POGO, illustrate this concept<sup>13</sup>:

**Example based on fraudulent component breakout costs:**

\$20 (declared value) watch with base metal case, base metal band, battery, and quartz analog movement (JP origin) with 85% of the watch's value allocated to its movement

<u>No. of Watches</u>	<u>Component</u>	<u>Classification</u>	<u>Duty Rate</u>	<u>Average Component Cost</u>	<u>Total Cost</u>	<u>Duty</u>
2,000	Movement	9102.11.2510	40¢ ea	\$17.00	\$34,000	\$ 800.00
	Case	9102.11.2520	8.5%	\$ 1.20	\$ 2,400	\$ 204.00
	Band	9102.11.2530	14%	\$ 1.50	\$ 3,000	\$ 420.00
	Battery	9102.11.2540	5.3%	\$ 0.30	\$ 600	\$ 31.80
<b>TOTAL DUTIES PAID</b>						<b>\$1,455.80</b>

**Example based on authentic component breakout costs:**

\$20 (declared value) watch with base metal case, base metal band, battery, and quartz analog movement (JP origin) with the watches' value correctly allocated between all of the components

<u>No. of Watches</u>	<u>Component</u>	<u>Classification</u>	<u>Duty Rate</u>	<u>Average Component Cost</u>	<u>Total Cost</u>	<u>Duty</u>
2,000	Movement	9102.11.2510	40¢ ea	\$5.43	\$10,860	\$ 800.00
	Case	9102.11.2520	8.5%	\$4.59	\$ 9,180	\$ 780.30
	Band	9102.11.2530	14%	\$9.79	\$19,580	\$2,741.20
	Battery	9102.11.2540	5.3%	\$0.19	\$ 380	\$ 20.14
<b>TOTAL LAWFUL DUTIES</b>						<b>\$4,341.64</b>

As the Average Component Cost, Total Duties Paid, and Total Lawful Duties sections show, the deceitful importer pays only around a third of the lawfully required duties by allocating 85 percent of the watches' cost to the movement rather than by using the actual cost breakdown of the components. POGO sources state that this is a common practice by watch importers, a practice that costs the federal government tens of millions of dollars each year. Sadly,

<sup>11</sup> United States International Trade Commission, "Chapter 91: CLOCKS AND WATCHES AND PARTS THEREOF," *Harmonized Tariff Schedule of the United States (2015)*, p. 1. <http://www.usitc.gov/publications/docs/tata/hts/bychapter/1501c91.pdf> (Downloaded June 17, 2015) (Hereinafter "Harmonized Tariff Schedule")

<sup>12</sup> Harmonized Tariff Schedule, p. 14.

<sup>13</sup> This example is based on an actual watch importer's breakdown of costs.

misreporting the value of goods to decrease duties owed is not isolated to watch importation. It also affects the collection of textile, apparel, computer part, and jewelry duties.<sup>14</sup>

POGO has learned that importers generally misreport duties owed by presenting false invoices with understated values to CBP while using separate, cost-accurate invoices for their customers, a practice known as “double invoicing.” POGO is aware that CBP is attempting to remedy the misreporting of watch component costs, but changes are occurring at an unacceptably slow rate. POGO has attempted to reach CBP on multiple occasions regarding the progress on any rule or procedure changes that would fix these problems, but has yet to receive a response. The amount of money lost because of misreporting is impossible for POGO to quantify without more information, but the fact that just the misreporting of watch components loses the government roughly tens of millions of dollars annually demonstrates that the losses are likely substantial.

In addition to duty evasion by these most likely small- to medium-sized importers, large importers are also able to avoid paying appropriate duties. A former CBP manager who spoke with POGO on the condition of anonymity states that CBP, without justification, discourages the collection of duties, penalties, and interest from various large importers and that the agency does not support employees who attempt to collect this revenue. This CBP manager had found that multiple large importers were being assessed duties, penalties, and interest that were far too low; the manager subsequently tried to collect the appropriate duties owed. After pushing the issue repeatedly against a rather large importer, the manager was reprimanded and removed from the audit. While not directly related to value misreporting, this is just another example of how CBP has possibly mismanaged its priorities related to revenue collection, and another reason its revenue collection practices need to be audited.

Not collecting the proper duties, interest, and penalties from importers encourages importers to be non-compliant and hurts compliant businesses. For example, let’s say an importer underpays \$300,000 in duties. If CBP collects these duties three years late and does not collect interest or penalties, CBP has essentially given the non-compliant importer a three-year, interest-free, \$300,000 government loan. If CBP never collects the duties or assigns any penalties, the non-compliant importer has essentially received an illegal \$300,000 profit boost that cannot be matched by compliant competitors. Failing to punish non-compliant importers puts American jobs at risk and inhibits compliant businesses’ abilities to compete both nationally and internationally.<sup>15</sup>

---

<sup>14</sup> “Through Customs own investigations . . . it has become increasingly clear that a large number of importers are deliberately undervaluing textile and apparel imports from China.” National Council of Textile Organizations, *Enforcing America’s Trade Laws in the Face of Customs Fraud and Duty Evasion*, May 5, 2011. [http://www.ncto.org/newsroom/Testimony20110505--Finance\\_Customs\\_TestimonyFINAL.pdf](http://www.ncto.org/newsroom/Testimony20110505--Finance_Customs_TestimonyFINAL.pdf) (Downloaded July 8, 2015) (Hereinafter “NCTO Customs Fraud Testimony”); “A number of recent [False Claims Act] lawsuits have alleged that importers fraudulently undervalued goods in order to reduce ad valorem duties . . . [.] *United States ex rel. Tu v. Kuo*, 3:12-cv-04166 (N.D. Ca.) . . . computer cables; women’s apparel . . . *United States ex rel. Krigstein v. Siouni and Zarr Corporation*, 1:11-cv-04247 (S.D.N.Y.); jewelry . . . *United States ex rel. Karlin v. Noble Jewelry*, 1:08-cv-07826 (S.D.N.Y.)” Kirsten Mayer and Timothy Cahill, “False Claims Act Enforcement of Customs Duties—Emerging Trends,” *International Trade Reporter*, Vol. 31, Issue 41, October 16, 2014, p. 1. <https://www.ropesgray.com/~media/Files/articles/2014/October/International-Trade-Reporter.ashx> (Downloaded July 8, 2015)

<sup>15</sup> NCTO Customs Fraud Testimony; National Council of Textile Organizations, “Current Issues.” <http://www.ncto.org/policy-positions/current-issues/> (Downloaded January 28, 2016)

DHS OIG is in the best position to investigate these issues, but its audits have not as of yet addressed CBP's revenue collection problems in any meaningful way.

## II. Recommendations

POGO recommends that the DHS Office of Inspector General perform in-depth audits of CBP to examine and illuminate any deficiencies in revenue collection and importer oversight, and make recommendations based on its findings. Questions POGO thinks it would be helpful to consider during DHS OIG's investigation include:

- Would establishing and enforcing a standard for the valuation of component costs for watches, and any other imports found in need of such guidance, improve collection accuracy and reduce duty underpayments?
- How can CBP eliminate any parts of its management culture that result in the repression of revenue collection actions?
- What are the best methods for empowering, training, and encouraging CBP's auditors and field offices to assess and collect appropriate duties, penalties, and interest from *all* importers?
- Would it be beneficial for CBP or its Inspector General to create an official avenue for CBP employees to report issues with importers that would require public documentation of all disagreements with final assessments of duties, fines, penalties, and interest?
- If the revenue collection problems at CBP are irremediable, could trade compliance and revenue collection functions be improved by moving said functions back to the Treasury Department, where revenue collection is a higher priority?

If you have any questions or need additional information, please contact Nicholas Pacifico at [npacifico@pogo.org](mailto:npacifico@pogo.org) or (202) 347-1122.

Sincerely,



Danielle Brian  
Executive Director

cc: Homeland Security Secretary Jeh Johnson  
Customs and Border Protection Commissioner R. Gil Kerlikowske  
Senate Committee on Homeland Security & Government Affairs Chairman Ron Johnson  
and Ranking Member Thomas R. Carper  
House Committee on Homeland Security Chairman Michael McCaul and Ranking  
Member Bennie Thompson  
Senate Committee on Finance Chairman Orin Hatch and Ranking Member Ron Wyden  
Senate Committee on Finance's Subcommittee on International Trade, Customs, and  
Global Competitiveness Chairman John Cornyn and Ranking Member Ron Wyden  
Senator Charles Grassley