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IS A FOREIGN TRADE ZONE FOR YOU?

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BACKGROUND

The Foreign-Trade Zones Act was passed in 1934 as part of the New Deal legislation. The FTZ Act was sponsored by Congressman Emanuel Celler of New York. **The stated purpose of the FTZ Act was to stimulate and expedite international commerce, make U.S.-based businesses more competitive and create employment opportunities in the U.S.** There was no provision for manufacturing in the 1934 Act -- **manufacturing permission was provided for by an amendment to the FTZ Act in 1950.** Interest in the FTZ Program escalated in 1980 due to a change in the Customs Regulations whereby the value of U.S. components, labor, overhead and profit were held to be non-dutiable. As of September 15, 2010 there were 274 approved General Purpose Zones, of which 257 are currently authorized and 660 approved Special Purpose Subzones, of which 515 are currently authorized.

WHO IS INVOLVED

1. Foreign-Trade Zones Board -- comprised of the Secretary of Commerce and the Secretary of Treasury. These officials or their designee are empowered to issue to appropriate applicants the grant of authority to establish, maintain and operate a Foreign Trade Zone project 19 U.S.C. 81a(b); 15 C.F.R. 400.2(b).
2. Foreign-Trade Zones Board staff -- Officials in the Department of Commerce, International Trade Administration responsible for overseeing the administration of Foreign Trade Zones. The Executive Secretary heads up this office 15 C.F.R. 400.2(f).
3. Port Director of Customs and Border Protection (CBP) -- Customs official with responsibility for overseeing the activation and operations of zone projects within his customs port of entry.
4. Grantee -- An entity to which the privilege of establishing, operating, and maintaining a foreign-trade zone has been granted. 19 U.S.C. 81a(h); 15 C.F.R. 400.2(r).

5. Operator -- A corporation, partnership, or person that operates a zone or subzone under the terms of an Agreement with the zone grantee. Where used in this part, the term "operator" also applies to a "grantee" that operates its own zone. 19 C.F.R. 146.1(15); 15 C.F.R. 400.2(s).
6. User -- A person or firm using a zone or subzone for storage, handling, or processing of merchandise. 19 C.F.R. 146.1(20); 15 C.F.R. 400.2(v).

FTZ TERMINOLOGY

1. FTZ Eligibility -- Issuance of a grant by the FTZ Board results in the designated area obtaining FTZ eligibility.
2. Activation -- Filing of an application with CBP by the Operator, with the Grantee's concurrence, results in the actual utilization of an FTZ eligible site as an FTZ.
3. Subzone -- a special purpose zone established as an adjunct to a zone project for a limited purpose.
4. Domestic Status Merchandise -- Merchandise produced in the United States or imported merchandise for which customs duties have already been paid.
5. Privileged Foreign Status Merchandise -- Imported merchandise which has not been cleared by CBP and for which the User wishes said merchandise to retain its identity, from a customs classification standpoint, regardless of its condition when it ultimately enters the customs territory of the United States.
6. Non-Privileged Foreign Status Merchandise -- Imported merchandise which has not been cleared by CBP and for which the User does not wish said merchandise to retain its identity, from a customs classification standpoint. Therefore, if said merchandise is altered from a customs classification standpoint, it will become classifiable in its condition when it ultimately enters the customs territory of the United States.
7. Zone Restricted Merchandise -- Merchandise which can not re-enter the U.S. customs territory.
8. C.F. 214 -- Document prepared by the User, signed by the Operator and approved by CBP, which authorizes the admission of merchandise into a FTZ and designates the status of the merchandise.
9. C.F. 216 -- Document prepared by the Operator and approved by CBP, which authorizes the User to engage in certain activities within the FTZ such as manipulation, repair, destruction and manufacture.

10. C.F. 3461/7501 -- Document prepared by the User, which must be approved by CBP and furnished to the Operator prior to the physical removal of any merchandise from the FTZ into the customs territory of the United States.
11. C.F. 7512 -- Document prepared by the User, which must be approved by CBP and furnished to the Operator prior to the physical removal of any merchandise from the FTZ for exportation of merchandise from the United States.

WHAT IS A FOREIGN TRADE ZONE?

FTZs are discrete areas located within the geographical territory of the U.S. but which are deemed to be outside the customs territory of the United States for customs purposes. An FTZ is established through the issuance of a grant by the Foreign-Trade Zones Board (a branch of the United States Commerce Department). This grant is generally bestowed upon a public or quasi-public entity such as a City, Port Authority or Chamber of Commerce, and the recipient of the grant is known as the Grantee. Traditionally, the grant initially issued was usually limited to a General Purpose FTZ, an area in which all Users can store their merchandise and which is run as a public utility by a party known as the Operator. In December 2008, the Foreign-Trade Zone's Board announced the establishment of the Alternative Site Framework (ASF) which provided the Grantees with greater flexibility in responding to the needs of companies desirous of obtaining FTZ designation.

Traditionally, if a company wished to have its own manufacturing facility designated as an FTZ the company would request a Grantee to file, on behalf of the company, a subzone application with the Foreign-Trade Zones Board seeking subzone designation (see process explained below). The subzone grant will indicate the type of manufacturing activities which the company will be allowed to conduct within the subzone. Traditionally, if a company desired to have its distribution facility designated an FTZ it was possible for said facility to become part of the General Purpose FTZ without the necessity of filing a subzone application. This could be accomplished either by locating the distribution facility within an existing General Purpose FTZ or by requesting the Grantee to expand the boundaries of the General Purpose FTZ to include the industrial park in which the distribution facility is located. Please note that it is not required that all sites making up a General Purpose FTZ be in a contiguous area -- the General Purpose FTZ can be located in numerous locations. Under the ASF, it is no longer necessary for a company desirous of obtaining FTZ designation for its distribution center to have an expansion application filed by the Grantee. Rather, under the ASF, the Grantee can file a simple boundary modification request with the Foreign-Trade Zones Board and the distribution center can receive FTZ designation within 30 days. Similarly, under the ASF, a manufacturing facility can obtain FTZ designation within 30 days, with the caveat that prior to engaging in manufacturing product under zone procedures, the company must seek specific manufacturing authority from the Foreign-Trade Zones Board.

The applicable Federal Statute, CBP Regulations and Commerce Department Regulations covering FTZ establishment and utilization can be found at 19 U.S.C. 81, 19 C.F.R. 146, and 15 C.F.R. 400 respectively.

MAJOR POTENTIAL BENEFITS OF A FOREIGN TRADE ZONE PROGRAM

FTZ usage can be an extremely valuable customs planning mechanism for a company that produces merchandise in the United States utilizing foreign materials and/or stores foreign sourced merchandise in the United States. The principal benefits provided by an FTZ are as follows:

- A. Postponement of duty payment on foreign merchandise until said merchandise physically leaves the FTZ facility either in its condition as admitted into the FTZ or as part of a finished article -- commonly referred to as "the duty deferral principle."
- B. Reduction of customs duties on foreign components which carry a higher duty rate than the finished article -- commonly referred to as "the inverted tariff principle."
- C. Elimination of customs duties on foreign merchandise re-exported from the United States either in its condition as admitted into the FTZ or as part of a finished article.
- D. Elimination of customs duties on foreign merchandise which is defective or which, during the production cycle, become waste.
- E. Logistics advantages, such as direct delivery and weekly estimated entries.

A. Duty Deferral

The most common and best understood advantage gained through FTZ utilization is the ability of a User to generate savings by means of duty deferral -- postponing the payment of customs duties on the imported merchandise until said merchandise physically leaves the FTZ. The variables to be considered in determining the amount of savings to be realized through the duty deferral benefit are (1) the value of the merchandise, (2) the pertinent duty rate, and (3) the amount of time the merchandise remains in inventory. The higher the value, the higher the duty rate, and the longer the merchandise remains in inventory the greater the incentive for utilizing an FTZ. Duty payment for foreign merchandise entered into the customs territory of the United States from an FTZ must be made within 10 working days (generally 2 weeks) from the date of the actual release of the merchandise from the FTZ.

It is to be noted that a similar benefit is available through customs bonded warehouses, although there are some significant differences. Foreign merchandise can be stored in a customs bonded warehouse for only five years -- in an FTZ there is no time limitation. Foreign merchandise and domestic U.S. merchandise cannot be mixed together in a customs bonded warehouse -- commingling of foreign and U.S. merchandise is permitted in an FTZ. In addition, no manufacturing is allowed in a customs bonded warehouse -- whereas manufacturing, so long as the grant so indicates, is permitted in an FTZ. Furthermore, imported merchandise stored in a customs bonded warehouse is not exempt from state and local ad valorem inventory taxation.

However, if a company is only looking at saving money on a duty deferral basis, a customs bonded warehouse may be the more cost and time efficient method to pursue. The application process for customs bonded warehouse status is generally only a matter of some 2-3 months, and involves significantly less in legal fees. Approval for customs bonded warehouse status is solely within the jurisdiction of CBP and there is no Notice requirement that an application for bonded warehouse designation be published in the Federal Register. You can designate your entire facility or a portion of your facility as a customs bonded warehouse. Of course, as noted above, a customs bonded warehouse does not afford the same degree of flexibility offered by an FTZ.

B. Duty Reduction

If a company intends to engage in any manufacturing or assembly operations within its contemplated facility, there may be an opportunity to reduce its duty liability on the component parts that it will be importing. This savings would result if a lower duty rate applies to the finished product than to the individual imported components. Through a process known as "status designation" at the time foreign merchandise is admitted into an FTZ, the company will be able, in certain situations to "step down" the applicable duty rates. By selecting "non-privileged" foreign status, the company would be admitting the foreign components into the FTZ in a suspended hiatus with regard to its classification. When the final article is actually removed from the FTZ, the duty rate applicable to the finished article would apply to the value of the "non-privileged" foreign status component. If the duty rate for the finished article is higher than the duty rate which would be applicable to a specific foreign component, such component should be admitted into the FTZ in "privileged" foreign status so as to freeze its duty rate at the lower rate applicable to the component. Thus, if an article to be produced in an FTZ is dutiable at a 3.9% rate and some of the foreign components are dutiable at a 2% rate whereas other foreign components are dutiable at a 5% rate the following should occur: the company would admit the foreign components which are dutiable at 2% into the FTZ as "privileged" foreign status merchandise thereby preserving the lower 2% rate of duty on the value of such components; the company would admit the foreign components which are dutiable at 5% into the FTZ as "non-privileged" foreign status merchandise thereby reducing the duty rate to be applied to the value of such components from 5% to 3.9%, resulting in a duty savings of 1.1% on the value of these components. The above example clearly demonstrates the flexibility provided to an FTZ User in manipulating the duty rates of merchandise admitted into an FTZ so as to enjoy the most favorable duty treatment available under the law.

C. Duty Elimination

If the company were to assemble and manufacture completed articles within a subzone and then export the finished articles from the United States, no duty would be owing CBP at all. Thus, there would be no need to apply for manufacturing duty drawback for these exported articles, a process which can be extremely tedious and time consuming and which results in only a 99% refund of the customs duties. It should be further noted that under manufacturing duty drawback, a manufacturing drawback contract must be filed with and approved by CPB, the customs duties are paid when the imported merchandise originally enters the U.S. customs territory, the 99% duty refund is not applied for until after the completed article is manufactured and exported from the U.S., and the duty refund is not issued until sometime thereafter -- the entire process often takes a

number of years, a time period during which the CBP is holding the importer's funds. Under the FTZ program, customs duty would be entirely eliminated for completed articles which are exported and the company maintains the utilization of 100% of its funds.

It is to be noted that imported articles which are stored in a FTZ and which are ultimately exported in the condition in which they were admitted into the zone are also exempted from duty payment. Thus, it is not necessary to claim same condition drawback on such merchandise since duties will never have been paid to CBP with regard to said imported merchandise.

D. Duty Elimination on Scrap and Defective Merchandise

Another benefit from having a manufacturing facility or distribution center designated as an FTZ is that a User need not pay duty on the portion of imported materials that ends up on the floor as scrap nor on that portion of imported merchandise which is defective. If scrap and/or defective merchandise runs to 3-5% or more of inventoried materials, then the company can consider this as a further sizable duty reduction.

E. Direct Delivery and Weekly Estimated Entry:

If the FTZ Operator qualifies as the owner or purchaser of the merchandise being admitted into the FTZ, the Operator can request, pursuant to 19 C.F.R. 146.39, that the merchandise be delivered to the FTZ without prior approval on a CF 214. This is a procedure that requires the filing of a written application by the FTZ Operator with the Port Director of CBP and certain criteria must be satisfied. Pursuant to 19 U.S.C. 1484(i), the weekly estimated entry procedure is available, at the option of the Operator or User of the FTZ. This procedure authorizes the use of a single entry (release) covering all merchandise to be released from the FTZ during a 7-day period., which results in significant savings from a timing and financial perspective. Rather than filing an entry for each imported shipment at the time of its arrival at the port of unloading, the importer can move the merchandise, in bond, to the FTZ and file a single entry each week covering any of the merchandise released for entry into the customs territory of the United States during the 7-day period. This dramatically reduces paperwork from both the perspective of the importer and CBP and should result in a reduction of the importer's brokerage fees and Merchandise Processing Fees.

OBTAINING FTZ DESIGNATION UNDER THE TRADITIONAL SITE FRAMEWORK

In order to establish a General Purpose FTZ, an application must be filed with the Foreign-Trade Zones Board in Washington, D.C. The application must be sponsored and filed by the appropriate entity (Grantee). The Commerce Department Regulations spell out with specificity the information that must be included within the application. The application consists of 5 Exhibits, the most significant one being Exhibit 4 setting forth the economic justification for the establishment of the General Purpose Foreign Trade Zone. It is to be noted that each Customs Port of Entry is entitled, by law, to one Foreign Trade Zone project. It is entirely possible however, for multiple FTZ projects sponsored by different Grantees to exist at a single Customs Port of Entry. Furthermore, a General Purpose FTZ can consist of a number of non-contiguous sites. The sole requirement with regard to General Purpose sites is that they be located within 60 statute miles or 90

minute driving time from the outer limits of the Customs Port of Entry. Once the application is filed, Notice of its filing will be published in the Federal Register, the Board will most likely hold a public hearing at the designated site to ascertain community support, and comments will be reviewed. At the present time, General Purpose FTZ applications take 8 to 12 months to receive approval. As a general rule, the initial General Purpose application requests warehousing permission only. Of course, if a manufacturing operation already exists within the property to be included within the General Purpose FTZ it is advisable to request the specific manufacturing authority at the time the General Purpose FTZ application is filed. To obtain manufacturing permission a great amount of detailed information concerning the manufacturing operation to be performed as well as the foreign material to be used must be included within the application. Furthermore, manufacturing operations within an FTZ come under close scrutiny and it is possible that a manufacturing request may slow up the approval process.

In order to establish a subzone, an application must be filed with the Foreign-Trade Zones Board in Washington, D.C. Although the application is generally prepared by the subzone user, the application must be sponsored by the appropriate Grantee. Like the General Purpose FTZ application, a subzone application consists of 5 Exhibits, the most significant one being Exhibit 4 which sets forth the economic justification for the establishment of the subzone. A subzone applicant must initially satisfy the three threshold criteria set forth in the Foreign-Trade Zones Board Regulations. The Board will reject the subzone application if it determines affirmatively that either:

- a. the activity is inconsistent to U.S. trade and tariff law, or policy which has been formally adopted by the Executive Branch; or
- b. Board approval of the activity would seriously prejudice U.S. tariff and trade negotiations or other initiatives; or
- c. the activity involves items subject to quantitative import controls or inverted tariffs and the use of the zone procedures would **be the direct and sole cause of imports**, that would not likely have occurred if zone procedures were not allowed.

If the application satisfies the threshold requirements, the following economic factors will be considered by the Board in evaluating the application:

- a. Overall employment impact;
- b. Exports and reexports;
- c. Retention or creation of manufacturing activity;
- d. Extent of value-added activity;
- e. Overall effect on import levels of relevant products, including import displacement;
- f. Extent and nature of foreign competition in relevant products;
- g. Impact on related domestic industry, taking into account market conditions; and
- h. Other relevant information relating to public interest and net economic impact considerations, including technology transfers and investment effects

At the present time, subzone applications, depending upon their complexity and the sensitivity of the industry involved, take 9 to 15 months to receive approval.

ROLE OF FOREIGN-TRADE ZONES BOARD

1. Review FTZ applications, expansion applications, subzone applications, manufacturing requests and boundary modification requests and issue Board Orders.
2. All ongoing activities are subject to review 15 C.F.R. 400.31(d)(1). The principal focus of reviews is likely to be manufacturing/processing operations. However, virtually any facet of zone operations is subject to review. The purpose of a review is to determine whether the zone based activity is in compliance with the Act, Regulations and Grant of Authority. An additional purpose for conducting a review is to determine whether a change in the circumstances associated with an approved activity requires a new public interest evaluation -- has the activity become detrimental to the public interest.
3. The Board may revoke a grant in whole or in part for repeated and willful violations of the Act 15 C.F.R.400.28(c).
4. A request for manufacturing/processing in an approved zone or subzone is subject to approval either through informal procedures or formal procedures 15 C.F.R. 400.28(a)(2) and 400.32(b).
5. Zone Schedules are subject to review by the Executive Secretary 15 C.F.R. 400.42(a)(2) and 400.42(b)(3).
6. Zone-restricted merchandise may be permitted to be returned into the customs territory by request to the Board 15 C.F.R. 400.44(c).
7. Retail trade requests may be processed by the Executive Secretary 15 C.F.R. 400.45.
8. Board shall publish Annual Report 15 C.F.R. 400.46(d)(2).

ROLE OF CBP

1. Port Director is local Representative of the Foreign-Trade Zones Board 19 C.F.R. 146.2; 15 C.F.R. 400.41.
2. Port Director approves activation and alteration requests 19 C.F.R. 146.6 and 146.7.
3. CPB will conduct spot checks and audits.
4. CBP will provide recommendation to the Board with regard to requests to return zone restricted merchandise into the customs territory 15 C.F.R. 400.44(b)(4).

ROLE OF ZONE GRANTEE

1. File all applications with the Foreign-Trade Zones Board.
2. Assist in marketing of zone project.
3. Select Operator.
4. Insure maintenance of facilities. 19 U.S.C. 811.
5. Insure zone is run as public utility. 19 U.S.C. 81n.
6. Concur in all activation requests filed with CBP 19 C.F.R. 146.6..
7. Insure that the Annual Report is timely filed with the FTZ Board. 19 U.S.C. 81p(b); 15 C.F.R. 400.46(d).
8. Submit the Zone Schedule to the Executive Secretary and the District Director 15 C.F.R.400.42(b).
9. Submit requests to CBP with regard to whether an activity constitutes retail trade and can be conducted within zone 15 C.F.R. 400.45(a).

ROLE OF ZONE OPERATOR

1. Supervise all admissions, transfers, removals, recordkeeping, manipulations, manufacturing, destruction, exhibition, physical and procedural security and conditions of storage in zone as required by law and regulations. 19 C.F.R. 146.4.
2. Payment of activation fee and annual fee. 19 C.F.R. 146.5.
3. Prepare written application to the District Director for activation of zone. 19 C.F.R. 146.6.
4. Make written application to the District Director for approval of an alteration of an activated area. 19 C.F.R. 146.7.
5. File the requisite Customs Form 301 Foreign Trade Zone Operator's Bond with the District Director. 19 C.F.R. 146.7.
6. Sign all C.F. 214s permitting merchandise to be place into the zone. 19 C.F.R. 146.9.
7. Prepare a Procedures Manual outlining the inventory control system and recordkeeping system to be followed at the zone. 19 C.F.R. 146.21.

8. Responsible for preparing a reconciliation report within 90 days after the end of the zone/subzone year. 19 C.F.R. 146.25.
9. Perform an annual internal review of the inventory control and recordkeeping system and report discrepancies to the District Director. 19 C.F.R. 146.26.
10. Maintenance of admission documentation. 19 C.F.R. 146.37.
11. Collect all in-bond documentation. 19 C.F.R. 146.40.
12. Filing of C.F. 216 for permission to manipulate, manufacture, exhibit or destroy merchandise in a zone. 19 C.F.R. 146.52.
13. Report shortages and overages to CBP. 19 C.F.R. 146.53.

ROLE OF ZONE USER

1. Payment of customs duties for merchandise entering customs territory.
2. In many instances, the zone user is responsible for maintenance of inventory control records, particularly where the zone user has physical possession of zone merchandise. 19 C.F.R. 146.4.
3. In many instances the zone user is the zone operator -- subzones.