



U.S. duty drawback: why now?



Most importers are familiar with U.S. duty drawback as a way to reclaim duties; after all, it's been available since the 18th century.¹ Since then, it has become a widely used mechanism to reclaim duties, fees, and certain taxes on imported goods that are subsequently exported or destroyed. While it was always popular, the combination of modernized regulations and a dynamic trade landscape have increased its appeal.

In 2016, with the implementation of the Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA), drawback was modernized, increasing the potential return on investment (ROI) for many drawback claimants. However, along with TFTEA's modernized regulations came additional compliance complexities that have to be navigated. Learning how to apply these new requirements to manage a duty drawback program became a priority with the

imposition of the Section 301 tariffs on imports from China—when tariff rates skyrocketed seemingly overnight. Further, an economy in flux has made tariff management a crucial component of a long-term savings strategy.

While drawback might seem tricky, the right combination of automation and human know-how allows for a streamlined process that optimizes duty recovery while prioritizing compliance.



¹ **What every member of the trade community should know about: Drawback,** customs and border protection, Dec. 2004.



Duty drawback puts money back in your pocket

Duty drawback is a refund of duties, fees, and/or taxes paid on goods imported into the United States that are subsequently exported or destroyed. It allows the drawback claimant to recover up to 99% of the duties paid on goods if certain requirements are met. In fact, there are several different types of drawback that companies can use depending on their operations:

Provision type	Direct identification	Substitution
Manufacturing Drawback	Applies when imported merchandise is further manufactured in the U.S. and is subsequently exported or destroyed.	Applies when either imported merchandise, or domestic product substitutable at the same 8-digit HTSUS, are used to manufacture articles that are then exported or destroyed.
Unused Merchandise Drawback	Applies to imported merchandise not undergoing further processing within the U.S. that is subsequently exported or destroyed.	Applies when imported merchandise or domestic products substitutable at the same 8-digit or 10-digit HTSUS are exported or destroyed without additional processing within the U.S. However, there are certain nuances that must be carefully observed to ensure compliance with drawback regulations.
Rejected Merchandise Drawback	Applies to merchandise exported or destroyed which does not conform to sample or specifications, has been shipped without the consent of the consignee, or has been determined to be defective at the time of importation or sold at retail.	

The two most common forms of duty drawback are manufacturing and unused merchandise drawback. Under manufacturing drawback, a company imports materials, further manufactures them and then exports the finished product. An easy example is a bicycle. A company may import the bicycle parts, manufacture

it into a bike and then export a finished bike. The exporter would then receive a refund on the duty paid on the imported components that were used in the subsequently exported bicycle. If those same parts were imported and then exported without further processing, unused merchandise drawback may apply to reclaim the duties.

While TFTEA didn't change the fundamental principles of duty drawback, it modernized the claim process. The major enhancements included:

- When applicable, substitution drawback allows a match to the 8-digit Harmonized Tariff Schedule ("HTS") classification. Additionally, domestic parts could now be used for substitution drawback claims if they had the same classification as the imported parts. As a result, significantly more products qualify for substitution drawback;
- TFTEA streamlined the timeline for filing claims to five years from the date of importation to the date of filing the claim and expanded record-keeping requirements to three years after liquidation of the drawback claim;
- TFTEA mandated the submission of all drawback claim information through CBP's Automated Commercial Environment ("ACE") portal. This accelerated many claims because CBP could process the drawback entries more efficiently; and
- Modernized requirements and compliance considerations for participating in third-party programs (i.e., when the importer and the exporter are different entities) enabling more drawback opportunities but also creating a legal nexus between the parties.



Why drawback programs are not successful

When drawback programs are not successful there are two primary reasons: (1) regulatory requirements are not followed; or (2) the drawback claimant's data or documentation is not complete and/or accurate.

For substitution drawback (unused or manufacturing) drawback is challenging because of a classification nuance. Under TFTEA, product classification only needs to match at the 8-digit HTS level. However, unused substitution drawback adds an additional wrinkle. If the subheading classification begins with "other" then the imports and exports must align at the ten-digit level. If at the ten-digit HTS level the description begins with "other" then they goods will not qualify for unused substitution drawback, and the claimant may only file unused direct identification. This requirement could be easily missed if a company does not fully understand the distinction around substitution and direct identification drawback.

Similarly, proper application of the first filed rule enables drawback claimants to optimize refunds. TFTEA mandated dual calculation for drawback—i.e., direct identification is based on the invoice price while substitution claims are based on a per-unit average price derived from the entered value and quantity reported on the import entry line number. In instances where both methods of calculation are used, the first filed rule mandates that only one calculation method is permitted per import entry line. Failing to manage this requirement can lead to missed drawback opportunities.

On the data side, validating a claim's underlying information can be complicated. Large volumes of import and export data must be tracked to tie product classifications together or to marry imports or exports. Without this data, compiling a drawback claim is an intensely manual process in which data and documentation from multiple sources must be aggregated. Many times, companies find the time commitment in preparing claims to be too taxing or the level of risk too high to sustain a drawback program. As a result, money is left on the table because preparing drawback claims is too resource intensive.

Harmonizing data is also difficult without automated tools. For example, companies filing drawback usually rely on the unit of measure stated on the bills of material or the invoice. However, units of measure may vary based on jurisdiction. For substitution drawback purposes (manufacturing or unused), the unit of measure must align with the HTS unit of measure reported on the import entry. In instances where the commercial documentation units of measure do not align with the HTS, companies must convert the quantities. While on a small-scale this may not be difficult, for larger or more complex operations undertaking a mass conversion can result in unit-level discrepancies that undermine the claim ultimately leading to compliance issues.

When companies end a drawback program it is typically because they faced insurmountable challenges in either managing the regulations or accessing complete and accurate data. These challenges can be ameliorated by involving duty drawback subject matter professionals who have both regulatory expertise and operational experience. Proper planning combined with a thorough analysis of available data will set many programs up for success.



Maximizing refunds

Maximizing refunds begins with tackling regulatory and data challenges. First, a technical team can help implement processes that comply with duty drawback requirements. The team must understand the specific requirements around the type of drawback being

claimed and have a plan to vet compliance. They can then develop processes and procedures that support compliant duty drawback filing while maximizing recovery. However, even the best team won't be successful without reliable data and supporting documentation.

Getting the data right without over-burdening the trade team includes sustainable access to reliable inputs including:

- Access to customs broker data at regular, pre-established intervals through a portal, email or direct feed. This data should include invoice level details, such as part numbers, line quantity, unit of measure, entry line value and country-of-origin;
- Automation to flag products that must have an eight or ten-digit HTS match and then to exclude them if they are an "other, other" classification; and
- Access to freight forwarder reporting to include date of export and invoice details, such as invoice and sales order number. A key component of this step is validating that the date of export reflects the date the products left the U.S.—not the day they were provided to the freight forwarder.

An important part of the process is modeling data before preparing a drawback entry to identify the largest refund. By doing so, the drawback claimant can identify the most advantageous combination of duty drawback types to include in the claim. Further, for drawback claimants using substitution drawback, data modeling facilitates matching transactions at values with the highest recovery. In many cases, maximizing recovery includes expanding a duty drawback program to include imports and exports from third party suppliers and customers. However, while including third parties may significantly increase refunds, the drawback claimant must first validate the entire universe of data to assess the probability of long-term success.

A duty drawback program that optimizes refunds begins with a team of experts who can implement and manage a process for collecting import and export data, validating it, addressing discrepancies and scaling the program as the program or the business changes.





How we can help

We know the challenges many companies face with drawback and we have developed solutions that alleviate

these burdens. Through our innovative, proprietary technologies and deep technical experience, the KPMG Trade & Customs team gathers upstream information, such as customs broker and freight forwarder data, and transforms it into a clean data model. For companies with existing programs, KPMG has an established transition approach focused on continuation and acceleration of future duty drawback filings.

Through our process, we will:

- Baseline the current status through information gathering sessions with stakeholders, customs brokers and freight forwarders where data flows are mapped;
- Establish automated feeds with key third-parties;
- Develop and embed unique logic to normalize data;
- Remediate data inconsistencies; and
- Perform mock audits to verify consistency among the supporting documentation and identify potential anomalies

Not only does our technical knowledge and sophisticated technology lead to a more robust program, it facilitates maximizing the use of multiple savings programs. In one instance, a company was using duty drawback and claiming Section 301 tariff exclusions but was having challenges managing both programs. Being able to optimize the available tariff

exclusions and duty drawback was critical to reducing costs. However, by implementing a process that segmented out imports with available exclusions and those that were appropriate for a drawback claim, the company saved more than two million dollars.

We also know how to apply our technology to existing programs so that both compliance and savings are optimized. Another company had a complex savings program that included an extensive US-Mexico-Canada Free Trade Agreement (“USMCA”) savings program as well as an unused direct identification program and a manufacturing substitution program. The challenge was identifying and separating the inventory to support both programs while accurately leveraging a multilevel bill of materials. KPMG was able to review the inventory and segment imports based on the warehouse location and the location of the production facilities. Further, by doing a deep dive into their data, we helped standardize and review the bills of material to reduce the hands-on sorting and filtering of all the multi-level details. These changes enabled the company to recover six million dollars in duties annually.

Looking ahead, we expect the dynamic trade environment to continue. Duty drawback can provide relief in a high-tariff environment with consistent, ongoing savings. The key is preparation and data modeling and monitoring to help ensure compliance and savings maximization. While every drawback program has unique complexities, KPMG is leading the way in developing innovative solutions that make duty drawback one of the top savings programs in our clients’ arsenals.

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