

IN THE ZONE

Creating Profits Through Savings Using Foreign-Trade Zones

BY JAMES F. CHESTER

Benjamin Franklin wrote, "A penny saved is a penny earned." Any U.S. company still around after the tumultuous early years of this decade can attest to the truth of that statement. Many companies managed to survive tough economic times, not by increasing revenue, but by implementing cost-cutting concepts, such as Six Sigma, just-in-time inventories and outsourcing. Some companies tapped into another money-saving tool: a foreign-trade zone (FTZ).

Although FTZs have been around nearly as long as the federal income tax, most current FTZ users became involved in the program within the past 20 years. Created by the Foreign-Trade Zone Act of 1934 — codified at 19 U.S.C. §81a, *et seq.* as amended in 2002 — FTZs are located within the United States but are considered to be outside the U.S. customs territory. As such, goods admitted into FTZs receive special benefits. Although oversight of the national FTZ program is vested in the Foreign-Trade Zone Board, day-to-day FTZ operations are supervised by U.S. Customs and Border Protection (Customs).

FTZs offer companies numerous ways to save on administrative costs, duties, taxes and fees. The extent to which a particular benefit will result in cost-savings for a company depends on the company's products, sourcing and operations.

Perhaps the most well known FTZ benefit is the ability to defer payment of Customs duties indefinitely, because no duties are owed on goods admitted into an FTZ until they are shipped from the FTZ into the U.S. customs

territory. Consequently, no duties will be owed on goods exported from an FTZ to anywhere outside the country. Nationally, this benefit saves FTZ users billions of dollars each year in deferred or avoided duties.

Also, companies that manufacture within FTZs may choose between the duty rate on raw materials and the duty rate on finished products, whichever is lower. For example, many petrochemical companies along the Texas Gulf Coast save millions of dollars each year by carefully selecting the lower tariff rates.

In addition, most FTZ goods are exempt from state and local business inventory taxes as long as they remain in the FTZ. This benefit can generate substantial property tax savings for companies that maintain significant inventories in Texas. Although local freeport exemptions — a tax exemption that Texas law empowers municipalities to grant if they so choose — allow some tax savings, they are much more limited (e.g., the goods must leave Texas within 175 days), and require additional administrative efforts. For goods stored in FTZs, tax exemptions are automatic and indefinite. For example, one company in Southeast Texas saves more than \$1 million per year in business inventory taxes by storing goods in an FTZ.

FTZ users are also eligible to participate in special programs, such as being able to file a week's worth of shipments from the FTZ at once (as opposed to filing Customs entries for each shipment), which can substantially reduce administrative costs and customs fees. One Central Texas

technology company saves more than \$500,000 in Customs fees each year by using an FTZ.

There are two types of FTZs: a general purpose zone (GPZ) and a subzone. GPZs are usually located near border crossings, airports and seaports, and they look much like any other warehouse. Once a GPZ is established, any company wishing to use the GPZ may do so. A company can store its goods in the GPZ as needed, and it will pay storage and related fees to the GPZ operator accordingly. Of course, a company's FTZ operations will be limited to that which can be accommodated within the GPZ warehouse facility.

By contrast, subzones are generally designed to accommodate the operations of a single company, and they are located wherever the company's operations are. A company seeking to establish a subzone will incur substantial upfront costs in commissioning the necessary studies, preparing the FTZ application, and lobbying various local and national authorities for approval of the application. Thereafter, however, the company can internalize the day-to-day administration of the subzone and thus save on FTZ operational costs.

SIGNIFICANT BENEFITS

Whether a company chooses to use an existing GPZ or establish a subzone will depend on a number of factors. For instance, if a company wants to manufacture goods within the FTZ, most GPZs will not be able to accommodate the goods; using a subzone would be a better option. By contrast, if a company merely wants to store goods in an FTZ temporarily before shipping them

to customers, it may be able to use a GPZ and thus avoid the upfront cost and delay associated with establishing a new subzone.

Nationally, the Foreign Trade Zone Board has created more than 250 GPZs, plus another 400 subzones. In Texas, there are more than 30 GPZs and more than 60 subzones. Texas border towns such as Laredo and El Paso certainly have their share of FTZs, as do well-known international trade-hubs such as Dallas and Houston. However, FTZs are located throughout the state, and can be found in such off-the-radar international trade centers as Waco, Texarkana and Longview.

Due to the nature of the global marketplace, when one company begins using an FTZ, many of its industry competitors begin looking into FTZs or else risk losing market share. The petroleum refining industry is responsible for the largest segment of FTZ operations, although significant FTZ manufacturing also occurs in the automotive, electronic and pharmaceutical industries.

Although most FTZ users are large companies, the Foreign-Trade Zone

Board has recently begun reaching out to small and mid-sized enterprises in an effort to offer the benefits of FTZs to those companies. Many of these companies have operations that cannot be accommodated into the basic warehousing operations of a GPZ but cannot afford the significant capital investment required to establish a subzone. One solution is a type of hybrid FTZ created by establishing an additional FTZ *site*, rather than an entirely new GPZ or subzone. Like a subzone, the site may be a single warehouse, often several miles from the primary GPZ site, and may be meant to accommodate the needs of a single company. However, in most instances, adding a new FTZ site to an existing GPZ is significantly less expensive and time-consuming than creating a subzone. Thus, the hybrid FTZ allows companies to obtain the benefits and convenience of a subzone without investing the time and money required to establish one.

Whether a particular company can benefit from an FTZ must be determined on a case-by-case basis. Nevertheless, given the significant benefits FTZs allow, companies should investi-

gate the feasibility of using an FTZ to decide if they need to get "in the zone" — particularly if one or more of their competitors already are.

The first step for any company interested in FTZs is to complete a basic calculation to begin to quantify the estimated annual savings FTZs may give the company. If the initial calculation is promising, the company should commission a more detailed feasibility study, which should include an approximation of start-up and ongoing costs, a more thorough estimation of annual savings and a recommendation regarding the type of FTZ that would best fit the company's business plans. **I H T**

James F. Chester is a shareholder in the Dallas office of Davis Munck, where he chairs the firm's international business and trade practice group. He is an adjunct professor of international trade law at Baylor Law School and of business law at the University of Dallas. He holds a master of laws degree in international economic law, is licensed to practice law in Texas and Washington, D.C., and is a licensed customs broker.