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Customs Proposes New Rules Regarding Duty Drawback Claims Involving Excise Taxes

U.S. Customs and Border Protection (“Customs”) has published a proposed rule in the October 15, 2009, *Federal Register* in which Customs proposes to preclude the filing of a substitution drawback claim for internal revenue excise tax paid on imported merchandise in situations in which no excise tax was paid on the substituted merchandise, or where the substituted merchandise is the subject of a different claim for refund or drawback of tax under any provision of the Internal Revenue Code. The proposed rule also adds an importation and entry bond condition to foster compliance with the amended drawback.

Under U.S. law, importers may apply for a refund of 99 percent of certain duties, taxes and fees if the imported merchandise is exported or destroyed under specified conditions. This refund, called “drawback,” is allowed in order to place a U.S. exporter on equal footing with foreign competitors by refunding most of the duties paid on imports used in domestic manufactures intended for export. There are several types of drawback permitted under Customs regulations, including “substitution drawback.” Substitution drawback allows other merchandise to be substituted for the imported merchandise for purposes of satisfying the exportation or destruction requirement. The substituted

merchandise must be: (1) commercially interchangeable with the imported merchandise on which the duties, taxes and fees were paid; (2) exported or destroyed within three years of the date of importation of the merchandise; and (3) not used within the United States before exportation or destruction and in the possession of the party claiming drawback.

In its notice, Customs explained that it has received and approved several substitution drawback claims involving products subject to federal excise tax (such as distilled spirits, wines, beer, tobacco products and cigarette papers and tubes, certain taxable fuels, and petroleum products). Several of the statutes establishing the federal excise taxes also have provisions exempting companies from the excise tax for domestically produced products for export. This has resulted in companies establishing arrangements whereby they would import a product subject to excise tax, pay the excise tax, export the same amount of domestically produced product (without paying excise tax), and then apply for drawback of 99 percent of the excise tax it paid on the imported product. Under these arrangements, the imported product is, in effect, free of 99 percent of federal excise tax.



Customs stated that these arrangements are contrary to the intent of the statute, and therefore has proposed amending its regulations to preclude the filing of substitution drawback claims in circumstances in which the internal revenue taxes have not been paid on the substituted domestic product, or where that merchandise is subject to a different claim for refund or drawback of Internal Revenue Code taxes. The proposed regulation also imposes a new condition on imported merchandise subject to Internal Revenue Code taxes, whereby the principal agrees not to file, or to transfer to a successor the right to file, a substitution drawback claim involving such tax if the substituted merchandise has been, or will be, subject to an exemption from the tax or a separate claim for a refund or drawback. For more information on these details, please contact Hunton & Williams through one of the attorney contacts listed on this client alert.

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