History and Operation of the Drawback Laws

From the Founding to TFTEA

Drawback dates back to the Tariff Act of 1789, and its original purpose remains the same today: to promote U.S. exports, manufacturing capital investment, and job creation in the United States. Congress modified the original drawback provisions several times in the years to follow, ultimately including them in the Tariff Act of 1930. The drawback program then remained relatively stable, if difficult to use, for the next half-century.

In 1980, Congress expanded drawback to include "same condition merchandise drawback," applicable when imported merchandise not used in the United States is later exported in the same condition as when it was imported.[1] In expanding the program, Congress codified the right to claim drawback of "any duty, tax, or fee imposed under Federal law because of its importation."[2] In 1984, Congress further expanded drawback by authorizing the "substitution" of exported products to better reflect modern commercial reality.[3] To resolve confusion about the types of taxes and fees recoverable by drawback, Congress clarified the substitution provisions in 2004 to ensure that the statute and Congressional intent were unambiguous. After 2004, it was clear that importers may claim drawback for all duties, taxes, and fees imposed under Federal law on an article upon entry or importation when they then export a substitute product. Alcoholic beverage excise taxes are imposed upon importation, and clearly meet the definition.

TFTEA, enacted on February 24, 2016, provides a simple and objective standard to determine if an exported product is an appropriate commercial substitute for an imported product in order to ensure that industry can better access drawback to promote U.S. exports. In doing so, Congress removed the "commercially interchangeable" threshold that U.S. Customs and Border Protection (CBP) previously used to make eligibility determinations for substitution drawback claimants. The claims process, once highly subjective, becomes simpler and more objective by using eight and ten-digit Harmonized Tariff Schedule (HTS) classifications to match imported and exported goods. TFTEA does not place <u>any</u> new restrictions on the ability of any U.S. manufacturer in any industry to benefit from the drawback program.

Wine and the Use of Substitution Drawback

Over the past two decades, the wine industry has used substitution drawback to grow U.S. wine exports by over 200 percent. These exports have enabled the wine industry to expand and, in turn, support a wide range of related manufacturing jobs in the glass and packaging industries. Between 2001 and 2007, U.S. wine exporters used substitution drawback for commercially interchangeable imported products. In May 2007, CBP suddenly revoked the commercial interchangeability rulings upon which wine producers had relied to support their drawback claims. In 2008, Congress responded by explicitly reinstating the pre-existing commercial interchangeability standard (the so-called "red for red, white for white" color determination).[4]

In amending the law, Congress did not create any additional rights to use the drawback program – the law was clear that those rights already existed for the alcohol beverage industry (including beer and spirits).

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[1] *See* Act of Dec. 28, 1980, Pub. L. 96-609, § 201, 94 Stat. 3560 (codified as amended at 19 U.S.C § 1313(j)(1)).
[2] *Id.* (emphasis added).
[3] Omnibus Trade and Tariff Act of 1984, Pub. L. 98-573, § 202, 98 Stat. 2973 (codified as amended at 19 U.S.C. § 1313(j)(2)).
[4] Food, Conservation, and Energy Act of 2008, Pub. L. 110-246, § 15421, 122 Stat. 2309 (codified as amended at 19 U.S.C. § 1313(j)(2)).

Instead, Congress clarified the scope of substitution, because the highly subjective and restrictive CBP standards were preventing the lawful use of the drawback program by making it difficult for the wine industry to use the drawback provisions in practice.

Beer and Spirits and Commercial Interchangeability

While the wine industry has successfully used the drawback program to encourage exports since 2001, CBP's "commercially interchangeable" standard has proved to be an insurmountable practical barrier for beer and spirits to exercise their identical rights to drawback. CBP has typically defined commercial interchangeability to require the same part number (sku and packaging) and value. For an exported beer or spirit to be considered commercially interchangeable with an import, the product would need, at a minimum to be the same brand of beer or spirit. CBP's evaluation has often included other subjective measures to make the program commercially unworkable. Congress recognized when crafting TFTEA that the "commercially interchangeable" standard was so subjective, unpredictable and restrictive that many industries were unable to use the drawback provisions as intended. Thus, Congress deliberately chose to move to an objective system to make the program more commercially workable and predictable. In crafting TFTEA, Congress could have, but did not apply any new restrictions on the beer, wine, and spirits industries' pre-existing rights to use the program in general.

How Substitution Drawback Works for the Alcohol Beverage Industry

Before TFTEA:

Since 2001, the U.S. wine industry used the aforementioned "red-for-red," or "white-for-white" color determination, later codified into law in the 2008 Farm Bill. For example, today when a wine producer imports a red varietal from France and subsequently pays the excise tax that attaches at importation, that wine producer is eligible to make a substitution drawback claim on those excise taxes when it exports a bottle of red wine produced in California, provided that the wines do not have a value differential of greater than 50 percent.

Since the enactment of section 1313(j)(2) in 1984, beer and spirits companies have been technically able to make drawback claims under the law, but such companies have been restricted by CBP's application of the "commercially interchangeable" standard to their products. For example, when a distilled spirits producer imports gin, in order to be able to claim drawback, the exported product must be of the same brand as the imported product, among other restrictions.

After TFTEA:

U.S. wine producers are still able to use the "red-for-red," or "white-for-white" color determination. The TFTEA Conference Report makes clear that wine may also use the 8 or 10-digit HTS codes prescribed by TFTEA to make drawback claims.[5]

Beer and spirits companies, like every other U.S. manufacturer, may also use the 8 or 10-digit HTS codes defined in TFTEA to make drawback claims. For example, a beer company may import beer and export a beer produced in the United States. All beer made from malt has a single 8-digit HTS code, and consequently a substitution drawback claim may be filed. The same is true for spirits companies; a company importing gin could make a substitution drawback claim for gin it produced in the United

[5] H.R. Rep. 114-376, at 221 (2015).

States, regardless of the respective brands or other distinctions, because gin has the same 8-digit HTS code.

19 U.S.C. § 1313 (j)(2) – "Notwithstanding Any Other Provision of Law"

In addition to the other drawback provisions of the Tariff Act of 1930, as amended, section 1313(j)(2) clearly authorizes the recovery of excise taxes where the other conditions of the statute are met. Congress amended the statute from time to time make this point clear. The current language specifically states, in relevant part, that "then, **notwithstanding any other provision of law**, upon the exportation or destruction of such other merchandise" the amount of each such duty, tax, and fee paid regarding the imported merchandise shall be refunded as drawback under section 1313(j)(2).

When Congress enacted substitution drawback in 1984, it allowed drawback for "any duty, tax, or fee" without qualifying the type of tax for which drawback could be claimed.[6] The use of the word "any" before "duty, tax or fee" indicates Congress' intent that "tax" be construed broadly to include any tax imposed by the federal government. In this case, "any…tax" includes federal excise taxes. When the Court of Appeals for the Federal Circuit narrowly interpreted the "duty, tax, or fee" language to include only excise taxes imposed "because of importation,"[7] Congress amended the law to clarify that any duty, fee, or tax imposed "*upon entry* or importation" is recoverable via drawback.[8] This amendment specifically targeted excise taxes.[9]

The phrase "any duty, tax, or fee" for purposes of 19 U.S.C. § 1313(j)(2) derives from the establishment of 19 U.S.C. § 1313(j)(1) in 1980, which was enacted after the 1958 law providing for drawback for alcohol excise taxes under 26 U.S.C. § 5062(b).[10] There is no conflict between the Internal Revenue Code (IRC) drawback provision and the Customs drawback provisions at issue. Whereas 26 U.S.C. § 5062(b) only addressed direct identification and destruction/loss drawback when it was enacted in 1958, the congressional intent to expand drawback to substitution drawback as contemplated by the 19 U.S.C. § 1313(j)(2) did not take place until 1984, providing an additional type of drawback claim that has not been addressed or limited to any extent by the alcohol excise tax provisions under the IRC.

Why Substitution Drawback Claims on Alcohol Excise Taxes Does Not Create "Multiple Drawback Claims"

Section 1313(v) of Title 19 prohibits claimants from seeking *multiple* drawback claims based on the same exportation. For example, section 1313(v) would prevent a party from exporting one case of domestic wine and then claiming substitution drawback for two different cases of imported wine based on the single act of exportation, an appropriate result given that this scenario does not encourage additional

[6] *See* Omnibus Trade and Tariff Act of 1984, Pub. L. 98-573, 98 Stat. 2973 (codified as amended at 19 U.S.C. § 1313(j)(2)).
[7] *Texport Oil Co. v. United States*, 185 F.3d 1291 (Fed. Cir. 1999).
[8] *See* Miscellaneous Trade and Technical Corrections Act of 2004, Pub. L. 108-492, § 1557, 118 Stat. 2579 (codified as amended at 19 U.S.C. § 1313(j) et seq.)) (emphasis added).
[9] *See* CBP, *Federal Excise Taxes Paid on Imported Petroleum Products*, June 5, 2008, https://www.cbp.gov/trade/entry-summary/drawback/petroleum/excise-tax.
[10] The clarifying amendment in 2004, "any duty, tax or fee imposed under Federal law upon entry or importation," restates Congressional intent, as does the re-adoption of the language in TFTEA.

exports. Excise tax exemptions under the IRC, however, do not involve multiple drawback claims against a single export.

The act of withdrawing merchandise from a TTB bonded facility for export does not constitute the first drawback claim on an export. All beer, wine and spirits produced in the U.S. must be made in a TTB bonded facility. Beer, wine, and spirits products remain in the TTB bonded facility until the producer is ready to move the product to a distributor for domestic sale or for the product to be exported. A beer, wine, or spirits producer would not pay taxes on products intended for export because of the Constitutional prohibition on taxing exports, and long-standing policy. The statutory scheme for tax exemption on exports is separate and distinct; it exists regardless of drawback and has nothing to do with drawback.

For section 1313(j)(2) substitution drawback claims, parties may only file one drawback entry covering specific exported merchandise. The withdrawal of merchandise from a TTB bonded facility (that will be matched with imported merchandise classified in the same HTS eight-digit subheading on which the excise tax was paid) is not accomplished by filing a drawback entry. Rather, the withdrawal is made pursuant to "Withdrawal of Spirits, Specially Denatured Spirits, or Wines for Exportation" on Form F 5100.11" filed with TTB, or in the case of beer, on TTB Form F 5130.12, "Beer for Exportation".

Filing Form F 5100.11 or Form F 5130.12 with TTB involves no request for drawback payment. While the excise tax attaches to the product when produced in the TTB bonded facility, the excise tax is assessed and paid when the product is withdrawn from a bonded facility for sale in the United States. When a producer withdraws an alcohol beverage product from a TTB bonded facility per Forms F 5100.11 or F 5130.12 there is no obligation to pay excise tax. They would not make a "request for drawback payment" when withdrawing the distilled spirits for export from the bonded facility.

CBP has granted substitution drawback claims since 2001 for wine exports, using wine withdrawn from TTB bonded facilities for export as substituted merchandise (except for a short period where the commercial interchangeability standard was at issue). In 2009, the Department of Treasury proposed a new regulation that would have eliminated substitution drawback administratively, but the Department withdrew the rulemaking due to significant Congressional pressure.[11] This history clearly demonstrates Congressional intent in allowing substitution drawback claims involving merchandise withdrawn tax free from a bonded facility. See attached Congressional letters filed in response to this 2009 effort by Treasury.

The IRC Provisions Governing Excises Taxes on Distilled Spirits Differentiates Between "Drawback" and "Withdrawal for Exportation."

IRC provisions governing excises taxes on distilled spirits authorize drawback in several specified situations. In each case, the IRC uses the term "drawback." Two examples:

1. **26 U.S.C. § 5062** provides for drawback of excise taxes paid on the exportation of distilled spirits from the United States. Unlike section 1313(j)(2), the exported merchandise must be the exact same merchandise on which the excise tax is paid.[12]
2. **26 U.S.C. § 5111** provides that "[a]ny person using distilled spirits on which the tax has been determined, in the manufacture or production of medicines, medicinal preparations, food

[11] Withdrawal of Notice of Proposed Rulemaking, 75 Fed. Reg. 9359 (Mar. 2, 2010).
[12] Parallel statutory provisions apply to beer (26 U.S.C. § 5055(2012)) and wine (26 U.S.C. § 5062 (2012)).

> products, flavors, flavoring extracts, or perfume, which are unfit for beverage purposes shall be eligible for drawback at the time when such distilled spirits are used in the manufacture of such products."

In contrast, 26 U.S.C. § 5214 allows distillers to withdraw spirits tax unpaid and undetermined from bonded premises in several specified situations including "exportation." Nowhere in the statute is such withdrawal referred to as a "drawback."[13]

Finally, the IRC allows for "drawback" recovery on the excise paid on U.S. manufactured product. Title 19 allows for drawback related to the imported product. The statutes deal with differing scenarios, and thus there is no conflict.

Drawback is an Export Incentive Program

TFTEA greatly expands the incentive for alcohol beverage companies to increase production in the United States to support increased exports. Exports lead to the creation of more U.S. jobs not just in the alcoholic beverage industry, but across the manufacturing supply chain, including bottle and can manufacturers, box and package manufacturers, farmers, and many others.

Imports of alcoholic beverage products will occur regardless of whether drawback provisions are fully implemented for alcohol beverages, largely because of geographic origin requirements, brand specificity and consumer preference. Like other manufacturers, beverage alcohol companies have, however, numerous choices on where to locate and expand production facilities, depending on a variety of cost, transportation and logistics issues, and implementation of full substitution drawback favors the expansion of U.S.-based manufacturing and jobs.

As noted above, the wine industry has used substitution drawback for nearly two decades, during which U.S. wine exports have grown more than 200 percent. This increase in exports has helped grow jobs in the U.S. wine industry and also in other supporting U.S. manufacturing industries, such as glass, paper, and packaging manufacturing throughout the United States. Full implementation of the drawback statute, as amended most recently by TFTEA, will help expand those benefits to additional industries and more American workers.

[13] Again, parallel exemptions apply to beer withdrawn for export (26 U.S.C. § 5053 (2012)) and wine (26 U.S.C. § 5362 (2012)).