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Corporate Law Alert

FOREIGN TRADE ZONES – RELIEF FROM TAX AND TARIFF COSTS

By Ashley A. Brackin

What is a Foreign Trade Zone? It is a program established by the federal government in the 1930's to expedite and encourage foreign commerce in the United States and to increase the global competitiveness of U.S. based companies.[1] Legally, a "Foreign Trade Zone" or "Zone" is a geographical area in or adjacent to United States Customs ports of entry where commercial merchandise receives the same customs treatment it would have if it were outside the commerce of the United States. Within the Zone, commercial merchandise of every description may be held without being subject to Customs entry procedures, import duties, and other ad valorem taxes.[2] This tax and tariff relief is designed to lower the costs of U.S. based manufacturing operations while creating and retaining the employment and capital investment opportunities that result from those operations.

The Foreign Trade Zone Program allows a manufacturer located in the United States to bring foreign-sourced parts or materials into a Zone, pay no duty, and incorporate those parts or materials into a finished product using U.S. parts and labor.[3] If the finished product enters the United States commerce, a manufacturer pays a duty on the value of the foreign non-duty-paid content only. If, however, the final product is exported from the United States, no customs duty or excise tax is levied. Thus, the Foreign Trade Zones Program has allowed U.S. based manufacturers to engage in economic sourcing from both foreign and domestic suppliers while displacing the duties otherwise levied on domestically finished products containing foreign parts.

How Can Foreign Trade Zones Save Your Company Money? The main economic benefit derived from participating in the Foreign Trade Program is relief from certain taxes and duties that otherwise would be imposed outside of a Zone. The following are a few important economic benefits that encourage companies to use the Program:

- *Relief from inverted tariffs.* If foreign supplies are brought into a Zone and manufactured into a product that carries a lower duty rate, the lower rate applies to the foreign content when the duty is paid.
- *Duty exemption on labor, overhead, and profit.* In calculating the dutiable value of foreign materials removed from a Zone, manufacturers may exclude zone costs of processing or fabrication, general expenses, and profit.[4] Therefore, customs duties are not owed on labor, overhead, and profit attributed to production in a Foreign Trade Zone.
- *Duty exemption on waste and scrap.* No duty is charged on most waste and scrap from production in Foreign Trade Zones.[5]
- *Relief from local ad valorem taxes.* Foreign manufacturing materials stored in a Zone or held in a Zone for export are not subject to any state or local ad valorem taxes.

The Foreign Trade Zone Program allows U.S. based companies participating in international trade to improve their competitive position by using their counterparts abroad while deferring, reducing, or even eliminating duties on foreign products admitted to the Zone. For this reason, U.S. based companies are continuing to establish operations in more than two hundred and fifty Zones located throughout the United States. To establish a Zone, a detailed application providing detailed information on a proposed zone project must be submitted and extensively reviewed by the Foreign Trade Zones Board/U.S. Department of Commerce. The attorneys at Adams and Reese LLP have the experience to advise you on the application for and use of the Foreign Trade Zone Program. Please contact us for advice on Foreign Trade Zone applications and issues.

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[1] The National Association of Foreign-Trade Zones <http://www.naftz.org>
[2] BIDC Business and Industry Data Center <http://www.bidc.state.tx.us>
[3] The Foreign-Trade-Zone Research Center <http://foreign-trade-zone.com>
[4] The National Association of Foreign-Trade Zones <http://www.naftz.org>
[5] The Foreign-Trade Zone Corporation <http://ftzcorp.com>

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