A GUIDE FOR REDUCING CUSTOMS DUTIES EFFECTIVELY *(and Legally)*

Baltimore Headquarters
1215 E. Fort Ave. Ste 201
Baltimore, MD 21230
www.shapiro.com

Phone
1-888-you-1915
you@shapiro.com

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INTRODUCTION
The importer is required to use reasonable care in the classification of its merchandise. However, there are many ways to reduce duty costs, regardless of the classification. This whitepaper will look at some possible solutions; however, not all strategies listed here will apply to your business. If you need assistance in determining whether any of these recommendations work for your particular situation, you should contact your Customs broker or a Customs attorney.

First Sale

An importer can structure transactions to take advantage of the first sale basis of Customs valuation. For example, Manufacturer A in China sells to Trading Company B in Hong Kong who sells to Importer C in the United States. In a multi-tiered transaction such as this, the importer can lawfully pay duty on the price from Manufacturer A to middleman B, rather than on the price Importer C pays to the middleman. This practice has been well established by Customs and the courts for over 20 years.

Of course, using first sale will take planning as the middleman may be reluctant to reveal his markup. Also, the goods must be clearly destined for export to the United States at the time of the first sale. Using first sale can result in significant duty savings on the difference in prices between the first and second sales.

Drawback

Put simply, drawback is the ability to recover duties on imported goods that are subsequently exported or destroyed. Up to 99% of duties paid can be recovered. Antidumping duties and countervailing duties are not recoverable under drawback.

The purpose of the drawback program is to aid exporters and help them compete in the international market without having to include the cost of duties in the sale price of the goods. Many importers routinely export without even considering this benefit. Many exporters do not realize they can claim drawback when sending goods to Canada or Mexico.

Drawback can be claimed by the importer or the exporter. The timeframe to file varies, but generally drawback must be filed within three years of the date of import. There are various types of drawback filings such as unused merchandise, rejected merchandise, and manufactured goods. There are also special drawback programs for NAFTA.

One of the primary reasons companies fail to take advantage of drawback is the inability to track import shipments to the related export. Drawback regulations are highly complex, particularly for manufactured items. Filing drawback claims requires a broker who specializes in the process. Not all Customs brokers are equipped to file drawback.

Miscellaneous Tariff Bill

Miscellaneous Tariff Bills (MTB) include temporary duty reductions or suspensions for a three year period. The MTBs are usually part of an omnibus tariff bill enacted by Congress. This legislation covers products that would not harm a U.S. producer and can include both finished goods as well as items used in manufacturing. MTBs often cover goods with high duty rates (a recent example includes shopping bags made of polypropylene which are normally dutiable at 17.6% and were duty free under the U.S.

Manufacturing Enhancement Act of 2010 until December 31, 2012), or high volume goods with low duty rates. MTB provisions are reported with a tariff number starting with 9902 and a secondary tariff number for the underlying provision. Importers interested in including their products on a MTB should contact their Congressional representatives.

Free Trade Agreements

A free trade agreement is an agreement between two or more nations to reduce trade barriers amongst themselves. Free trade agreements have been very helpful to U.S. economic growth as stimulators for exports by opening up foreign markets to U.S. companies. FTAs also spur import growth through reduction or removal of duties. The merchandise processing fee is exempt for many free trade agreements, thereby increasing cost savings.

In a unilateral agreement, preferential treatment is allowed for goods coming into the U.S., but there is no reciprocity for U.S. products going into the beneficiary countries. Unilateral agreements include the Generalized System of Preferences (GSP), Caribbean Basin Economic Recovery Act (CBERA), Caribbean Basin Trade Partnership Act (CBTPA), Andean Trade Preference Act (ATPA), Andean Trade Preference Drug Eradication Act (ATPDEA), and the African Growth and Opportunity Act (AGOA).

Bilateral agreements provide reciprocal treatment for products of the United States exported to participating countries. The U.S. currently has bilateral free trade agreements with Israel, Jordan, Chile, Singapore, Australia, Morocco, Bahrain, Oman, Peru, Korea, Colombia, Panama, North American Free Trade Agreement (NAFTA) with Canada and Mexico, and Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) with Costa Rica, Honduras, El Salvador, Guatemala, Nicaragua, and Dominican Republic.

Korea is significant since it is the largest trading partner outside of the NAFTA partners with whom the U.S. has an agreement. The U.S. International Trade Commission estimates that the reduction of Korean tariffs and tariff-rate quotas on goods alone could add between $10 and $12 billion annually to the U.S. Gross Domestic Product and around $10 billion to annual merchandise exports to Korea.

Once an FTA has entered into force, the U.S. government continuously reviews the FTA partner's laws and other measures to ensure it maintains its commitments. Ultimately, a party can be removed from an FTA for non-compliance. For example, Bolivia was suspended from the Andean Trade Preference Act in December 2008 because of failure to cooperate in counternarcotics efforts.

Free trade agreements tend to be textile-centric. While on the surface many agreements are intended to stimulate trade between the parties, another effect of textile-centric FTAs is to draw trade away from China. The fallout of textile-centric FTAs is the collection of duties for U.S. Customs. Textiles comprise 42% of U.S. Customs duties paid even though they account for only 8% of trade. The average duty rate for non-textiles is 4%. The average duty rate for textiles is 16%. So textiles account for not only the greatest percentage of duties collected, but also the greatest percentage of loss in duties. This is primarily due to non-compliance with various free trade agreement regulations and less than honest importers trying to falsely claim FTAs.

Customs will often ask an importer to provide evidence that a shipment was actually produced in the FTA country. The importer may have to come up with purchase orders, production records, timesheets for the factory workers, and proof of payment to the supplier. Textile shipments under FTAs are considered high risk by Customs and draw a red flag in an audit as compliance tends to be very low.

Since complying with free trade agreements can be administratively burdensome, many companies do not claim FTAs and lose out on the duty savings. So while an importer should consider the overall savings by using an FTA both in duties and merchandise processing fees, it should also bear in mind the documentary responsibilities of proving compliance with the FTA.

Terms of Sale

Incoterms, or terms of sale, will dictate which party is responsible for the cost and risk for each leg of the cargo's international journey. Incoterms are reviewed every 10 years, with the latest revision in 2010. Under the C and D terms, the seller must contract for the main carriage and will include the freight cost in the cost of the goods. The C terms are CPT, CIP, CFR and CIF. The D terms are DAT, DAP, and DDP.

In March 2000, U.S. Customs issued Treasury Decision 00-20 outlining the proper deduction methods for prepaid ocean freight and insurance in order to determine the entered value of imported merchandise. Customs states that if the actual costs are not available or cannot be verified, costs for international transportation and insurance cannot be excluded from the CIF invoice value. These costs can only be deducted if they are the "actual" figures for freight and insurance. The Treasury Decision states, "If the importer of record does not know the actual costs for freight, insurance and other costs incident to international shipment, it must declare the entire value without a deduction for freight, insurance and other costs incident to international shipment."

The importer of record is required to use reasonable care to properly value the merchandise. Neither estimated freight and insurance charges, nor charges outlined by the supplier on the commercial invoice, is acceptable for deductions on the Customs entry. For example, on a commercial invoice with an FOB price of $10,000, and line for ocean freight of $4000 for a total CFR price of $14,000, duty must be paid on $14,000 unless the importer has proof of the actual ocean freight payment such as a carrier's freight bill. If the importer is paying duty only on the $10,000, he must be prepared to substantiate the $4000 ocean freight deduction to Customs.

Customs considers actual costs to constitute those amounts ultimately paid to the international carrier, freight forwarder, insurance company, or other appropriate provider of such services. Customs regards proof of actual cost to be commercial documents to and from the freight or insurance service provider such as:

- *An invoice listing freight/insurance costs*
- *A separate contract listing freight/insurance costs*
- *A freight/insurance bill*
- *A rated bill of lading/air waybill*
- *Proof of payment of freight/insurance charges such as letter of credit, bank statement, check*

All of these are are examples of documents which may serve as proof of actual freight or insurance costs. If costs are estimated and not documented, Customs considers this a failure to exercise reasonable care on the part of the importer. Customs will disallow the deduction and the importer can be faced with penalties. It is unacceptable to simply state the freight and insurance charges on the shipper's commercial invoice. Moreover, the seller has most likely marked up the charges, and thus may be reluctant to provide proof of the actual costs.

Therefore, under C and D terms, U.S. importers end up paying duty on freight and insurance included on the commercial invoice as Customs requires documentary evidence of the actual charges in order to deduct them. This is a very common valuation error and a focus for Customs during an audit.

Importers can save money by switching to FOB or FCA terms to avoid paying duties on "non-dutiable" charges. Even if the freight rate ends up being higher than what the supplier is charging, the overall cost could be lower when duty savings are taken into consideration.

Periodic Monthly Duties

Under Periodic Monthly Statement (PMS) processing, Customs allows an interest free, once a month duty payment. Duties are paid on the 15th business day of the month following the month of release. Importer's terms are effectively extended from 10 business days to 30-45 days. The importer gets the use of that capital longer and receives benefits to its cash flow. Customs receives the benefit of processing a single monthly payment instead of multiple daily payments.

Bonded Warehouse

Bonded warehouses are used by importers to delay duty and tax payments, and are also used for the storage of goods that will be ultimately exported. Only the harbor maintenance fee is paid at the time the goods are entered into the bonded warehouse. Duties, taxes and other fees such as the merchandise processing fee are paid when the goods are withdrawn for consumption.

Goods may remain in the warehouse for up to five years from the date of importation. Bonded warehouses are typically used for storage purposes only. Manipulation of goods is permitted only with Customs' approval.

The importer has several removal options when placing goods in a bonded warehouse. The goods can be withdrawn for consumption with duties and taxes paid on the rates in effect at the time of withdrawal; the goods can be withdrawn for export; the goods can move in bond to another port; or the goods can be transferred to another bonded warehouse. When re-warehousing goods subject to IRS tax, such as alcoholic beverages, the tax is due after the first withdrawal.

Importers can transfer the right to withdraw if the goods are sold while in the bonded warehouse.

Foreign Trade Zone

Foreign Trade Zones (FTZ) are secure areas located at or near ports of entry, and are legally considered to be outside the Customs territory of the United States. Goods in an FTZ are generally considered to be in international commerce. FTZs are very beneficial to local economies and can save importers money by deferring duty payments and streamlining entry procedures with weekly entry summary reporting.

Additionally, manufacturing processes in FTZs can lead to what is known as inverted tariffs. When goods are manufactured in a zone, the finished product may have a lower duty rate than the foreign inputs. Duties are not owed on labor, overhead, or profit attributed to FTZ manufacturing operations. If the same production operations were done overseas, the value of the labor, overhead and profit would be subject to

U.S. Customs duties as they would be included in the cost of the goods.

Unlike a bonded warehouse, goods may remain in an FTZ indefinitely. Also, domestic merchandise may be mingled with imported goods.

Temporary Importation Bond

Merchandise may enter the United States temporarily without payment of duty or merchandise processing fee by posting a Temporary Importation Bond (TIB). The harbor maintenance fee and any IRS tax due are paid at the time of entry. Goods entered under a TIB may not be imported for sale or sale on approval. The intent must be to export or destroy the merchandise within a certain period of time, not to exceed three years from the date of importation.

Just because the goods are in the U.S. temporarily does not automatically qualify them for TIB treatment. The merchandise must satisfy the TIB provisions found in the Harmonized Tariff Schedule of the United States heading 9813. Typical TIB conditions include articles to be repaired or processed (note that simply repackaging an item does not count as processing); samples for use in taking orders; articles for examination and reproduction; articles for testing, experimental or review purposes; works of fine art or scientific apparatus for exhibition; and automobiles for show purposes (there is a 6 month limit for these with no extensions permitted).

Carnet

A carnet is an international Customs document that simplifies Customs procedures for the temporary importation of goods duty free. Carnets are typically used for commercial samples, professional equipment and exhibition goods. The carnet is valid for one year only but permits unlimited entries and exits. A carnet does not exempt the holder from obtaining the necessary licenses and permits. Carnets are accepted in over 70 countries.

Binding Ruling

The binding ruling program allows the importing public to obtain written classification information from U.S. Customs. The classification is binding at all ports of entry unless the ruling is revoked by Customs headquarters. A binding ruling could result in a lower duty rate for the product in question. Because binding rulings are publicly available (see www.rulings.cbp.gov), importers should check rulings for goods similar to their own to see if a more favorable duty rate may be applicable.

Tariff Engineering

The concept of tariff engineering dates back to an 1881 Supreme Court case Merritt v. Welsh. The Court considered, hypothetically, the situation in which a sugar manufacturer would alter the color of the sugar in order to obtain a lower duty rate. The Court stated, “Great stress is laid on the charge that sugars are manufactured in dark colors on purpose to evade our duties. Suppose this is true; has not a manufacturer a right to make his goods as he pleases?” This case laid the groundwork so that importers have the right to fabricate their goods to avoid high duties, as long as there is no deception or fraud.

For example, a dress made of 51% polyester and 49% cotton is considered a polyester dress and has a duty rate of 16%. By slightly altering the fabric content to 51% cotton and 49% polyester, the dress is now considered a cotton dress with a duty rate of 8.4%.

Certain candles from China are subject to antidumping duties of 108.3%. The scope of the antidumping order includes only candles with wicks, so manufacturers started producing wickless candles in an attempt to evade the significant antidumping duties. U.S. Customs does not consider wickless candles to be candles, but rather articles of wax. The National Candle Association is challenging the classification of the wickless candles in an effort to have them classified as candles for possible inclusion in the antidumping case.

Another infamous example of tariff engineering is the application of a textile layer to the sole of footwear. In the extreme this could reduce the duty rate from 48% to 7.5%. The World Customs Organization added a note to the Explanatory Notes to the Harmonized Tariff that said "a detachable textile material, applied to but not embedded in the sole" was to be disregarded in determining the constituent materials of the outer sole. U.S. Customs was not content with this language and added a U.S. Note to the tariff in 2012. However, Customs is still deciding how to interpret the Note's phrase, "characteristics usually required for normal use of an outer sole, including durability and strength."

So while tariff engineering is legal, the process can be very tricky. You should contact your Customs broker or a Customs attorney for assistance in navigating this complex terrain.

Conclusion:

There are myriad ways importers can lower their duty costs – all perfectly legal and acceptable in the eyes of U.S. Customs. The strategies outlined above could be used by many importers, regardless of company size. Lower your costs and increase your competitiveness. Many of these solutions are low risk, so why leave money on the table?

ABOUT SHAPIRO

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