

Customs and Global Trade Update

February 2015



Audit report focuses on TCO Compliance

The Auditor General has released a report into the administration of the tariff concession system that exposes Customs' future approach to compliance, weaknesses in how Customs administers the system and areas where Australian industry needs to be more engaged. The Auditor General's findings are relevant for importers that use tariff concession orders (TCOs) and Australian industry that competes against imports.

We recommend all importers read the Auditor General's summary of the [audit report](#).

THE REVIEW

The review was into the administration of the TCO system by the Australian Customs and Border Protection Service (Customs). A TCO is a tariff concession obtained on application by an importer. It is generally available where an importer can show that there was no Australian manufacturer of substitutable goods in the ordinary course of business. Once made, imports of goods covered by the TCO are duty free and the concession can be used by any importer. Australian manufacturers can object to the making of TCOs or seek their revocation once made.

THE TCO SYSTEM

The Auditor General reported that despite the availability of other concessions such as free trade agreements, TCO's are still being heavily used. In 2013-14 Customs received 941 TCO applications and made 770 TCOs. The total TCOs in existence exceeds 15,000.

Consistent with anecdotal evidence, it is getting harder to have TCOs granted. In 2009-10 there were nearly 1,200 TCO applications with almost all made by Customs. By 2013-14 not only had the number of TCO applications dropped, the success rate of applications had fallen by nearly 20%.



LOCAL MANUFACTURERS

It is clear from the report that Customs is focused on ensuring that local manufacturers are aware of the TCO system and are objecting as necessary. This is evidenced by Customs writing to industry groups, directly notifying industries of TCO applications, facilitating objections and meeting with specific manufacturers.

As Customs' role is merely to administer the system, it is surprising that they are acting to ensure local manufacturers' interests are protected ahead of importers and Australian consumers.

Given that objections are solicited by Customs, it is not surprising that where they do object, local manufacturers are almost always successful. In 2013-14 there were 45 objections to TCO applications by local manufactures, of which 43 were upheld.

However, despite this success rate, there are still relatively few objections. In 2013-14 Customs contacted 186 potential manufacturers in respect of TCO applications. Local manufacturers only responded to Customs on 40% of occasions and only objected on 10 occasions.

A key recommendation of the audit was to raise awareness of the TCO system with local manufactures, presumably so they can object. There was no mention of increasing awareness of the system with importers to ensure that duty is not paid where there is no local industry. This was consistent with a general theme of the report that local manufacturers need protection from the use of the system, as opposed to the system being a mechanism to ensure importers and the general community do not pay duty where there is no local industry to protect.

THE AUSTRALIAN CUSTOMS AND BORDER PROTECTION SERVICE

Customs was found to be running an effective system for administering TCO applications and the decision making process. However, some interesting findings were:

- » There was no internal quality review of the TCO decision
- » Customs' compliance officers do not receive specific training on TCOs
- » Customs is trying to have local industry object to more TCOs. In 2013-14 it invited 186 local manufacturers to lodge objections
- » Where Customs becomes aware of local manufacturers it will actively assist in identifying TCOs that infringe on the local manufacturer
- » Where TCOs were not made, reasons for decisions were only recorded 59% of the time.

COMPLIANCE

The audit found that Customs did not have adequate systems in place to review the number, scope and outcome of compliance activities. As such, Customs is starting from a low base when it comes to compliance and there is room for it to become more sophisticated.

The Auditor General reported that the National Refunds Centre (NRC) believes that there is a high level of non-compliance in respect of TCO use. Consistent with this, in 2013-14 the NRC identified 225 instances of concession misuse (not just TCOs) which was an increase of 23% on previous years.

Some areas where non-compliance was accepted were surprising. For instance, on 11 occasions a TCO applicant did not give local manufacturers any time to respond to enquiries before lodging an application. Only on one of these occasions was the application rejected on the basis on insufficient enquiries with local manufacturers.

Another example is where misleading information is provided in TCO applications. There were no instances of compliance action in respect of such misleading information. The Auditor General suggested that sanctions should be considered where there is a pattern of non-compliance.

Most interesting was that Customs informed the Auditor General that it is moving away from its current approach (desk based review) to an investigation model whereby officers will be conducting investigations with a view to issuing infringement notices or gathering evidence to support prosecutions. This approach will move from one of control to one of enforcement.

LESSONS

While the audit focused on Customs, its findings provide valuable guidance to importers and local manufacturers. Relevantly:

- » If an objection is made to a TCO application, it is time to get help. The objection probably follows a request by Customs that the local manufacturer objects. In these circumstances, Customs needs to be held to the strict requirements of the Customs Act to ensure that they are impartial and fully review the claims of local manufacture
- » As Customs has no internal QA system, if you consider a decision is wrong, you need to seek a review. Do not assume that Customs has made the correct decision or that more than one person in Customs has reviewed the decision. In 40% of cases where a TCO was rejected, reasons for a decision were not even documented
- » Where competition from imports is strong, local manufacturers should strongly consider objecting to TCOs. It is clear that Customs will encourage such objections and the success rate in the period reviewed was 95%

- » Importers need to take TCO compliance seriously. The Auditor general's strongest criticism of Customs was reserved for its approach to compliance. Customs can be expected to become more systematic in its approach to compliance. Further, Customs has stated that future compliance activities will be focused on issuing infringement notices and building prosecution cases.

WHAT NEXT

The Auditor General made the following recommendations, to which Customs agreed:

1. Customs, with the Department of Industry, develop a communication strategy to increase system awareness, primarily with local manufacturers
2. Customs strengthen its guidance to assessment officers and reinforce the importance of documenting key decisions
3. Customs strengthen its approach to managing compliance data and develop an appropriate set of performance indicators to determine the effectiveness of its compliance program.

The first the recommendation involves Customs reviewing the information available to stakeholders (including importers and local industry) regarding TCOs. We would like to see:

- » Clear guidance on when Customs will refer to the stated use of goods in the TCO application when interpreting the wording of the TCO
- » Clear guidance on when additional features, functions, parts or accessories will take an imported good outside of the terms of a TCO
- » What level of supply is sufficient to show a local manufacturer is prepared to accept an order for substitutable goods
- » A database of rejected TCOs and the goods which were considered to be substitutable
- » A publically available database of:
 - Revoked TCOs
 - Rejected TCO applications, and
 - Industries or goods where Customs considers that there is an Australian manufacturer.

The above information will help provide more predictability in respect to Customs' decision making and decrease the number of unsuccessful TCO applications. Further, such information would help local manufacturers determine when there is merit in objecting to TCOs or seeking revocation of existing TCOs.

Ultimately, the report demonstrated that Customs is concerned about compliance with the TCO system, that it will be shifting to a harder compliance approach and that it is proactively contacting local industry to object to TCOs. All of these are good reasons to increase your efforts around TCO compliance. While the temptation is to focus on the duty paid, Customs will be most interested in the duty saved by use of TCO. Brokers and importers need to look at the same issues and ensuring that their TCO use can stand up to Customs review.

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