

HOW
U.S. COMPANIES
CAN
PROFIT
FROM
Drawback

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U.S. EXPORTERS WHO USE IMPORTED ARTICLES TO PRODUCE OR MANUFACTURE THEIR PRODUCTS FOR EXPORT CAN INCREASE THEIR COMPETITIVENESS AND REDUCE CUSTOMS DUTIES BY TAKING ADVANTAGE OF DRAWBACKS.

If your company is using imported merchandise in the production or manufacture of its products for export from the United States and isn't obtaining *drawback*, then it is incurring a cost that can be avoided. From a competitive standpoint, a reduction of your customs duties expense would enable your company to price its products lower in its foreign markets.

The term *drawback* means a refund, wholly or partially, of the ordinary customs duty or tax because of a particular use made of the imported good on which the duty or tax was collected. More specifically, it is a refund of duties paid on certain imported goods that are manufactured and re-exported, never used in the U.S. and re-exported, or never used in the U.S. and properly destroyed.

Generally, the party entitled to receive drawback is the exporter unless the manufacturer or producer has reserved the right to such drawback with the knowledge and consent of the exporter.

There are several types of drawback authorized by the drawback law. Three major types include direct identification manufacturing, substitution manufacturing, and rejected merchandise.

Direct Identification Drawback. According to Section 1313(a) of Title 19, United States Code (19 USC), if articles are manufactured in the U.S. with the use of imported merchandise and are subsequently exported or destroyed, drawback not exceeding 99% of the duties paid on the imported merchandise is recoverable. This provision doesn't permit substitution of the imported merchandise.

In this instance, manufacture or production is defined

as a process by which merchandise is made into a new and different article having a distinctive name, character, or use. It also includes a process in which the merchandise is made fit for a particular use although the merchandise is not made into a new and different article.

Substitution Manufacturing. If both imported merchandise and domestic merchandise of the same kind and quality are used to manufacture articles, some of which is exported or destroyed before use, drawback not to exceed 99% of the duty paid on the imported merchandise is recoverable on the exported or destroyed merchandise. In this regard, it doesn't matter whether the actual imported merchandise or the domestic merchandise of the same kind and quality was used in the exported or destroyed articles.

The term "same kind and quality," per 19 CFR 191.2(x), means that the imported merchandise or drawback products and the other substituted merchandise must be capable of being used interchangeably in the manufacture or production of the exported articles with no substantial change in the manufacturing or production process. This definition is a modification of a former circular definition that provided little guidance.

Rejected Merchandise. Certain rejected merchandise also generates drawback. Exporters can recover up to 99% of the duties paid on merchandise that is exported or destroyed because it doesn't meet specifications or doesn't match with samples. The same rule applies if the merchandise was shipped without the consent of the consignee or was determined to be defective at the time of importation.

Other types of drawback are authorized by Section 1313. They include a drawback of certain internal revenue taxes paid on domestic alcohol, duties paid on imported salt used to cure fish and meat, duties paid on materials used to construct and equip vessels and aircraft, and duties paid on imported merchandise used in the U.S. to repair jet aircraft engines manufactured abroad originally when the engines are exported. If imported merchandise is unused and exported or destroyed properly, the duties paid may be recovered; the same is true of unused substitution merchandise. Duties paid on certain packaging material also may be recovered at the rate of 99%.

BASIS OF DRAWBACK CLAIM

The basis of any claim for drawback depends on the amount of the imported merchandise that is actually in, that is, *appears in*, the exported article after the manufacturing process. Alternately, drawback is paid based on the

DRAWBACK BEGAN IN 1789

Described by Adam Smith in *The Wealth of Nations*, drawback in the U.S. dates back to the second Act of Congress, July 4, 1789. Generally, the first Act provided for a drawback of 99% of the duties paid on merchandise if exported within a year after the duty was paid. The purpose of the law was not just to build up export trade, but to enable manufacturers to compete in foreign markets with the same goods manufactured in those other countries.*

Later changes to the original law included a drawback for rejected merchandise, if the goods did not meet sample or specifications, and an allowance for the substitution of domestic merchandise for the imported merchandise. In 1984, substitution rules were added for same-condition drawback and exchange, or tradeoff, of domestic for imported merchandise. Further, the North American Free Trade Agreement (NAFTA) contained provisions pertaining to Customs modernization that substantially amended the drawback law, making major changes to each of the most commonly used kinds of drawback and drawback procedures. The changes were intended to expand U.S. exports and ease drawback use and its administrative burdens. Regulations implementing the new law went into effect in April 1998.

* *Tidewater Oil Co. v. United States*, 171 U.S. 210 (USSC, 1898).

Table 1: RECORD KEEPING FOR MAJOR DRAWBACK TYPES

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Manufacturing Drawback—direct identification (Section 1313(a))

1. Evidence of importation and receipt of imported merchandise,
2. Evidence of use of imported merchandise in manufacturing or production, and
3. Dates of manufacture or production and
 - ◆ Quantities used or appearing in articles manufactured or produced,
 - ◆ Quantities and description of articles manufactured or produced,
 - ◆ Quantities and value of waste incurred, and
 - ◆ Quantities of finished articles released from Finished Goods for exportation or destruction and claimed for drawback.

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Manufacturing Drawback—substitution (Section 1313(b))

1. Evidence of importation and receipt of imported merchandise.
2. Records that establish identification and specifications of merchandise designated as basis for the claim.
3. Evidence of manufacture or production of articles made with the designated imported merchandise and of articles made with substituted domestic, duty-paid, or duty-free merchandise.
4. Evidence that substituted merchandise was used to produce exported or destroyed articles of the same kind and quality as the designated merchandise.
5. Evidence that completed articles were exported or destroyed under Customs supervision within five years after the date of importation of the designated merchandise.

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Rejected Merchandise Drawback (Section 1313(c))

1. Evidence of importation and receipt of imported merchandise.
2. Evidence that imported merchandise did not meet specifications, was shipped without consent, or was defective at the time of importation.
3. Evidence that imported merchandise was exported or destroyed under Customs supervision.

full amount of the imported merchandise *used* in the manufacturing of the exported article. And drawback is paid on the quantity of merchandise *used* to manufacture the exported article *reduced by* an amount equal to the quantity of imported merchandise that could be bought with the money received for the waste.

The drawback regulations permit destruction under

Customs supervision instead of exporting the manufactured articles, but they strictly prohibit the use in the U.S. of the manufactured articles after their manufacture and before their exportation or destruction. Destruction in this instance means the complete destruction so that the merchandise has no commercial value. Exporters must give prior notice to destroy merchandise under Customs supervision at least seven working days before the date of destruction. When Customs waives the right to witness the destruction, the exporter must submit documents signed by a disinterested third party that destruction occurred and no articles of commercial value remained after the destruction.

PROCEDURES AND RECORDS

Exporters must know before making contracts that they will be entitled to drawback because a drawback ruling authorizing a manufacturer to operate under a drawback provision is a prerequisite to a drawback payment. Exporters may apply for a specific drawback ruling or elect to use a general ruling.

There are several general manufacturing drawback rulings available,

for example, for steel, sugar, and unfinished textile goods. There is also a general drawback ruling that covers all commodities under Section 1313(a). Several general manufacturing drawback rulings have been published in the *Customs Bulletin* with instructions as to the procedures for complying with them. Similar information also appears in Appendix A to Part 191 of the Customs Regu-

lations. If the exporters believe they can comply with the conditions of a general ruling, they must notify the Customs drawback office in writing of their intent to utilize the ruling. The Drawback Center then authorizes the exporters to operate under the general ruling. Procedural instructions for the submission of written intent are detailed in Appendix A of Part 191 of the Customs Regulations.

To obtain specific drawback rulings, the exporters must send drawback applications, using the appropriate sample format, to Customs headquarters for approval. There are samples of specific manufacturing drawback formats in Appendix B to Part 191 of the Customs Regulations. The completed applications should be sent to the U.S. Customs Service's Duty and Refund Determination Branch in Washington, D.C. Once the applications are approved, the exporters receive a copy of their approval letters that, with the applications, comprise their manufacturing drawback rulings.

No proposal is required for same-condition drawback, but the exporters should contact their local Customs offices before exportation. Any changes to any of the manufacturing drawback rulings require the filing of new applications using the procedures described above.

Importers, intermediate transferors, manufacturers or producers, exporters or destroyers, and claimants are all required to keep appropriate documentation. Custom rules allow identification by accounting method so that merchandise or articles don't have to be physically separated or tracked unit by unit.

Table 2: EXAMPLES OF RECORDS FOR DRAWBACK

1. Importation and receipt of imported merchandise

- ◆ Customs import documents or certificate of delivery supply receipt of imported merchandise.
- ◆ Purchase order or contract of purchase, invoice, packing list, vendor confirmation.
- ◆ Accounts payable, disbursements, letters of credit, payment documents.
- ◆ Receivers, inventory records, transaction log, store control.
- ◆ Import bill of lading, delivery records from point of import to plant.

2. Manufacturing or production

- ◆ Inventories, raw materials, work-in-process, finished goods, including references traceable to the source of the materials and to the materials destroyed, must show what materials were "used in" or "appear in" finished goods.
- ◆ Dated and current bills of material, formulas, scrap or waste records.
- ◆ Job or work orders, inventory picks, travelers, serial or lot number control records.
- ◆ Inventory methodologies—FIFO, LIFO, inventory turnover rates.
- ◆ Stores requisitions, work-in-process records showing production actually occurring.

3. Nonconformance, shipped without consent, or defective

- ◆ Signed agreement between importer and foreign supplier that imported merchandise was defective at the time of import.
- ◆ Purchase order, contracts, sales confirmation, and specifications.
- ◆ Statement attesting to the fact that the merchandise was shipped without consent.

4. Exportation

- ◆ Originally signed bill of lading, air or freight waybill, cargo manifest, notice of foreign trade zone transfer, foreign customs documentation, landing certification, delivery record from plant to export, loading ticket or report, shipping release.
- ◆ Sales invoice, packing list, customer purchase order, sales contract.
- ◆ Receivables, cash receipts.
- ◆ Warehouse withdrawals, inventory pick lists, finished goods transaction log.

5. Destruction

- ◆ Specific identification of merchandise or article destroyed.
- ◆ Documents of transfer, receipt, transportation to include time and fact of destruction.

Four accounting methods authorized for general drawback purposes are:

1. FIFO (first-in, first-out),
2. LIFO (last-in, first-out),
3. Average, and
4. Low-to-high.

The low-to-high method allows three alternatives as described in Section 191.14(c) (3). Generally, all receipts, whether imported or not, and all withdrawals from the inventory, whether for export or not, must be accounted for in the accounting records. The accounting method selected must be used without variation for at least one year.

Records supporting any of the methods are subject to Customs' review. The exporter must be able to establish how, under generally accepted accounting principles and the provision of the regulation, the records account for all merchandise or articles in, all receipts into, and all withdrawals from the inventory (see Table 1).

The records required to support drawback claims must be retained for at least three years after the payment of the claim. Some exporters may not routinely maintain records, including receiving documents and production and use records, for the requisite three years, so exporters need to review their record retention policies to ensure compliance (see Table 2).

TIME FRAME AND PAYMENT

Drawback claims generally must be filed within three years after the exportation or destruction of the articles. A manufacturing claim can be filed before a manufacturing drawback ruling is effective, but no payment will be made until the manufacturing drawback ruling is approved. The drawback claimants must establish that the manufactured articles subject to drawback were exported within five years after importation of the imported merchandise. For unused and rejected merchandise drawback, the time period for exportation is three years after importation. Certain steps are necessary to prove exportation, and supporting documentary evidence must identify the date and fact of exportation and the exporter, as detailed in Part 191 of the Customs Regulations. Exporters have to exercise reasonable care to provide the appropriate records and information to enable Customs to perform its duties properly.

The destruction of articles must meet the same statutory time period to file a complete drawback claim as for exported articles. Companies are required to give notification of destruction at least seven working days before

the intended date of destruction.

Once a claim is determined to be satisfactory in all respects, the drawback amount is verified, and the drawback is paid to the exporter or destroyer. If the right to claim drawback has been transferred to a third party through appropriate procedures, that party will receive the payment. Generally, error-free drawback claims are certified for payment within three weeks of the electronic filing of the claims. Under certain conditions, acceleration of payments is authorized by Section 192.92 of the regulations.

The amount of duties that can be refunded, reduced, or waived under drawback is the lesser of the total amount paid or owed on the non-NAFTA components when imported into the U.S. or the total amount of duties paid or owed on the finished good in the NAFTA country to which it is exported. There is a ban on refunds, reductions, or waivers by a NAFTA country for certain purposes, however, such as antidumping or countervailing duties.

WHERE TO OBTAIN INFORMATION ON DRAWBACKS

Any person, corporation, or business entity may participate in the drawback program. There are eight drawback centers located throughout the U.S. that can provide information or assistance in preparing proposals, filing the appropriate forms in a timely manner, and so on. The Customs Service has a home page and links to other pertinent sites and sources of information at www.customs.ustreas.gov. The Service also maintains the Customs Electronic Bulletin Board (CEEB), an automated system that provides current, relevant information and may be accessed by a modem or through the Customs home page. In addition, the Customs Service publishes the *Customs Bulletin and Decisions (Customs Bulletin)* weekly and produces new rulings, regulations, and compliance publications.

As a note of caution, the exporter's failure to exercise reasonable care may lead to a delay in the release of merchandise or the imposition of penalties. Since customs issues can be complex, exporters may request advance rulings from Customs or solicit advice from consultants in the customs field. ■

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