



WORLD CUSTOMS ORGANIZATION

ORIGIN IRREGULARITY TYPOLOGY STUDY

July 2013

Abstract

Based on the inputs provided by WCO Member Customs administrations, this study focuses on the irregularity cases related to rules of origin, which are the non-compliant cases regarding rules of origin except the “fraud” cases committed with deliberate intention.

The analysis of the information provided shows that Customs administrations regard the low level of familiarization with the origin criteria, especially the Product Specific Rules and cumulation/accumulation provisions, as the major cause of irregularities related to rules of origin. The information provided by Customs administrations seems to indicate that the insufficiency of knowledge is found not only within the trading community, but also within the issuing authorities of the certificate of origin.

Also recognized is an observation by Member Customs administrations that some of the procedural provisions stipulated in the agreements were not functioning efficiently. The Members pointed out that they encounter many cases where the certificates of origin are incomplete or contain incorrect information. They also face cases where genuine certificates of origin are issued to those goods that do not satisfy the applicable rules of origin. Regarding administrative cooperation for verification, Customs in the importing countries tend to experience some difficulties in securing the necessary cooperation from the responsible authorities in the exporting countries.

* * *

TABLE OF CONTENTS

- 1. Introduction 1
 - 1.1. Definitions 1
 - 1.2. Scope and objective 2
- 2. Features identified from Member’s inputs 3
 - 2.1. Irregularities related to origin criteria 3
 - 2.1.1. Product Specific Rules 3
 - 2.1.2. Cumulation/accumulation 5
 - 2.2. Procedural malfunctions 5
 - 2.2.1. Proofs of origin 6
 - 2.2.2. Administrative cooperation 7
- 3. Conclusion 8
 - 3.1. Summary of the findings 8
 - 3.2. Possible way forward 9

1. Introduction

Rules of origin are becoming increasingly relevant for many players involved in international trade, particularly for Customs administrations. This derives from the rapid rise in the number of free trade agreements (FTA) which have entered into force around the world in recent decades. This is sometimes said to be boosted by the situations in the WTO Doha Round negotiations. The significance also stems from the distinctive and various preferential rules of origin which are built-in to each of these agreements.

The WCO Secretariat, responding to the calls from its Member Customs administrations and in line with the Revenue Package initiative launched in 2009 including the Action Plan Phase II of Revenue Package adopted in 2013 by the WCO Council, developed this Origin Irregularity Typology Study as a reference material for the use of its Members as well as the stakeholders involved.

This study is primarily based on the experiences of WCO Member Customs administrations. In order to develop the study, the WCO Secretariat has requested the Members to provide information relating to irregularities in the area of rules of origin. From April 2012 to February 2013, 36 Members have provided inputs to the Secretariat, which correspond to approximately 20% of WCO Members. The list of responding Members is annexed hereto. The relatively low rate of responses does not necessarily imply that the non-responding Members do not encounter any challenges related to the topic. Rather, it could be considered that they do face some issues but have not identified the extent to which they can share the experience with other Members. In any case, although the total number of responses and/or the impartial representation from certain regions may lead to a particular bias on the result of the analysis, the study is developed with the intention to capture some common characteristics in the current difficulties encountered through day-to-day Customs operations around the world.

This study constitutes a part of the WCO Comparative Study on Preferential Rules of Origin. The analysis contained is value neutral and not intended to challenge any existing origin legislations or related operational procedures of any WCO Member.

1.1. Definitions

The term “irregularity” is defined in the WCO Guidelines for Post Clearance Audit (hereinafter referred to as the PCA Guidelines) as follows:

***Irregularity** means the breach of laws and regulations, regardless of its cause, such as deliberate intention (fraud), negligence, or simple mistake (error).*

As indicated in this definition, the term “irregularity” not only covers the wilful fraudulent cases, but also all other cases which lead to incompliance. More specifically, the PCA Guidelines also describe fraud, negligence and error in the following manner:

***Fraud** means the wilful intent of a taxpayer to evade a tax. More specifically, in terms of fraud against Customs laws and regulations, "commercial fraud" can be described as follows:*

“Any offense against statutory or regulatory provisions which Customs are responsible for enforcing, committed in order to:

(a) Evade, or attempt to evade, payment of duties/levies/taxes on movements of commercial goods; and/or

(b) Evade, or attempt to evade, any prohibition or restrictions applicable to commercial goods; and/or

(c) Receive, or attempt to receive, any repayments, subsidies or other disbursements to which there is no proper entitlement; and/or

(d) Obtain, or attempt to obtain, illicit commercial advantage injurious to the principle and practice of legitimate business competition.”

Negligence means a lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the given circumstances. The term covers:

(a) Omission of something that a reasonable person, guided by the considerations that ordinarily regulate the conduct of human beings, would do, and

(b) Doing something that a prudent, reasonable person would not do.

Error means a mistake in a Customs declaration.

Particularly in the area of rules of origin, not only fraud in a limited sense but also negligence and error is presumably causing significant challenges at the border and consequently having implications on revenue collection. This assumption stems out from the fact that a certificate of origin issued in the exporting country is predominantly required and utilized as a documentary proof for import clearance purposes of Customs¹.

1.2. Scope and objective

With regard to the scope, this study covers all the irregularity cases **other than “fraud”** as in the definition under the PCA Guidelines. The fraud cases are excluded in order to ensure unrestricted access to a wider audience. This is in light of the possible sensitivity that the information on fraud may subsume, in relation to the enforcement activities of Customs².

The objective of this study is to provide reference materials regarding origin irregularities. By doing so, it is aimed at generating further discussion and ideas on how to improve the origin-related operations, in order to diminish the difficulties faced in administering rules of origin at the border.

This study sheds light on the topics that the Members see as difficulties in dealing with origin irregularities. It also aims to raise some possible solutions to address the difficulties identified. Taking into account the variety of stakeholders involved in the whole stream of procedures relating to rules of origin, the target audience are not only Member Customs administrations but also the other authorities and businesses involved.

¹ Atsushi Tanaka, WCO Research Paper No. 20: *World Trends in Preferential Origin Certification and Verification* (November 2011)

² In the WCO, the fraud cases including origin fraud are dealt with by the Working Group on Commercial Fraud (WGCF) which is a restricted membership body. Some tools have been developed such as the COMMERCIAL FRAUD TYPOLOGIES SUMMARY and the CUSTOMS ENFORCEMENT GUIDE AGAINST ORIGIN FRAUD.

2. Features identified from Members' inputs

This section illustrates the key features regarding origin irregularity, based on the inputs provided from WCO Member Customs administrations.

2.1. Irregularities related to origin criteria

12 out of the responding Members (33 %) have mentioned origin criteria, e.g. the Product Specific Rules, cumulation/accumulation provisions, etc. as an area of concern. Irregularities of this kind are reported mostly by using such expressions as incorrect application, misuse, mistakes, irregular implementation and misinterpretation.

The descriptions appear to refer to those declarations or claims of certain originating status which do not satisfy the required origin criteria, but not necessarily indicating a sign of deliberate intention.

Key features identified:

1. The stakeholders involved in the implementation of preferential rules of origin are not sufficiently acquainted with Product Specific Rules.
2. Irregularities seem to occur from the low level of familiarization with the origin criteria not only by traders but also by the issuing authorities of certificates of origin.
3. There seems to be a general lack of knowledge regarding cumulation/accumulation provisions of FTA.

2.1.1. Product Specific Rules

Product Specific Rules (PSR), if stipulated in a set of rules of origin, is one of the most dominant elements of rules of origin. The lack of full acquaintance with the applicable PSR seems to be the leading factor which triggers an origin irregularity. 9 out of the responding Members (26 %) have referred to PSR. Some of them described the actual case discovered during their post clearance audit, while others indicated irregularities in a more general manner.

A developed country has described a case where canned tuna was imported with invalid GSP Form A from a beneficiary country, which did not actually satisfy the wholly obtained requirement. The reason for not meeting the requirements was that the required percentage of crew on a fishing boat was not satisfied. In the series of like transactions, there were also cases relating to the use of raw materials caught by a third country fishing boat, which led to the disqualification of GSP preferential rules of origin.

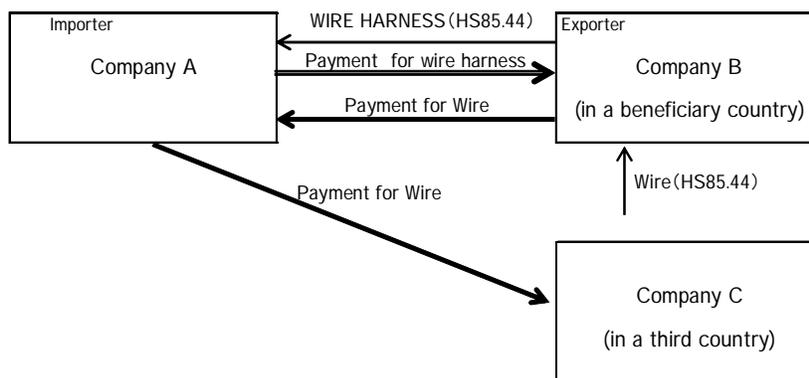
Another developed country has explained some irregularity cases regarding import transaction using GSP. These cases are revealed through Post Clearance Audit (PCA).

Example 1: epoxy resin of HS39.07 imported under GSP

A company imported epoxy resin of HS39.07 from a beneficiary country. The importer used the GSP duty rate, claiming that the goods were wholly produced in this beneficiary country. The manufacturing process and materials used were checked through PCA, and it transpired that raw materials under the same Heading 39.07 originating in the importing country and a third country were used in the production of the final product. Therefore, it was revealed that the wholly produced rule was not satisfied. Moreover, the product did not satisfy the Change of Tariff Heading (CTH) which is the origin criteria in this case.

Example 2: wire harness of HS85.44 imported under GSP

Company A imported wire harnesses of HS85.44 from Company B in a beneficiary country using GSP preferential duty rate. The imported goods were claimed to be wholly produced. However through PCA, it was revealed that a non-originating material of the same Heading 85.44, wire originating in a third country, was used in the production of the imported goods. Under the GSP scheme of the importing country, the applicable origin rule is CTH, with a De Minimis threshold of 5% in value for Chapter 85. As a result of the PCA, it was established that the imported goods satisfied neither of these requirements.



Other Members made more general points with regard to the PSR. The following are some extracts of the comments:

- Misinterpretation of the rules by the issuing authorities. Issuance of certificates on products that do not qualify.
- Misapplication of the product specific rule. Many cases exist where goods are claimed to be qualifying for preferential tariff treatment on the grounds of satisfying the origin criteria on certificates of origin yet this has been found not to be the case.
- The rules of origin, especially concerning textile products, are difficult to understand and fulfil.
- Issuance of certificates for goods that do not satisfy the origin criteria. Misinterpretation of rules of origin by Member States.

As expressed in the above comments, the Members regard the misunderstanding and/or misapplication as a major issue. Some of the comments point out that the certificate of origin is not always issued properly by the issuing authorities in the exporting country, indicating that in some cases a genuine certificate of origin is issued for goods that do not satisfy the applicable rules of origin.

2.1.2. Cumulation/accumulation

Cumulation/accumulation provisions are found in many preferential rules of origin. The concept of cumulation/accumulation allows countries that are part of a preferential trade agreement to share production and jointly comply with the relevant rules of origin provisions³. Thus in general, the ultimate goal of the cumulation/accumulation provisions is to alleviate the requirements to fulfil the origin criteria.

However, despite the positive aim to relax the requirements, some Member Customs administrations argue that cumulation/accumulation provisions seem to be one of the causes of origin irregularity.

4 out of the responding Members (11%) have referred to cumulation/accumulation in one way or another, through describing their difficulties with origin irregularity. Some excerpts from the comments are as follows:

- There are cases of irregular application of cumulation provisions, not considered as misuse but instead have been caused by a lack of knowledge of participants involved in Customs procedures.
- Although cumulation of origin does not exist between exporting and importing countries, the authorities of the exporting country may issue and endorse proofs of origin based on the cumulation provisions.

2.2. Procedural malfunctions

For the purpose of the following explanation, procedural provisions in rules of origin refer to: a) the requirements for the importer to prove the originating status of the goods to Customs administrations of the importing country, and b) the fulfilment of consignment criteria where appropriate, for the purpose of making a claim for preferential treatment. The verification procedures are also covered, which are undertaken when any doubts arise on the documentary evidence or on the originating status.

21 out of the responding Members (60%) have mentioned the origin procedures and reported that the relevant procedures are not necessarily functioning as expected. Many of the irregularities of this kind were relating to the proof of origin and the administrative cooperation for verification.

³ Comparative Study on Preferential Rules of Origin, WCO, <http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin.aspx>

Key features identified:

4. Member Customs administrations often encounter simple and obvious, but unacceptable failures in the certificates of origin.
5. Customs in the importing country find that the administrative cooperation for verification is not functioning appropriately, with the verification requests not answered in a timely manner in many instances.

2.2.1. Proofs of Origin

16 out of the responding Members (44%) have referred to certain kinds of irregularity in connection with the requirements for the proof of origin.

Many of the responses referred to the quality of the information on the documentary proof. Broadly they can be grouped by their characteristics. Some comments are extracted as follows:

Incompleteness of information

- Inaccurate completion of boxes on the certificate of origin. Insufficient description of the goods on the certificate of origin and/or invoice.
- No goods description or the goods description differs from the imported goods. The certificate issuer has not written the date or not signed the certificate.
- The proof of origin is imperfect, e.g. obligatory information is missing.
- Invoice numbers not stated on certificate of origin.
- Sometimes the percentage content is not indicated on certificates of origin so it is difficult to ascertain origin of the imported goods.

Inconsistency with the commercial document

- Certificate of origin shows an invoice different to that submitted by the importer. Inconsistency between the description of the goods contained in the certificate of origin and the description shown in the commercial invoice.
- Inconsistency with the invoice numbers and the certificate of origin.
- Discrepancies between the entries on the certificates and those on other supporting commercial documents.
- Goods indicated on invoices are sometimes not quoted on certificates of origin submitted to Customs. Certificate of origin may contain invoice numbers, dates and values that differ from the attached invoice.

Inappropriate stamps and signatures

- Seals used do not conform to declared seals.
- Incorrect stamps used on certificate of origin.

Format error

- The format of certificate of origin does not match official format.
- Proof of origin is formally incorrect, e.g. copy or wrong form.
- Proofs of origin may be issued in an incorrect format due to diversity. For example, Certificate of Origin Form A is issued instead of EUR1 Movement Certificate.

Procedural non-compliance

- Regarding Form A certificates in general, application seems to take place often subsequently, even systematically in some of the beneficiary countries, i.e. “issued retrospectively”, which should be only an exceptional measure.
- Copy of the proof of origin submitted instead of original.

From the comments cited above, the Member Customs administrations seem to experience many problems with the quality of the certificates of origin. Although many of the failures reported are simple and obvious in nature, the inappropriate certificates of origin are in fact regarded as irregularities by Customs in the importing country.

2.2.2. Administrative cooperation

Customs in the importing countries tend to experience some difficulties in securing the necessary cooperation from the responsible authorities in the exporting countries. 10 out of the responding Members (28%) have touched upon the malfunction of administrative cooperation for verification.

A developed country has reported that out of the 426 Form As verified in 2010, 330 were confirmed as authentic and properly issued. Of the 96 remaining, 93 failed to be verified because no reply was received from the Customs authorities in the exporting countries. Likewise in 2011, out of the 404 Form As verified, there have been 71 failures, with 70 of those due to no reply being received from the Customs authorities in the exporting countries. Looking at the figures, this country pointed out that the overwhelming proportion of verification failures arises from Customs authorities in beneficiary countries failing to reply, not necessarily from proven misinterpretation, misapplication of rules, or fraudulent intention on the part of the exporters.

Similar observations were made by other Members as well. The following are some excerpts of the comments:

- Reluctance of some countries' authorities to cooperate in verifying preferential certificates of origin.
- Secretariats and member states of various trade agreements do not respond timeously on queries.
- Omission to answer origin survey by companies; procedures take time, lack of response from other countries.
- Very often the results of verification do not meet the deadline.
- Rapid replies for verification of GSP certificate of origin which might suggest that the investigation was not thorough; no response at all to verification request.

These comments seem to imply that Customs administrations find certain structural problems in the conventional procedures for origin verification conducted through administrative cooperation.

Although more than half of the responding Members have touched upon these procedural malfunctions, there was a country that shared a completely different perspective.

This country has expressed that they have not experienced any systemic problems regarding origin statements or documents. They do not require origin statements or certificates to bear official seals or stamps or authorized signatures that could be compared to specimen signatures on file. Therefore, they do not have a central bureau responsible for the management of specimen signatures, official seals/stamps or information on approved exporters. Under some trade agreements that they are party to, there may be an emphasis on the verification of the documentary aspect, i.e. the verification of the authenticity of origin statements or documents, but for the most part, they focus their verification and enforcement activities on the post-release verification of the origin of the imported goods. Non-compliance by exporter or importer is addressed through a vigorous penalty regime and education/outreach activities. Where evidence of incorrect origin statements or documents is discovered, this is factored into their risk management framework for future or on-going compliance verification activities to better identify, detect and enforce these errors before they become systemic in nature.

3. Conclusion

3.1. Summary of the findings

As the title of this study implies, the initial expected outcome of the study is to collect detailed cases of origin irregularities and, through the categorization of the characteristics from the case studies, to identify the supporting mechanisms. However, the focus of the responses from Member Customs administrations turned out to be different than expected.

The responses of Member Customs administrations shows that the source of origin irregularities stems out from two main factors: one is the low level of acquaintance with rules of origin by the stakeholders, the other is the malfunction of the procedural provisions under some rules of

origin. There were only a few inputs from Member Customs administrations that focused on the individual phenomenon or the actual details on how an origin irregularity could be constituted.

One third of the responding Customs administrations indicated that the lack of proficiency by the stakeholders involved in the origin-related operations seems to cause origin irregularities. The stakeholders not only include private businesses but also the authorities issuing the certificate of origin in the exporting countries. In particular, some PSRs and cumulation/ accumulation provisions tend to be regarded as difficult to comprehend. Nearly half of the responding Customs administrations pointed out that they encounter some certificates of origin with omissions or inadequacies.

Regarding the procedural aspects, the responses appear to draw attention to the possible existence of certain systemic issues. Nearly half of the responding Customs administrations raised their disappointment with the low quality of the certificate of origin, even though they are issued by a government authority whose work is supposedly of assured quality. Also, almost a third of the responding Members raised problems relating to the malfunction of the administrative cooperation for verification. The malfunction of administrative cooperation does not constitute an origin irregularity by the fact itself; however, Member Customs administrations see it as a major problem that they do not have an efficient means to address the risk of origin irregularities.

3.2. Possible way forward

What actions could possibly be taken to tackle the current challenges and move forward to address the issue of origin irregularities?

One effective suggestion to address the issue is to have increased training and awareness-raising for the main players involved. This could include Customs officers, the issuing authorities, exporters, importers, etc. By increased level of understanding, Customs officers may improve their ability to effectively detect the irregularities at import clearance or through PCA; issuing authorities may have a lower error rate in the certificates they produce and thereby increase the reliability of certificates of origin; the exporters can correctly fulfil the origin criteria and correctly make out origin certification and declarations; importers can make sure that the rules of origin are satisfied before concluding a contract for import, etc.

In terms of the procedural aspect, it might be worth considering introducing and/or intensifying the use of self certification systems. This could imply a shift of emphasis from the authenticity of the documentary proof of origin to the post-clearance verification focusing on the originating status of the goods.

With regard to the administrative cooperation for verification, an alternative could be to introduce and/or make the full use of direct methods for verification. Customs in the importing country might find it practical if they contact the exporter or visit the premises of the producer by themselves, so as to reach and obtain the information they are looking for. On the other hand, this approach could entail some issues regarding the exercise of public powers in a foreign country. Careful consideration is necessary and a balance must be sought in relation to domestic laws when such methods are to be introduced. Provisions in this regard must be available in the applicable FTA.

The ultimate option could be an importer-based system, where the declaration of origin is made by the importer and the verification is conducted only with the importer, coupled with a strong penalty scheme. The idea behind this system would be to align the responsibility with the benefit. The importer would solely bear the responsibility to prove the originating status of the goods in relation with Customs in the importing country, in return for the benefit of the preferential duty rate applied. In the importer-based system, Customs would only have to deal with the importer, which could make the process much more predictable and stable.

* * *

LIST OF MEMBERS THAT RESPONDED

*Numbers in parenthesis adjacent to the names of the regions represent the responses in each region

NORTH OF AFRICA, NEAR AND MIDDLE EAST (3)

- Egypt
- Kuwait
- Morocco

WEST AND CENTRAL AFRICA (1)

- Senegal

EAST AND SOUTHERN AFRICA (5)

- Kenya
- Rwanda
- Zimbabwe
- Malawi
- Uganda

SOUTH AMERICA, NORTH AMERICA, CENTRAL AMERICA AND THE CARIBBEAN (8)

- Barbados
- Canada
- Mexico
- Bermuda
- Chile
- Peru
- Bolivia
- Guyana

EUROPE (16)

- Bosnia and Herzegovina
- Italy
- Spain
- Denmark
- Kazakhstan
- Sweden
- Finland
- Lithuania
- Switzerland
- Germany
- Montenegro
- Turkey
- Ireland
- Netherlands
- Ukraine
- Norway

FAR EAST, SOUTH AND SOUTHEAST ASIA, AUSTRALASIA AND THE PACIFIC ISLANDS (3)

- Hong Kong, China
- Japan
- Maldives

RESPONSES BY REGION

