Everything You Want To Know About Foreign-Trade Zones

Foreign-Trade Zone FAQ

A QAD Leadership White Paper for
Global Trade and Transportation Execution

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EVERYTHING YOU WANT TO KNOW ABOUT FOREIGN-TRADE ZONES

The United States Foreign-Trade Zones (FTZ) program was created in 1934 when Congress passed the US Foreign- Trade Zones Act.

The Act was one of two key pieces of legislation passed in the midst of the Great Depression. It was an attempt to mitigate some of the destructive effects of the 1930 Smoot-Hawley Tariffs.

It was intended to “expedite and encourage foreign commerce” in the United States. The Act designated certain geographic areas as Foreign-Trade Zones, in or adjacent to US Customs Ports of Entry. These are under the oversight of the US Bureau of Customs and Border Protection (CBP).

Commercial merchandise would be treated, for Customs purposes, as though it were outside the commerce of the United States.

Since 1986, regulatory oversight for FTZ sites has been conducted on an audit-inspection basis.

Merchandise of every description may be held in a zone without being subject to Customs duties and other ad valorem taxes.

This is designed to lower the costs of US-based operations engaged in international trade. As a result, this helps create and retain the employment and capital investment opportunities.

THE BENEFITS OF FTZS

An FTZ enables companies to lower importing costs and enhance inventory control as well as improve supply chain velocity and flexibility. In this section we outline how FTZs benefit enterprises.

RELIEF FROM INVERTED TARIFFS

Inverted tariffs occur when a component or raw material is subject to a higher duty rate than the finished product.

The Foreign-Trade Zone program allows companies to obtain relief from inverted tariffs.

Without the help of an FTZ, importers of certain finished products pay a lower duty rate than a US-based manufacturer of the same product. This gives the importer an unintended advantage over the domestic manufacturer.

The Foreign-Trade Zones Program levels the playing field in these circumstances.

For example: A Foreign-Trade Zone user imports a motor (which carries a 4 percent duty rate)[1]. It is then used in the production of a vacuum cleaner (which is duty free)[2]. When the vacuum cleaner leaves the FTZ, it enters US commerce. Now, the duty rate on the motor drops from the 4 percent rate to the “free” vacuum cleaner rate.

However, if the manufacturer had not used an FTZ, it would have been required to pay the 4 percent duty rate.

By participating in the zones program, the manufacturer is able to eliminate the duty on the component. As a result, the manufacturer reduced its component cost by 4 percent.

DUTY EXEMPTION ON RE-EXPORTS

Typically, an importer is required to pay customs duties at the time the imported merchandise enters US commerce.

Foreign-Trade Zones on the other hand are considered to be outside US commerce. Therefore, no customs duty is owed on foreign merchandise unless and until it leaves the zone for domestic consumption.

If the foreign merchandise is exported from the zone, no duty is ever due. Duty avoidance on re-exports is one of the biggest cost-saving benefits of an FTZ.

Companies are more competitive if they can avoid duties on imported merchandise that is re-exported. FTZs allow them to stage their merchandise for international distribution from the US. Therefore, a company can keep its US-based distribution operations efficient, and pursue international sales at the same time.

DUTY ELIMINATION

An often overlooked FTZ benefit is duty elimination on waste, scrap, and yield loss.

Without a zone, an importer pays the customs duty as material is brought into the United States. In a zone, only the merchandise that subsequently enters US commerce is dutiable.

No duty is paid on irrecoverable yield loss or merchandise that is scrapped or destroyed in the zone.

There are also zone advantages for recoverable scrap that can be sold or recycled.

DAMAGED OR NON-CONFORMING ITEMS

Companies can use a Foreign-Trade Zone to obtain savings related to damaged or non-conforming items.

No duties are owed on defective or damaged merchandise while it is being tested, repaired, or stored in an FTZ.

Merchandise may be altered, repackaged, and/or relabeled while in a zone to meet US requirements.

Furthermore, no duty is required if merchandise is re-exported.

> This flexibility and control over inventory disposition can eliminate the need to file complex claims with US Customs.

Companies can also use FTZs to mark the country of origin, or other regulatory labeling, before goods enter the US. This may yield significant cost savings compared to using foreign labeling or operations.

WEEKLY ENTRY SAVINGS

Under Weekly Entry procedures, the zone user files only one Customs entry per week, rather than filing one per shipment.

Thus, CBP does not process an entry for each and every import shipment. As a result, the zone user pays for only one entry per week.

Until 2000, this benefit was available only to FTZ manufacturing operations.

Companies located outside of a Foreign-Trade Zone pay a Merchandise Processing Fee (MPF) for each and every formal Customs entry (shipment).

The MPF is a fee based on 0.3464[3] percent of the value of the merchandise being entered. This does not include duty, freight, and insurance charges.

There is a minimum $27.23 and a maximum $528.33 MPF[4] per entry, regardless of the duty rate on the imported merchandise.

The reduction of MPF under FTZ weekly entry procedures is where many importers can yield substantial savings from the FTZ Program.

For example:

- An importer receives 10 shipments per week.
- Each has a value of $200,000.
- Without an FTZ, the importer pays the maximum MPF of $528.33 on each of the 10 shipments, resulting in a total MPF cost of $5,283.30 for that week ($528.33 x 10).
- Under FTZ weekly entry procedures, the importer makes one entry per week as goods leave the zone, regardless of the number of shipments from the zone, and pays a single MPF capped at $528.33.
- Per annum, the importer pays an MPF $27,473.16 ($528.33x 52 weeks) instead of the much higher amount of MPF if a zone was not utilized.

The example stated produces weekly savings of $4,754.97 and annual savings of $247,258.44.

Weekly Entry procedures in Foreign-Trade Zones enable companies to remain competitive from US locations.

CASH FLOW (DUTY DEFERRAL)

In a Foreign-Trade Zone, duty payment is deferred on merchandise brought into a zone. Duties are only paid when goods are entered into US commerce. The additional cash flow may be used as working capital to earn interest or be invested.

This benefit is similar in concept to free trade zones in other countries. It can be especially important to companies with high volume imports or merchandise with high duty rates, such as textile products.

ZONE-TO-ZONE TRANSFERS

A vendor located in one FTZ may sell goods to a company located in another zone. The vendor can transfer those goods to the purchasing company's FTZ with no duty paid on the goods.

Manufacturers whose end products have a lower duty rate than the raw materials or components can receive those raw materials from another zone duty unpaid. This can reduce or eliminate the raw material and component duty rates.
As a consequence, US suppliers can be more competitive than they otherwise would be were they to pass their duty costs on to their US-based customers.

GOVERNMENT AND MILITARY SALES

Foreign merchandise may be entered into the United States duty free if the vendor has a qualifying government contract in place.

No entry is filed with CBP until the product leaves a zone. With FTZ status, companies can defer making Customs entries until the qualifying government contract is in place.

This benefit is particularly important to US-based manufacturers who manufacture products for both commercial and government sales. Sometimes companies import parts before they know what number of finished goods will be sold to the government. A number of parts may be used in goods sold to the government. Others will be incorporated into products sold in commercial markets.

US-based military suppliers need to remain competitively priced. FTZs allow them to implement a cost-reduction strategy for both military and commercial operations.

AD VALOREM TAX RELIEF

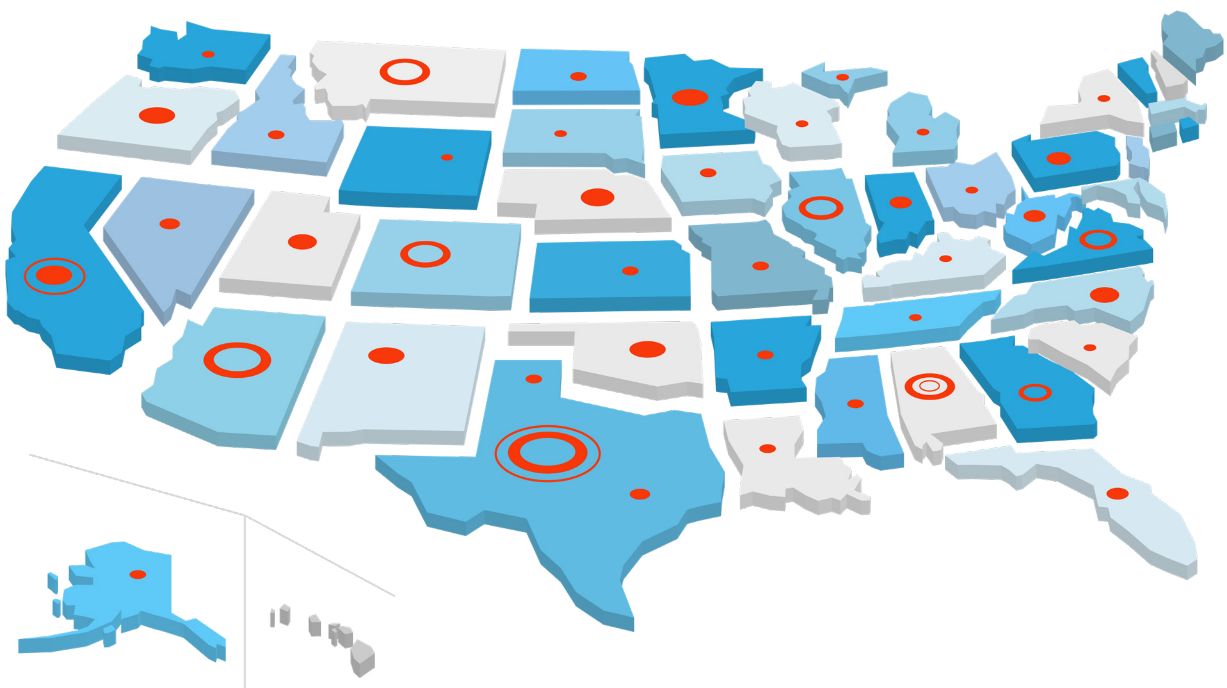
The federal law that established the US Foreign-Trade Zones Program allows companies to obtain exemptions from inventory taxes.

The Foreign-Trade Zones Act exempts most merchandise from such taxes in Foreign-Trade Zones.

Certain tangible personal property is generally exempt from state and local ad valorem taxes. However, a small number of states assess local taxes on business inventories.

WHERE ARE ZONES LOCATED?

There are Foreign-Trade Zones in all 50 states and Puerto Rico. Each zone is established through the authorization of the US Foreign-Trade Zones Board to a local “Grantee” organization. A Grantee is the corporation (almost always a public entity) to whom the privilege of establishing, operating, and maintaining a Foreign-Trade Zone project has been granted by the FTZ Board. Companies that use zones do so under the auspices of their local grantee organizations.



HOW DO YOU GET ZONE APPROVAL?

OBTAINING FOREIGN-TRADE ZONE STATUS

In order to realize the benefits offered by the Foreign-Trade Zones Program, your company must:

- Be located in an FTZ or
- Receive FTZ site designation, and
- Be approved to commence FTZ operations ("activated")

Companies receive FTZ site designation from the Foreign-Trade Zones Board. Companies are approved for FTZ activation by the local office of Customs and Border Protection.

ACTIVATION WITH CUSTOMS AND BORDER PROTECTION

Before you can "go-live" and begin receiving your FTZ benefits, you must activate with the CBP.

About 10 percent of this process is regulatory paperwork and documentation. The majority of a successful activation relies on the implementation of efficient operations, procedures, and systems.

IMPLEMENTATION OF SOFTWARE

Companies operating an FTZ need a robust Foreign-Trade Zone inventory and record keeping system. This allows them to manage day-to-day FTZ operations. The system will need to:

- Meet CBP regulatory requirements
- Produce CBP reports, forms, and CBP entry documentation
- Perform many other tasks and processes unique to the Foreign-Trade Zones program

WHAT ARE THE CHALLENGES TO FTZ ACTIVATION?

You need to craft a detailed and well thought out project plan and sustainable process for your FTZ. Failure to do so can lead to significant challenges. This can include fines, penalties, and liquidated damages resulting from non-compliant operations.

WHAT ARE FTZ MANAGED SERVICES?

Companies want to maximize the benefits of being in a zone; however, they may not have the time, resources, and experience needed to compliantly manage their FTZ operations.

By outsourcing administration, companies can obtain greater levels of efficiency, compliance and savings.

HOW QAD CAN HELP

There are a number of methods to obtain FTZ status. QAD is uniquely qualified to ensure you receive this designation. We have a 100 percent success rate and unmatched level of expertise.

We will work to gain a complete and accurate understanding of your supply chain transactions. QAD FTZ experts have years of hands-on experience combined with consulting success. This ensures your firm will have a successful FTZ activation, built on efficient and compliant procedures. In short, we will ensure that you maximize your FTZ savings.

QAD FTZ also offers the most technologically advanced software available. Designed by true FTZ practitioners, our software ensures that you are, and will remain, compliant.

QAD's FTZ experts have an exceptional success rate for applications to the FTZ Board.
We can help you with:

- Feasibility and cost-benefit analysis
- Foreign-Trade Zone site designation
- Foreign-Trade Zone Production Authority
- Activation with US Customs and Border Protection (CBP)
- Re-engineering your current FTZ operations to maximize savings
- FTZ project administration

QAD is also available to assist zone users with compliance questions, conduct compliance reviews, and provide FTZ marketing services.

Furthermore, we can also provide FTZ Managed Services. QAD's experienced FTZ consultants handle all day-to-day operations for FTZ users. This alleviates common problems like employee turnover and high operating expenses. QAD manages zones of all sizes and can manage multiple zone sites as well.

QAD's FTZ experts have helped companies in numerous industries to successfully apply for and activate Foreign-Trade Zones. These include:

- Aerospace products
- Automobiles and automotive parts and components
- Bulk chemicals
- Dietary supplements
- Electronics
- Forklifts
- Life Sciences and pharmaceuticals
- Petroleum and petrochemicals
- Shipbuilding and repair
- Textiles
- Upholstered furniture

ABOUT QAD - TRUSTED GLOBAL TRADE AND TRANSPORTATION EXECUTION (GTTE)

QAD GTTE provides industry-leading global trade compliance, and multi carrier transportation execution solutions from a single, integrated platform. An ISO-certified company, QAD assists companies to streamline their import, export and transportation operations, optimize deliveries, and increase logistics ROI. QAD GTTE is a scalable and extensible solution that integrates with existing ERP and WMS solutions. Industry leaders in every region of the world rely on QAD to leverage thousands of carrier services and manage millions of global trade and shipping transactions every day.

For more information about QAD, visit our website: www.qad.com

Notes

[1] Correct as of April 2021. Duty rates are subject to change.

[2] Correct as of April 2021. Duty rates are subject to change.

[3] Correct as of May 2023. May be subject to change.

[4] Correct as of May 2023. May be subject to change.

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