Court of International Trade Clarifies Vessel Repair Customs Issues

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For many years, the cost of foreign dry-docking of U.S. flag vessels was not considered dutiable under the vessel repair statutes administered by U.S. Customs which impose an ad valorem duty of 50% on the cost of foreign repairs. In 1994, the U.S. Court of Appeals for the Federal Circuit issued an opinion in a lawsuit involving a Texaco ship that underwent shipyard overhaul in Athens, Greece. The Court concluded that it is proper to

Interpret [the term] "expenses of repairs" as covering all expenses (not specifically excepted in the statute) which, but for dutiable repair work, would not have been incurred.

This "but for" test, which holds that "expenses of repairs" does not cover expenses that would have been incurred even without the occurrence of dutiable repair work, became the new test for whether a specific item was or was not dutiable. Some time after the "Texaco" case was decided, Customs expanded it even further and declared that items such as dry-docking, use of tugs, pilotage, etc. were for a "mixed purpose" and should be partially dutiable. They thus applied the ratio of dutiable to non-dutiable expenses during a shipyard period and said that this same ratio should determine what portion of the dry-docking and similar expenses should be dutiable.

This substantial expansion of the dutiable items was challenged in a court case filed in the U.S. Court of International Trade which is the Federal District Court with jurisdiction over Customs appeals. The Court issued a decision in the case of American Ship Management, LLC v. United States on August 17, 2001 and held that the "particular apportionment used by Customs was arbitrary, capricious and in violation of the classification designated by *Texaco*." The result should be substantial savings on duty by U.S. flag ships on their foreign shipyard overhauls.

The Court further held that "Therefore, only the maintenance expense of dry-docking for the period of time in excess of that necessary for a mandatory inspection and/or modifications are dutiable under the *Texaco* test." The case involved the shipyard overhauls of two ships, one an APL ship undergoing an overhaul in South Korea and the other, a SeaLand ship undergoing an overhaul in Hong Kong. Both ships had mandatory ABS inspections which made it necessary to dry-dock the vessels and conduct an extensive survey. Despite this requirement for the dry-docking, Customs assessed duty on an apportioned or pro rata basis on the cost of the dry-docking and all related general costs, such as tugs and pilotage. The Court held that Customs used an incorrect method of assessing duty. This new test, while opening the opportunity for significant savings in duty costs, does change the method of how the costs are calculated and the manner of providing supporting information.

In preparing the application for relief, there will have to be proof of how long the survey or inspection took during the dry-docking period. Thus if there was a dry-docking of 8 days and the survey took 6 days, the additional two days would be dutiable if no other non-dutiable work was done during those two days. As a practical matter, in most cases, the regulatory survey is usually conducted during the entire time the ship is in the dry-dock, so no additional duty should be assessed. The invoice from the shipyard should have a breakdown, by day, of the cost of the dry-docking. Although it is not presently clear, we would recommend that the invoice include the cost of docking and undocking, as well as the cost of all lay days during which the ship was in the dry-dock. Similarly, there should be a certification or listing of the number of days required for the survey or inspection. If the ship also had to be in the dry-dock for a modification, there should be a certification showing how and why the modification made it necessary for the ship to be in the dry-dock and how long the modification took to complete.

This is not the only recent change in the manner of assessing duty by Customs. On March 26, 2001, the U.S. Customs Service published a Final Rule regarding foreign repairs to American vessels in the *Federal Register*. These new regulations were a complete revision of existing Customs regulations dealing with vessel repairs. This unprecedented new interpretation is so prejudicial and pervasive that it can only be described as one that now makes virtually all supplies and parts used in routine repairs and preventative maintenance performed by the crew members while the vessel is sailing on the high seas subject to the 50% ad valorem duty. Thus if the crew members use a washer in making a repair while the ship is underway, they have to report the washer to Customs and include proof that the washer is made in the U.S. This applies even if the washer is bought in the U.S. or has been on the ship since the ship was built. The new rule also makes such repairs subject to burdensome recordkeeping and reporting requirements.

The new regulations also make major changes in the processing of Customs entries involving vessel repairs, including eliminating the right to an administrative appeal of Customs' decisions (the "Petition for Review") and eliminating the "liquidation" process that establishes finality for Customs determinations. The changes are so extensive and so prejudicial to U.S. shipping companies, that they have prompted complaints by a number of senior Senators with oversight responsibility for Customs and U.S. vessels.