Why Use a Foreign Trade Zone?

by Kenneth D. Morris, Esq.

Foreign Trade Zones (FTZs) are generally restricted-access sites in or adjacent to a Customs port of entry, but legally defined as outside the Customs Territory of the United States. These zones may be operated by a public or private corporation with the authorization of the Foreign Trade Zones Board and with U.S. Customs oversight. The FTZ allows domestic or foreign businesses to conduct certain operations inside the zone without being subject to formal Customs entry procedure and payment of duties and tariffs. Although retail trade is not allowed in a zone, a business can conduct a wide range of activities, including without limitation, assembly, processing, relabeling, manufacture, testing, repackaging, cleaning, repair, etc.

For economic reasons, using a FTZ can provide important benefits to a company. If an importer, for example, brings some merchandise into a FTZ for manufacture, if the resulting product requires a lower duty rate, the business pays the lower rate instead of the higher tariff at time of importation of the original merchandise. There is no duty paid while the article is being manipulated, repaired or stored in the FTZ. Additionally, if the item is re-exported, there is no duty. A FTZ can either be established to embrace multiple activities and multiple users or a specific company can establish a general-purpose zone for a specific use. Pennsylvania, for example, has six (6) FTZs. Several of those have sub-zones as well. In the Eastern part of the State, a FTZ exists for Philadelphia and Reading; Lehigh Valley was expected to apply for a FTZ in mid-2005.

How might the establishment of a specific zone benefit an individual company? Take, for example, a chemical processor. If the processor conducts operations within a zone, duty is owed only when the finished merchandise leaves the zone. Suppose a processor wants to produce chemical X in the United States but needs to import chemical Y in order to do so. Chemical Y carries a 15% duty. If he simply imports chemical Y, he will pay the 15% duty. Let's assume he imports $10,000,000 worth of chemical Y. The duty then is $1,500,000. But suppose he brings chemical Y into a zone and manufactures chemical X in the zone using the raw material there. Let's further assume the processing operations consume 30% of chemical Y during the processing. Perhaps it was heat during the processing which caused the loss; or perhaps it was scrap metal which was lost during the manufacture. After manufacturing chemical X, the company brings both X and Y out of the zone. But when the company then brings chemical Y out of the zone, the 15% duty is only applied to $7,000,000 worth of chemical because of the 30% loss. Instead of paying duty on the full $10,000,000 had it originally been imported into the U.S., the company has just saved $450,000 by using the zone to do the processing since the 15% is applied to $7,000,000 instead of the full $10,000,000.

FTZs are generally governed by the rules of the Foreign Trade Zones Board. The Board has authority to entertain applications to enlarge zones or sub-zones. For example, in December, 2005, on behalf of Merck, the Philadelphia Regional Airport Authority, grantee of FTZ No. 35, submitted an application to the Board to expand Merck's sub-zone in West Point, Pennsylvania. Originally established in 1994, Merck is now seeking to add 168 buildings to the sub-zone to expand production capacity. Such expansions are an important tool for a company seeking to stay competitive and increase production efficiencies. Those savings can be passed on to research and other development activities.

Why are FTZs increasingly attractive? One reason has to do with the Trade Development Act of 2000. Companies using FTZs now can file weekly entry summaries with U.S. Customs when goods leave the zone. Weekly filings reduce the time and expense of filing for each shipment. Not only does this reduce the company's internal cost, but it also reduces customs brokerage fees and the importer's Merchandise Processing Fee. That Fee is typically assessed by U.S. Customs at a rate of 21% on the value of merchandise of each entry, with a maximum of $485 per entry. Now, instead of paying thousands of dollars on many entries each week, the importer pays only $485 for a single weekly entry. In some cases, the savings could easily reach many thousands of dollars.

Another reason has to do with security. Because of the security precautions already in place in a FTZ, shippers find it easier to participate in Customs Trade Partnership Against Terrorism (C-TPAT). Participation by an importer in C-TPAT is voluntary; participation, however, promises to reduce security criteria for importation, thus saving time and money for the company. New security criteria was published only in 2005 and developed further in communication with the trade community. Although the initial burdens a company must meet may require some considerable time, Customs believes that participation will mean an importer is six times less likely to undergo a security-related cargo examination and four times less likely to undergo a trade-related examination than companies which do not particiate. Less disruptions for any company's Supply Chain means greater predictability and savings in time and money. In order for an importer to be C-TPAT certified, he must meet the requirements of the C-TPAT Security Criteria document. Fundamentally, an importer will need to apply risk analysis to all aspects of the importation supply chain. For example, various security measures must be in place and verified if a foreign facility is used.

As of March 25, 2005, importers new to the C-TPAT program will have their security profile verified against revised security criteria. Companies already certified will have 180 days to bring their own security measures into compliance. The benefits of participation in this program will mean fewer cargo inspections (less delay) and greater speed to entry.

If you would like to learn more on the benefits of using a Foreign Trade Zone, please contact me:

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