By Marshall V. Miller, Esq.

Successful real estate professionals understand their marketplaces. When a U.S. company focuses on its global market, in many instances, this means that the company is establishing overseas manufacturing, production, and distribution operations. This can create a negative impact on the U.S. real estate professional. The Foreign-Trade Zone program provides the opportunity for firms in the U.S. to utilize U.S. facilities and real estate in their efforts to globalize their business. It is a very effective tool to lower the cost of production to make U.S. operations more attractive, as compared to similar activity in a foreign country.

Very few products are solely manufactured from U.S. materials; in almost every industry, foreign-sourced materials are essential. The Foreign-Trade Zone program takes this business reality and may create financial saving for U.S.-based activity. It also provides a mechanism to increase U.S. material use, because the operations are located near U.S. suppliers.

The Foreign-Trade Zone program is used by companies with a sophisticated view of financial management in the import/export process. These firms understand that the program provides unique financial advantages to U.S.-based warehousing, distribution, and production activity. A real estate professional that is reviewing all opportunities for the structuring of new facilities in the United States should understand the U.S. Foreign-Trade Zone program and how it can be an effective tool to structure operations. In many instances, the financial savings of foreign-trade zone use equals or exceeds the real estate cost of establishing a facility. This provides a significant incentive to locate operations in a foreign-trade zone.

What Is It?

The Foreign-Trade Zones Act was passed by Congress in 1934 and amended in 1950 to allow manufacturing to occur within a zone. The program is administered by the Foreign-Trade Zones Board, chaired by the Secretary of Commerce, with the Secretary of the Treasury and Secretary of the Army as members. The Board oversees an Application process to establish these zones with the close cooperation of the U.S. Customs Service, which is involved in the approval and oversight of day-to-day activities. The program was originally intended to create U.S. business opportunities similar to the free zones that successfully operated in Europe and the Middle East for centuries. The goal of the Act was to contribute to the expansion of international trade by enhancing U.S. production and job opportunities.

A foreign-trade zone is an area that may be a single building, an industrial park, or an existing company's production or warehousing facility. Facilities that are available for more than one company are considered general-purpose zones. Subzones are all or a portion of a company's existing or new operation solely used for that company. For U.S. customs duty purposes, zones are not considered within the customs territory of the United States. Generally, merchandise admitted to a foreign-trade zone can be subject to a wide range of warehousing and production activities. The zone user has the option of electing the most advantageous customs duty rate on merchandise warehoused or produced either in on the basis of the imported material or the finished product. This unique choice, plus the non-payment of customs duties on labor, overhead, and profit, waste and scrap (in most instances), exports, etc. may offer very significant financial savings opportunities.

Where Are They?

In 1980, there were 59 general-purpose zones and nine subzones in the U.S. Dollar volume was $5 billion and 9,880 people were employed in the zones. Today, there are 201 general-purpose zones and 270 subzones with 59 pending applications. Dollar volume for fiscal year 1993 (the last report) was $200 billion and 300,000 people were employed in the zones. Both dollar volume and employment for 1994 are estimated to be significantly higher than the last fiscal year report.

U.S. foreign-trade zones are located in 48 states an Puerto Rico. A number of large-scale industrial park environments have foreign-trade zone status, including Alliance Airport in Forth Worth, Texas and California Commerce Center in Ontario, California. In addition, a number of port authorities have set aside large portions of their properties at seaports for foreign-trade zone purposes including the Ports of Seattle and Portland, South Carolina State Ports Authority, and the Port Authority of new York and New Jersey. General-purpose zones catering to both small and large users consist of public warehousing activities as well as a company's existing building. The most recent large-scale general-purpose foreign-trade zone use was for Nokia Mobile Phones Trading (USA), Inc./Nokia Mobile Phones Manufacturing (USA), Inc. that established a new 370,000 sq. ft. facility at Alliance Airport.

The major advantage for firms using a foreign-trade zone industrial park environment is that there is no need to secure approval from the Foreign-Trade Zones Board for warehousing and distribution operations, as it has already been approved. A company can move into an existing approved general-purpose zone area and immediately undertake operations. Further, if manufacturing authority is required, this authority can be secured very promptly by a "fast-track' procedure that is uniquely available under the Foreign-Trade Zones Board regulations for manufacturing in general-purpose zone environments. Normal processing time for such activity is 60 to 90 days. In the most recent example, we were able to secure manufacturing authority for Nokia in less than 30 days. This is a significant time and cost advantage over the foreign-trade subzone environment.

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A foreign-trade subzone must be established by the submission to the Foreign-Trade Zones Board of an application with a filing fee. The normal processing time for subzone applications is approximately one year. A wide range of firms in many industries have foreign-trade subzone status for their existing facilities. Most U.S. assembly plants of Ford, General Motors, and Chrysler are foreign-trade subzones. The automotive industry is the largest single user of the Foreign-Trade Zone program, representing more than 50 percent of the dollar volume. Besides the Big Three: Nissan, Toyota, Mitsubishi, Honda, BMW, and Subaru-Isuzu, utilize the foreign-trade zone law for their vehicle assembly facilities. Many motor vehicle parts suppliers manufacture their products in foreign trade zone status and transfer them inbond to final assembly plants. Additionally, a wide range of other firms, including IBM production facilities in Charlotte and Raleigh, North Carolina (personal computers), General Electric Appliance Park in Louisville, Kentucky (refrigerators, stoves, dishwashers, etc.), Kawasaki in Lincoln, Nebraska and Maryville, Missouri (motorcycles, jet skis, 4-wheel vehicles, and industrial engines), AT&T in Shreveport, Louisiana (business telephones), and Bristol-Myers Squibb, Merck, Sanofi, Nycomed, SmithKline Beecham, Searle, and other pharmaceutical firms utilize the U.S. Foreign-Trade Zone program. All of these companies are securing significant financial advantages by using the U.S. Foreign-Trade Zone Program.

Financial Savings Opportunities

The significant financial advantages that companies realize in using a foreign-trade zone include:

1. Cashflow - Customs duties are paid on merchandise shipped out of the facility when it is sold in the United States. No customs duties generally are paid on scrap and waste merchandise and on merchandise that is exported to another country. The savings can be figured as the average value of inventory on hand, times the average customs duty rate, times the interest rate. This holding cost is avoided in a foreign-trade zone.
2. Exports - As previously noted, merchandise that is exported never has a customs duty payment. under any other procedure, merchandise would be imported into the U.S., customs duties paid, and, only once merchandise is exported, drawback claimed.
3. Scrap / Waste - Under certain circumstances, merchandise that is not shipped from the facility in its original condition, declared as scrap / waste, and destroyed is not subject to U.S.

customs duties. There may be a significant financial savings for broken or damaged material, obsolete material, and scrap / waste material generated in manufacturing.

4. Inverted Customs Savings - In many instances, the customs duty rate of imported material is different and usually higher than the duties on the finished product. A foreign-trade zone provides the opportunity to remedy this situation by allowing a firm to pay the customs duty rate of either the imported material or the finished product. the payments are based solely on the value of the foreign material in the finished product.
5. Valuation - The customs dutiable value for merchandise produced in a zone is the value of foreign material utilized and does not include domestic material, labor, overhead, and profit. This provides a significant financial opportunity over merchandise made in a foreign country that is shipped into the United States and duties paid with its customs valuation based upon all of the materials plus labor, overhead, and profit.
6. Inventory Tax - Section 15E of the Foreign-Trade Zones Act provides for an exemption under certain circumstances from state and local ad valorem personal property tax.
7. Other Taxes - Certain states provide additional tax exemptions for foreign-trade zones. Arizone provides a special significantly reduced real and personal property tax rate for activated foreign-trade zones.

The financial savings generated by zone use can be significant. As previously noted, under certain circumstances, this savings can equal or exceed the cost of a new facility.

NAFTA/GATT-WTO

The rapid development of free trade arrangements and the reduction of customs duties under the Uruguay Round of GATT have raised recent questions as to whether foreign-trade zones have continued viability. it is most important to understand that, as all of these particular new elements have been structured, the U.S. Foreign-Trade Zone program was considered. Under NAFTA, manufacturing in a foreign-trade zone is manufacturing in the United States for NAFTA qualification purposes for merchandise shipped to Canada and Mexico. This provides the opportunity for companies to import materials, utilize them in manufacture of a NAFTA-qualified article, and ship them to Canada or Mexico as a NAFTA-qualified article at a lower duty rate into those countries. The Uruguay Round of GATT significantly changed customs duty rates ona wide range of products. it eliminated or curtained zone use in some instances and opened up new savings opportunities in other areas. This means that U.S. manufacturers of toys, pharmaceuticals, furniture, and other products now have foreign-made competitors' products imported into the U.S. Customs duty free. The U.S. Foreign-Trade Zone program provides these firms the opportunity to import essential materials and produce a finished product in a foreign-trade zone environment which is customs duty free.

Conclusion

Any real estate professional trying to be a part of the global marketplace should consider the U.S. Foreign-Trade Zone program. Its dramatic growth in the United States results from the desire of U.S. business to be more globally competitive. No federal, state, or local financial subsidies are involved in a foreign-trade zone. The sole benefit is to treat a U.s. business, for most customs duty purposes, as if it were located in a foreign country. This market-driven device has had a significant impact on many industries in retaining U.S. production and employment as well as stimulating new activity. ✦

Marshall V. Miller is a principal in the Kansas City, Missouri and Washington, D.C. law firm of Miller & Company P.C. Miller is internationally recognized for his involvement in the development of the U.S. Foreign-Trade Zones Program. A co-founder of the National Association of Foreign-Trade zones, he serves as General Counsel. The firm has represented and helped structure more than 200 general purpose foreign-trade zones and special-purpose manufacturing subzones.