

# Foreign-Trade Zones

*The Rockford Area, with the Chicago/Rockford International Airport (RFD) as grantee, enjoys Foreign Trade Zone #176 status. RFD also houses the Rockford Port of Entry.*

## What is a Foreign-Trade Zone?

A foreign-trade zone is a restricted-access site, in or within 60 miles or 90 minutes driving time, to a Customs port of entry that operates under the sponsorship of a corporation granted authority by the U.S. Foreign-Trade Zones Board and under supervision of the Customs Service.

## What are the Benefits of a Foreign-Trade Zone?

Foreign Trade Zones (FTZs) are treated, for the purposes of tariff laws and Customs entry procedures, as being outside of the Customs Territory of the United States. Foreign and domestic merchandise may be admitted into zones for operations such as storage, exhibition, assembly, manufacture and processing, without being subject to formal Customs entry procedures, the payment of Customs duties, or the payment of federal excise taxes. When merchandise is removed from the FTZ, Customs duties may be eliminated if the goods are then exported from the United States. If the merchandise is formally entered into U.S. commerce, Customs duties and excise taxes are due at the time of transfer from the FTZ.

For U.S.-based companies involved in international trade, the FTZ program provides a means of improving their competitive position vis-a-vis their ability to defer, reduce or even eliminate Customs duties on products admitted to the zone. There is no time limit on the length of time that merchandise can remain in a zone. This benefit equates to a cash flow savings that allows companies to keep critical funds accessible for their operating needs while the merchandise remains in the zone.

## What activities are permitted in a Foreign-Trade Zone?

Merchandise entering a zone may be:

Assembled	Displayed	Stored
Tested	Repaired	Manufactured
Sampled	Manipulated	Salvaged
Relabeled	Mixed	Destroyed
Repackaged	Cleaned	Processed

## Application Procedure:

Applications are submitted to the Foreign-Trade Zones Board (Dept. of Commerce). The application must provide extensive information on the proposed zone project. Customarily, applicants are state or local government entities, port or airport authorities, economic development agencies or not-for-profit corporations. If a private corporation requests subzone status, the application is submitted by the grantee of the FTZ on behalf of that company.

## FTZ #176:

2004/2005 FY volume: ~\$45 Million of product

Size: 2,700 acres in Rockford, Rochelle and Woodstock

Type: General purpose

Structure: Consists of 4 subzones (1 activated) and 7 general purpose zone sites (2 activated)

# FTZ BENEFITS

## CASH FLOW, INVENTORY, TAX & SUPPLY CHAIN SAVINGS

- ✓ **Cash Flow** – Customs duties are paid only when foreign merchandise is shipped into US Customs territory. Therefore, standing inventory is held in the FTZ subzone/site without duty, often resulting in large savings, particularly during the first year.
- ✓ **Weekly Entry: Customs broker fee & MPF (merchandise processing fee)** – The Customs broker collects fees for preparing and filing each entry with U.S. Customs & Border Protection; Customs collects the MPF, which is assessed (with a minimum of \$25 and a maximum of \$485) against each entry filed. The FTZ program allows consolidation from daily or per-container entries into weekly entries, often resulting in a substantial savings.
- ✓ **Supply chain timeline** – There is no need to hold product for customs clearance. This often results in a 1-3 day reduction in the supply chain which benefits not only manufacturers and other end users, but 3PL (third party logistics) providers.
- ✓ **Direct delivery** – With prior approval by Customs, FTZ operators can facilitate the movement of foreign product: they do not need to wait for Customs officers to be present before breaking seals or even shipping products. This benefit is especially valuable to 3PL's and large distribution centers with cross dock operations.
- ✓ **Return on Investment** – Normally, the ROI will be begin 12-18 months from start of the project.
- ✓ **Duty deferral** – There is significant deferral on the average inventory during the first year in the FTZ program with capital costs captured each subsequent year.
- ✓ **Inventory Control** – FTZ reporting demands accurate reporting to follow foreign merchandise from receipt, processing and shipment for export or entry in the Customs territory of the U.S, reducing inaccurate inventory, emergency shipments and tracking of all import receipts from the point of origin to the final destination. In this post-9/11 age, additional reporting requirements (10+2 filing/Safe Port Act of 2006) will be required by the end of 2007. Increased accountability will reduce staff time needed to deal with government regulations.
- ✓ **Quality Assurance & Customs compliance** – With the high quality of inventory control systems required, quality control is a side benefit. These benefits include location and tracing of all foreign merchandise, including those returned or destroyed under Customs supervision. This reporting will assure that only duty or associated fees will be paid. In addition, the system can help pinpoint problems in production.
- ✓ **Accounting system** – Fungible inventory methods, such as FIFO and FOFI (Foreign First) inventory accounting methods, have been approved by Customs for zone operations.
- ✓ **Inventory insurance costs** – The insurable value of foreign merchandise in an FTZ subzone/site will not include Customs duties already paid, reducing insurance premiums.
- ✓ **Cargo insurance** – Some FTZ operators and end users have been successful in negotiating a reduction in cargo insurance rates by arguing that direct shipment avoids pilferage opportunities at the point of Customs entry.

## IMPORT, EXPORT & ZONE-TO-ZONE TRANSFER

- ✓ **Exports** – Foreign merchandise in the zone may be re-exported free of duty and federal excise tax.
- ✓ **Export returns** – Returns of foreign merchandise to exporters using the FTZ program pay no duties on these products. Outside the zone, duties were paid upon export and again on return.
- ✓ **Duty Drawback** – Outside of the FTZ, drawback on returns allow recovery of previously-paid customs duty. This includes products that remain on site (such as manufacturing equipment), in the Customs territory, or exported outside the U.S. For items exported, the law is especially complex and the company often experiences a long wait for the funds. Inside the zone, no duties are paid so this cumbersome process is not necessary.
- ✓ **Bonded warehouses** – These offer many of the same benefits as the FTZ but historically have placed two restrictions: 1) a time limit; and 2) goods entering a FTZ subzone/site from a bonded warehouse must be admitted in Zone Restricted (ZR) status. ZR status means this merchandise cannot benefit from the inverted tariff relief.
- ✓ **Zone-to-Zone transfer** – Duty deferral benefits are available when transferring product "in bond" from one zone to another. This may be most beneficial to firms with multiple FTZ subzones/sites around the country or for 3PL's serving an end user who may hold their own FTZ status – also to box stores with regional warehouses each holding FTZ designation. It is also possible to pay duty on the original price of the component to the first FTZ user, not on the subsequent prices.
- ✓ **Temporary Importation Bond (TIB)** – The TIB allows merchandise to enter the U.S. in-bond. It can also be used to ship from the FTZ location to a location inside the U.S. Customs territory for processing and return to that FTZ subzone/site for further processing and eventual sale in the U.S.
- ✓ **Temporary removal procedure/exhibition** – Merchandise may be removed from an FTZ subzone/site in-bond and returned without Customs duty payment. Examples would include demonstration models for trade shows or special traveling displays.
- ✓ **Antidumping/Countervailing duties** – Use of an FTZ defers the payment of these duties until merchandise enters the U.S. Customs territory. Exported merchandise is not subject to these duties.

- ✓ **Entireties Provision** - Importers can decide whether to apply the entireties provision (all necessary parts classified as the finished product) to merchandise admitted to an FTZ
- ✓ **General System of Preferences (GSP)** – Products deleted from the GSP list that were admitted to an FTZ in Privileged Foreign (PF) status, may retain the GSP duty-free status even after the change date.

#### U.S. QUOTAS

- ✓ **Timing** – Merchandise may be held in an FTZ subzone/site, even if it is subject to a U.S. quota restriction. When the quota is lifted, the merchandise may be entered immediately in the U.S. marketplace for distribution, providing a distinct marketing and sales advantage.
- ✓ **Avoidance** – If foreign merchandise within an FTZ subzone/site is ‘substantially transformed’ into a non-quota item, it can enter Customs territory without the quota restrictions.

#### PRODUCTION

- ✓ **Scrap/waste/damaged goods** – No duties are paid on most scrapped product. If the FTZ user is paid for the scrap, duty is assessed against the lower scrap value.
- ✓ **Consumed merchandise** – Merchandise consumed in processing in the FTZ is generally not subject to Customs duties.
- ✓ **Inverted tariff** – In situations where zone manufacturing results in a finished product that has a lower duty rate than the rates on foreign inputs (inverted tariff), the finished products may be entered at the duty rate that applies to its condition as it leaves the zone – subject to public interest considerations.
- ✓ **Value Added** – Value added to merchandise in an FTZ subzone/site is not dutiable. Customs duties are not owed on labor, overhead and profit attributed to production operations in the FTZ.
- ✓ **Production equipment** – Certain duty deferral and reduction benefits apply on production equipment admitted to the FTZ for assembly and testing prior to use in production. Duties are deferred until the equipment is placed in service. During the assembly and testing period (which can be substantial for a complex assembly or manufacturing process), no duties are paid. If the machine is defective, no drawback is necessary if part or all is returned to the manufacturer overseas. Since no duty is paid until it is a functional part of the production line, payment of duty moves much closer to the generation of revenue, resulting in a substantial cash flow savings. In addition, the duty rates on parts are often higher than the finished unit, producing direct duty savings.
- ✓ **Spare parts** – While just-in-time supply chain logistics and lean manufacturing have transformed much of the industrial landscape in the past 25 years, many suppliers still hold spare parts in this country for immediate shipment. This foreign merchandise may be held in the FTZ or returned to the vendor free of duty or destroyed without payment of duty as the product never entered the U.S. commerce.
- ✓ **Security** – Customs & Border Protection (CPB) is responsible for FTZ supervision and security requirements. Penalties are severe (2 years in prison and \$250,000/offense) for unauthorized withdrawal, including employee theft. For many employers, this is a decided benefit.
- ✓ **Commingling** – Domestic and foreign merchandise may be commingled in the FTZ.

#### TAX, COMPLIANCE ISSUES & OTHER BENEFITS

- ✓ **Inventory taxes** – In several states, ad valorem taxes on inventory are assessed. By federal law, merchandise inside the FTZ is not inside the U.S. Customs territory, and therefore not subject to these taxes.
- ✓ **Transfer of title** – Title to merchandise may be transferred in the FTZ, as long as there is no "retail" sale. The global supplier can own it until it is shipped just-in-time to local manufacturers.
- ✓ **Federal laws restricting import** – Various federal laws govern the ability to import foreign merchandise, often restricting or prohibiting for a variety of reasons. Some FDA, DOT, EPA and USDA laws may not apply to goods while inside the FTZ.
- ✓ **Changing circumstances** – U.S. laws relating to Customs, quotas, and international trade are constantly in flux. FTZ status provides great flexibility in responding to these external regulations. The 3 benefits below illustrate current savings available as a result of FTZ status.

*The following State of Illinois benefits are available to businesses operating inside one or more State-designated areas such as Enterprise Zone, FTZ, or River's Edge Redevelopment Zone. Inclusion in several areas will not restrict access, but benefits are available under only one designation. Business must be designated as a "high impact business" (see 20 ILCS 655/5.5, 1997), with notification of determination within 90 days after application.*

- ✓ **Illinois Job Creation Incentives** – Available to FTZ operators/users adding 5 or more full-time (30 hours per week or more) employees during one tax year and employed 180 consecutive days: employers will be eligible for a tax credit in the amount of \$500 per eligible employee (see 35 ILCS 5/201 from Ch. 120, par 2-201).
- ✓ **Illinois Investment Credit** – Business taxpayers spending \$12,000 in improvements designed to create 500 full-time equivalent jobs or \$30,000 to create 1,500 full-time jobs will be eligible for one-half of one percent of basis of property that is placed in service. (see 20 ILCS 655/5.5 and 35 ILCS 5/203 from Ch. 120 par 2-203)
- ✓ **Illinois Municipality tax on public utilities** – May be exempt from taxes on utilities for a period not to exceed 20 years (see 65 ILCS 5/8-11-2, 1997).