

WHAT IS A FOREIGN TRADE ZONE?

A Foreign Trade Zone (FTZ, or Zone) is an area of land within the United States, located at or near a U. S. Customs port-of-entry, where foreign and domestic merchandise is generally considered to be in international commerce (not in U. S. Commerce Territory). Foreign merchandise may enter this area without formal Customs entry or the payment of Customs duties or government excise taxes.

Zone use is growing rapidly. This steady growth is making a significant contribution to U.S. jobs, U.S. production and increased foreign trade.

- At the beginning of the 1980's, there were 59 Trade Zones and 9 Sub-zones employing slightly over 11,000 people. Merchandise passing through these Zones was estimated at \$5 billion annually.
- Today, there are more than 200 approved Zones and 252 approved Sub-zones with more than 300,000 people employed. The 190,000 direct jobs in Zones today have created well over half-a-million additional jobs in the United States!
- The combined value of merchandise received and exported is an estimated \$200 billion.
- It has been estimated that for every 100 direct jobs created by Zones, 167 additional jobs are created outside the Zone.

Forty-eight states and Puerto Rico have established Foreign-Trade Zones. 90% of all firms using FTZs, more than 2,200 firms, are U.S. companies. More than 80% of merchandise admitted to U.S. Zones is of domestic origin. Displacing an import is just as important in our balance of trade as is an export. Zones help the balance of trade further by stimulating exports. In this way, Zones help make U.S. companies much more competitive in export markets, which benefits our nation as a whole.

The U.S. Customs Service carries out most of the duties and responsibilities of the Secretary of the Treasury. The principal interest and concern of Customs in Zones is:

- control of merchandise moving to and from the Zone
- seeing that all revenue is collected properly
- that there is no evasion of U.S. laws and regulations governing the merchandise.

If the merchandise is later exported from the Zone, no U.S. Customs duty or excise tax is levied. If the final product is imported into the United States, Customs duty and excise taxes are due, but only at the time they leave the Zone and enter U.S. Customs Territory.

In cases where foreign components are brought into the Zone and combined into a new product, the user may elect to pay the lower of the duty applicable to the product or to the component parts, and no duty must be paid on the portion of the value of the product created by domestic parts or labor in the Zone.

Finally, Zone procedures provide an extremely flexible method of handling domestic and imported merchandise, allowing users to save time, transportation and handling charges. A Zone provides U.S. businesses the opportunity to save both money and time on goods sourced abroad.

What are the advantages of conducting business in a Zone?

1. Payment of duty is deferred on goods in the Zone until they are actually brought into the U.S. Customs Territory. This results in cash flow savings.
2. Duties are reduced or eliminated on materials subject to defect, damage, obsolescence, waste and scrap.
3. Zone users can pay the duty rate on component material or merchandise produced from component materials -whichever is lower (must be chosen at time of entry into the Zone).
4. Most merchandise subject to U.S. quotas may be held in a Zone until quotas open.
5. Quality control inspections can identify sub-standard goods to be destroyed or returned without duty payment.
6. No country-of-origin labels are required on merchandise admitted to a Zone.
7. Merchandise used/consumed in Zone processing are generally not subject to duties.
8. Generally, duty payable on Zone merchandise need not be included when calculating insurable value.
9. Duty avoided altogether if goods exported from the U.S.
10. Goods may be exhibited duty free to assist in market development.
11. The goods may be stored indefinitely.
12. Reducing freight costs: goods can be repacked.
13. Lower insurance costs: the Zone is a high security area.
14. Stockpiling quota merchandise for immediate availability at quota openings.
15. Exporting goods into the zone: Goods can be considered exported by placing them in a zone. This can speed drawback payments and can be used in other instances where export is required but you are not ready to ship the goods.

What can you do with merchandise in a Zone?

Manufacture: In order to manufacture, the user must apply for and receive special approval from the Zone Board. "Manufacturing" as a practical matter means any operation that changes the Harmonized Tariff Schedule of the United States (HTSUS) classification of the merchandise.

How, in a practical sense, is merchandise handled in the Zone?

Merchandise in a Zone is handled in much the same way as outside of a Zone. The differences are that an inventory system must be in place that is capable of assigning and tracking the merchandise's Zone status, and that additional operations on the merchandise, such as manipulation or manufacture, must occur in defined and segregated areas.

There are four kinds of merchandise status in a Zone and they are the keys to understanding Zone operations. All merchandise in the Zone will at all times be one and only one Zone status. In many cases, the user chooses the zone status of merchandise. This is the mechanism by which the user is able to choose among tariff classifications and achieve lower total duties. In other cases, zone status is dictated by the nature of the merchandise.

When foreign merchandise is brought into a Zone, it may be declared either privileged or non-privileged foreign status. Foreign status means it has not entered the U.S. Customs Territory, and therefore duty has not been liquidated. A user may choose:

- **Privileged** foreign status in order to lock in the duty rate of the merchandise at the time it entered the Zone. Users will do this when they are planning to manipulate or manufacture so as to change its tariff classification, and the duty of the finished product would be higher.
- A user who elects **Non-privileged** foreign status has not locked in a duty classification or rate. A user will choose this status for merchandise that enters a Zone and is going to be manipulated or manufactured, becoming part of merchandise that will be differently classified in a lower rate. After the change, the user will apply for the merchandise to become privileged foreign status to lock in the lower duty rate.

Goods entering the zone from the U.S. Customs Territory are accorded **domestic status**. When these goods exit the Zone for the U.S. Customs Territory, no duty is due on them. Frequently, these are components that will be assembled with foreign status merchandise, or finished goods warehoused with foreign status merchandise for ease of order-filling operations.

Zone-restricted status is perhaps the most unusual classification. Merchandise in Zone restricted status is considered to have been exported from the U.S. Zone. Restricted merchandise may not be manipulated or manufactured in a Zone. It may not be brought into the U.S. Customs Territory from the Zone unless the Zone Board rules specifically that its return is in the public interest. This classification is used when merchandise is transferred into a Zone for the sole purpose of satisfying a legal requirement for exportation or destruction.

Since manipulation and manufacture are permitted in a Zone, articles transferred to the Customs Territory may be composed in part of privileged foreign, non-privileged foreign and/or domestic status parts. The inventory control system in use in the zone must keep account of this all.

PROBLEMATIC IMPORTED ARTICLES:

- **TEXTILES AND TEXTILE PRODUCTS**: If subject to Quota/VISA/License requirements and entered into the Zone, the articles may be prohibited from entering the commerce of the United States. Recommendation: File consumption entry for all Textiles and move articles into Zone.(1)
- **ARTICLES SUBJECT TO ANTIDUMPING**: Goods normally subject to Antidumping duties and entered into a Zone cannot avoid special duty assessment.(2)
- **ARTICLES UNCONDITIONALLY DUTY FREE**: Many articles, properly classified are duty free under the Harmonized system Tariff.
- **ARTICLES CONDITIONALLY DUTY FREE**: Many other articles are duty free under the Harmonized system Tariff only if certain conditions are met. For example, certain country of origin, certain end use.

Why use a Foreign Trade Zone use over other tariff reducing procedures?

- Customs Bonded Warehouse: An FTZ is considered outside of U.S. Customs Territory, whereas a bonded warehouse is not. Customs entry is made at the time goods enter the bonded warehouse, but not the FTZ. Therefore, duty payment is not delayed, reduced or eliminated in a bonded warehouse, and there is limited ability to evaluate and reclassify merchandise. The range of permitted activities in a bonded warehouse is considerably restricted. Manipulation is permitted only in a class 8 bonded warehouse, and manufacturing may occur only in a class 6 bonded warehouse, and only for export. The bonded warehouse alternative involves the cost of a bond when merchandise is admitted to the warehouse. As a rule, only dutiable merchandise may be placed in a bonded warehouse, while all non-prohibited merchandise, foreign and domestic, may be admitted to a zone. Finally, merchandise may remain in a Zone for an unlimited period, while its stay in a bonded warehouse is limited to five years.
- Drawback: Under drawback, an importer who has paid Customs duties upon the arrival of goods in the U.S. may apply to Customs for a refund or "drawback" of duties on qualifying merchandise. Drawback allows free movement of merchandise within the U.S., and no knowledge of export is necessary at the time of importation. But the documentation can be extensive, as can certain requirements, such as whether activity is "incidental" to same condition drawback. Moreover, a 1% drawback retainage is charged, and the importer's funds are tied up in duties paid until the drawback application is approved and paid. One indication of the practical difficulties involved in drawback is the estimate that of approximately \$18 billion collected in Customs duties last year, about \$1.3 billion should have been returned to manufacturers through duty drawback. But only about \$350 million of that amount actually was reimbursed by Customs.
- Temporary Importation Bond: Temporary importation bonds are used when the merchandise is certain to be re-exported or destroyed within the one to three year period permitted by these bonds. Goods admitted under TIB are allowed free movement within the Customs Territory, and the procedure is simpler than drawback. However, Zones do not have time restrictions and much more flexibility with the manipulation of merchandise within a Zone. In the Zone program, no bond equal to double the estimated duties is required, it is not necessary that articles be repaired, altered or processed, and the importer may change its mind on the ultimate disposition of merchandise.
- Carnets: Carnets are used when transporting merchandise from country to country. The limiting factor with a carnet is that the merchandise must leave the U.S. at some point. It cannot remain for sale or permanent storage.

The following table can be used to provide a thumbnail sketch of possible savings by using an FTZ.

1	Total Entered Value	x duty rate	= current cost
2	% of #1 assembled into Engines	x duty rate	= savings
3	% of #1 wasted	x duty rate	= savings
4	% of #1 sold as parts	x duty rate	= opportunity cost*

*Deferred payment of duty

Who are the "players" involved in the operation of a Zone, and where does a private business user fit in?

There are three primary entities involved in the oversight, administration, operation and usage of a Zone.

- The Grantee is the corporation or public entity that has been given the privilege of establishing, operating and/or maintaining a Zone by grant of authority from the U.S. Foreign Trade Zones Board.
- An Operator is a corporation, partnership, or person that operates or manages a Zone. Sometimes this is the grantee (such as the Capital Region Airport Commission), but often it is one acting under the terms of an agreement with the grantee. Customs holds the operator responsible for compliance with the Customs regulations.
- The Zone User is a business or individual that uses a Zone for storage, handling, processing, or manufacturing merchandise in Zone status, whether foreign or domestic. Usually, the Zone User is the party which requests a Customs permit to admit, process, or remove Zone status merchandise.

Users pay the grantee or operator for services such as rent on facilities, storage, handling, promotion, and similar services. They may be permitted by the grantee to construct their own buildings or structures in which they conduct their own business. In Subzones, the Operator and User are usually the same party.

How does a company start operations in the Zone?

You will submit an application for activation to the local Port Director of Customs. A principal part of the application will be a detailed Procedures Manual that sets forth the inventory control and record keeping system to be used in the zone. The number and complexity of regulations in the Procedures Manual is dependent upon the types of activities in which the company will be engaged.

The Port Director will investigate the qualifications, character and experience of the Operator, and the security, suitability and fitness of the facility to receive merchandise in Zone status. She will visit the Zone for a security review. An Operators Bond must be obtained and submitted to the U.S. Customs Port Director.

After specific sites in the zone have been activated, a company seeking to use them for its operation merely enters into an agreement with the airport or Zone operator similar to a lease. Also, payment of an annual user fee is required as well as agreement to comply with the Zone #207 Procedures Manual. It is possible for a zone user to employ other procedures, such as alternative inventory control methods, but it must apply for this under its own Procedures Manual. A zone user seeking to manufacture must make an additional application and pay an application fee.

The Zone Program allows certain areas, such as entire manufacturing facilities, to avail themselves of the benefits of the Zone program even if they are located many miles from the nearest zone. These offsite areas are Subzones. Potential users must apply specifically for authority to become a Subzone to the U.S. Foreign Trade Zones Board. Such applications must be made in cooperation with the nearest Zone. While the Board encourages use of already approved zones, if Subzone use would provide substantial benefit to a company, if locating at a

zone would be impracticable, and if approval would be in the public interest, the Board will approve a company's Subzone application. Hundreds of companies around the U.S. are using them now.

When should a company consider applying for a Subzone and what is the procedure?

Under the law, the Zone Board's review of Subzone applications is carefully focused, and a company should evaluate its proposal against the well-known criteria that will be applied. The FTZ Board will review Subzone applications to determine the need for Subzone services, as opposed to locating in an existing general purpose zone, the adequacy of the operational and financial plans of the applicant, the suitability of the site, the extent of local and state support for the project, its compatibility with economic development goals and land use plans, and the interests of affected persons.

The Board is required to consider three threshold factors, and the presence of one must disqualify the application.

1. Is the application considered on a product by product basis, inconsistent with trade or tariff law of the U.S.?
2. Would granting the application seriously prejudice ongoing trade negotiations of the U.S.?
3. Would use of the FTZ Subzone be the direct and sole cause of extra imports where either the goods are subject to a quota or to an inverted tariff schedule?

If the application passes scrutiny under the threshold factors, then the Board faces the core of its inquiry:

- Will the Subzone yield a positive net economic effect on the U.S. and locality?
- Will the Subzone help improve the international competitiveness of U.S. firms engaged in domestic economic activity?
- Will use of the Subzone counterbalance the Customs advantages available to overseas producers who export their products to the U.S. and other markets in competition with products made in the U.S.?
- The Board will look to such factors as impact on overall employment, imports, exports, and re-exports, manufacturing, extent of value-added activity, foreign economic competition and the like.

In the event the Subzone application is for permission to manufacture on site, the Board must consider an additional criteria: is the Subzone in the "public interest?" The Board examines whether the application will produce demonstrable public benefit, including:

- Will it expedite international trade, especially in competition with foreign plants?
- Will it encourage and facilitate exports?
- Will it help attract offshore activity and encourage retention of domestic activity?
- Will it help local and state economic development efforts?
- Will it help create employment opportunities?

Technically, the application for a Subzone is submitted by the local FTZ on behalf of itself and the ultimate Zone user.

The requirements for a Subzone application are spelled out in detail in Regulations and Manuals.

The key elements are:

- (1) A Site Description, which should include facilities and services, production process, materials and components, foreign sourced items with relevant tariff information.
- (2) Operations and Finances which describe the operational plan, including who the operator will be, physical security and a summary of plans for financing capital and operating costs.
- (3) Economic Justification outlining how the Subzone will benefit the community economically, how it is congruent with the community's goals and strategies, and the anticipated impact, both directly and indirectly on the community.
- (4) Letters of Support.

FTZ RECORDKEEPING

Entry through Customs at a port of entry, the operations in a Zone must comply with strict regulations over inventory control. Record keeping is an important aspect of Zone supervision, allowing Customs to check the representation made in the records against the physical reality found in the zone and against independent records of other parties, such as Customs, carriers, sellers to the Zone, and buyers from the Zone.

The burden on the User may be considerable, if it means a substantial departure from previous accounting and inventory control systems, or it may be minimal. The cost to the User also depends upon the complexity of its operations in the Zone. If it's a simple warehousing operation, the additional cost will be minimal, particularly if a Zone lot system can be employed. If several components are being assembled in several stages, and if operations produce scrap or waste, then record keeping will be more involved.

The FTZ #207 Procedures Manual, and the U.S. Customs Foreign Trade Zone Manual for Grantees, Operators, Users and Customs Officers spell out in exact detail the record keeping requirements, which are found in Part 146 Customs Regulations. Both the Zone Operator and local Customs Officials will work with a company to ensure efficient compliance. Moreover, hosts of consulting firms provide advice, inventory control system books and software for just this purpose.

The Operator must maintain a manual or automated inventory control and record keeping system or a combination of manual and automated systems capable of:

- (1) Accounting for all merchandise, including domestic status merchandise, temporarily deposited, admitted, granted a Zone status and status changed, stored, exhibited, manipulated or manufactured, destroyed, transferred and/or removed from a zone.
- (2) Producing accurate and timely reports and documents as required by regulation.
- (3) Identifying overages and shortages of merchandise in a zone in sufficient detail to determine the quantity, description, tariff classification, zone status, and value of the missing or excess merchandise.
- (4) Providing all the information necessary to make entry for merchandise being transferred to the Customs Territory including, but not limited to, quantities, descriptions, values, HTS classification, and status.

- (5) Providing an audit trail to Customs from admission, through storage, manipulation, manufacture, destruction, exhibition and/or transfer of merchandise from a Zone either by Zone lot or Customs-approved inventory method.

The operator may authorize a Zone User to maintain its individual inventory control and record-keeping system as well as procedures manual. However, the Operator will remain responsible to Customs and liable under its bond for supervision, defects in, or failure of a system.

A zone lot number or unique number will be used to identify and trace merchandise in a Zone. Inventory records will specify by zone lot number or unique identifier:

- (1) Location of merchandise
- (2) Zone status
- (3) Cost or value, unless Operator's or User's financial records maintain cost or value and the records are made available for Customs review
- (4) Beginning balance, cumulative receipts and removals, adjustments, and current balance on hand by date and quantity
- (5) Destruction of merchandise
- (6) Scrap, waste, and by-products.

The Operator must take at least an annual physical inventory of all merchandise in the zone (unless continuous cycle counts are taken as part of an on-going inventory control program), and prepare a reconciliation report within 90 days after the end of the Zone/Subzone years. Records must be readily available for Customs review, either within the activated area, or close enough to the activated area so as not to impede, delay, or create confusion during a Customs spot check of audit.

SELECTED CUSTOMS REGULATIONS:

146.63 (d) Textiles and textile products.

- (1) Subject to the existing statutory authority of the Board, textiles and textile products admitted into a Zone, regardless of whether the merchandise has privileged or nonprivileged foreign status, which would have been subject to quota or visa or export license requirements in their condition at the time of importation (if entered for consumption rather than admitted to a zone), may not be subsequently transferred into Customs territory for consumption if, during the time the merchandise is in the Zone, there has been a change by manipulation, manufacture, or other means: In the country of origin of the merchandise as defined by 12.130 of this chapter. To exempt from Quota or visa or export license requirements other than a change brought about by statute, treaty executive order or Presidential proclamation from one textile category to another.
- (2) Goods subject to Antidumping must be entered into the zone under Privileged Status. The only way to lawfully avoid the payment of special duties is to export the articles from the zone. Citation Attorney Kaz Kano of Barnes, Richardson & Colburn (ph 312/565-2000).

§146.64 Entry for warehouse.

- (a) Foreign merchandise. Merchandise in privileged foreign status or composed in part of merchandise in privileged foreign status may not be entered for warehouse from a zone. Merchandise in nonprivileged foreign status containing no components in privileged foreign status may be entered for warehouse in the same or at a different port.
- (b) Zone-restricted merchandise. Foreign merchandise in zone-restricted status may be entered for warehouse in the same or at a different port only for storage pending exportation, unless the Board has approved another disposition.
- (c) Textiles and textile products. Textiles and textile products which have been changed as provided for in §146.63(d) may be entered for warehouse only if the entry is endorsed by the port director to show that the merchandise may not be withdrawn for consumption.
- (d) Time limit. Merchandise may neither be placed nor remain in a Customs bonded warehouse after 5 years from the date of importation of the merchandise.

§146.65 Classification, valuation, and liquidation.

- (a) Classification –
- (1) Privileged foreign merchandise. Privileged foreign merchandise provided for in this section will be subject to tariff classification according to its character, condition and quantity, at the rate of duty and tax in force on the date of filing, in complete and proper form, the application for privileged status. Classification of merchandise subject to a tariff-rate import quota will be made only at the higher non-quota duty rate in effect on the date privileged foreign status was granted. Notwithstanding the grant of privileged status, Customs may correct any misclassification of any such entered merchandise when it posts the bulletin notice of liquidation under §159.9 of this chapter.
 - (2) Nonprivileged foreign merchandise. Nonprivileged foreign merchandise provided for in this section will be subject to tariff classification in accordance with its character, condition and quantity as constructively transferred to Customs territory at the time the entry or entry summary is filed with Customs.

§146.68 Transfer for transportation or exportation; estimated production.

- (a) Weekly permit. The port director may allow the person making entry for merchandise provided for in §146.63(c) to file an application for a weekly permit to enter and release merchandise during a calendar week for exportation, transportation, or transportation and exportation. The application will be on Customs Form 7512 stating at the top the words "Application for Weekly Zone Permit," and will be filed with the port director. A pro forma invoice or schedule like that must accompany the application required in §146.63(c)(1). If actual transfers will exceed the estimate for the week, the person with the right to make entry shall file a supplemental Customs Form 7512 to cover the additional merchandise to be transferred from the Subzone or zone site. No merchandise covered by the weekly permit may be transferred from the zone before approval of the application by the port director.
- (b) Individual entries. After approval of the application for a weekly permit by the port director, the person making entry will be authorized to execute individual Customs Forms 7512 for exportation, transportation, or transportation and exportation of the merchandise covered by permit. Upon transfer of the merchandise, the operator shall obtain a receipt from the carrier on Customs Form 7512 to ensure its assumption of liability under the carrier's or cartman's bond. Customs will consider the time of entry to be when the removing carrier signs the receipt for the merchandise. The operator shall give the bonded carrier a copy of the individual Customs Form 7512 and the destination copy (Customs Form 7512 – C), as provided for in §18.2(c) of this chapter. The operator also shall ensure that the port director receives a copy of the Customs Form 7512 and the origin copy (Customs Form 7512 - C) by the end of the next working day after the carrier has received for the merchandise.

§146.1 Definitions.

- (a) The following words, defined in section 1 of the Foreign-Trade Zones Act of 1934, as amended (19 U.S.C. 81a), are given the same meaning when used in this part, unless otherwise stated: "Board", "Grantee", and "Zones".
- (b) The following are general definitions for the purpose of this part:
- (1) Act. "Act" means the Foreign-Trade Zones Act of June 18, 1934, as amended (48 Stat. 998 - 1003; 19 U.S.C. 81a-u).
 - (2) Activation. "Activation" means approval by the grantee and port director for operations and for the admission and handling of merchandise in zone status.
 - (3) Admit. "Admit" means to bring merchandise into a zone with zone status.
 - (4) Alteration. "Alteration" means a change in the boundaries of an activated zone or Subzone; activation of a separate site of an already-activated zone or Subzone with the same operator at the same port; or the relocation of an already-activated site with the same operator.
 - (5) Customs territory. "Customs territory" is the territory of the U.S. in which the general tariff laws of the U.S. apply. "Customs territory of the United States" includes only the States, the District of Columbia, and Puerto Rico. (General Note 2, Harmonized Tariff Schedule of the United States (19 U.S.C. 1202)).
 - (6) Constructive transfer. "Constructive transfer" is a legal fiction which permits acceptance of a Customs entry for merchandise in a zone before its physical transfer to the Customs territory.
 - (7) Deactivation. "Deactivation" means voluntary discontinuation of the activation of an entire zone or Subzone by the grantee or operator. Discontinuance of the activated status of only a part of a zone site is an alteration.
 - (8) Default. "Default" means an action or omission that will result in a claim for duties, taxes, charges, or liquidated damages under the Foreign Trade Zone Operator Bond.
 - (9) Merchandise. "Merchandise" includes goods, wares and chattels of every description, except prohibited merchandise. Building materials, production equipment, and supplies for use in operation of a zone are not "merchandise" for the purpose of this part.

- (10) Domestic merchandise. ``Domestic merchandise" is merchandise which has been (i) produced in the U.S. and not exported therefrom, or (ii) previously imported into Customs territory and properly released from Customs custody.
- (11) Foreign merchandise. ``Foreign merchandise" is imported merchandise which has not been properly released from Customs custody in Customs territory.
- (12) Conditionally admissible merchandise. ``Conditionally admissible merchandise" is merchandise which may be imported into the U.S. under certain conditions. Merchandise which is subject to permits or licenses, or which may be reconditioned to bring it into compliance with the laws administered by various Federal agencies, is an example of conditionally admissible merchandise.
- (13) Prohibited merchandise. ``Prohibited merchandise" is merchandise the importation of which is prohibited by law on grounds of public policy or morals, or any merchandise which is excluded from a zone by order of the Board. Books urging treason or insurrection against the U.S., obscene pictures, and lottery tickets are examples of prohibited merchandise.
- (14) Fungible merchandise. ``Fungible merchandise" means merchandise which for commercial purposes is identical and interchangeable in all situations.
- (15) Operator. ``Operator" is a corporation, partnership, or person that operates a zone or Subzone under the terms of an agreement with the zone grantee. Where used in this part, the term ``operator" also applies to a ``grantee" that operates its own zone.
- (16) Reactivation. ``Reactivation" means a resumption of the activated status of an entire area that was previously deactivated without any change in the operator or the area boundaries. If the boundaries are different, the action is an alteration. If the operator is different, it is an activation.
- (17) Subzone. ``Subzone" is a special-purpose zone established as part of a zone project for a limited purpose, that cannot be accommodated within an existing zone. The term ``zone" also applies to a Subzone, unless specified otherwise.
- (18) Transfer. ``Transfer" means to take merchandise with zone status from a zone for consumption, transportation, exportation, warehousing, cartage or lighterage, vessel supplies and equipment, admission to another zone, and like purposes.
- (19) Unique identifier. ``Unique identifier" means the numbers, letters, or combination of numbers and letters that identify merchandise admitted to a zone with zone status.
- (20) User. ``User" means a person or firm using a zone or Subzone for storage, handling, or processing of merchandise.
- (21) Zone lot. ``Zone lot" means a collection of merchandise maintained under an inventory control method based on specific identification of merchandise admitted to a zone by lot.
- (22) Zone site. ``Zone site" means the physical location of a zone or Subzone.
- (23) Zone status. ``Zone status" means the status of merchandise admitted to a zone, i.e., nonprivileged foreign, privileged foreign, zone restricted, or domestic.

146.24 Transfer of merchandise from a zone.

- (a) Accountability.
 - (1) All zone status merchandise transferred from a zone will be accurately recorded within the inventory control and recordkeeping system.
 - (2) The inventory control and recordkeeping system for merchandise transfers must have the capability to trace all transfers back to a zone admission under a Customs authorized inventory method.
- (b) Information. The inventory control and recordkeeping system must be capable of providing all information necessary to make entry for transfer of merchandise from the zone.

§146.4 Operator responsibility and supervision.

- (a) Supervision. The operator shall supervise all admissions, transfers, removals, recordkeeping, manipulations, manufacturing, destruction, exhibition, physical and procedural security, and conditions of storage in the zone as required by law and regulations. Supervision by the operator shall be that which a prudent manager of a storage, manipulation, or manufacturing facility would be expected to exercise, and may take into account the degree of supervision exercised by the zone user having physical possession of zone merchandise.
- (b) Customs access. The operator shall permit any Customs officer access to a zone.
- (c) Safekeeping of merchandise and records. The operator is responsible for safekeeping of merchandise and records concerning merchandise admitted to a zone. The operator, at its liability, may allow the zone importer or owner of the goods to store, safeguard, and otherwise maintain or handle the goods and the inventory records pertaining to them.
- (d) Records maintenance. The operator shall (1) maintain the inventory control and recordkeeping system in accordance with the provisions of subpart B, (2) retain all records required in this part and defined in §162.1(a) of this chapter, pertaining to zone merchandise for 5 years after the merchandise is removed from the zone,

and (3) protect proprietary information in its custody from unauthorized disclosure. Records shall be readily available for Customs review at the zone.

- (e) Merchandise security. The operator shall maintain the zone and establish procedures adequate to ensure the security of merchandise located in the zone in accordance with applicable Customs security standards and specifications.
- (f) Storage and handling. The operator shall store and handle merchandise in a zone in a safe and sanitary manner to minimize damage to the merchandise, avoid hazard to persons, and meet local, state, and Federal requirements applicable to a specific kind of goods. All trash and waste will be promptly removed from a zone. Aisles will be established and maintained, and doors and entrances left unblocked for access by Customs officers and other persons in the performance of their official duties.
- (g) Guard service. The operator is authorized to provide guards or contract for guard service to safeguard the merchandise and ensure the security of the zone. This authorization does not limit the authority of the port director to assign Customs guards to protect the revenue under section 4 of the Act (19 U.S.C. 81d).
- (h) Miscellaneous responsibilities. The operator is responsible for complying with requirements for admission, manipulation, manufacture, exhibition, or destruction, shortage, or overage; inventory control and recordkeeping systems, transfer to customs territory, and other requirements as specified in this part. If the operator elects to transfer merchandise from within the port limits (see definition of "district" at §112.1) to his zone, he shall receipt for the merchandise at the time he picks it up for transportation to his facility. He becomes liable for the merchandise at that time.

§146.6 Procedure for activation.

- (a) Application. A zone operator, or where there is no operator, a grantee, shall make written application to the port director geographically nearest to where the zone is located to obtain approval of activation of a zone or zone site. The area to be activated may be all or any portion of the zone approved by the Board. The application must include a description of all the zone sites covered by the application, any operation to be conducted therein, and a statement of the general character of the merchandise to be admitted. The port director may also require the operator or grantee to submit fingerprints on Standard Form 87 at the time of filing the application. If the operator is an individual, that individual's fingerprints may be required. If the operator or grantee is a business entity, fingerprints of all officers and managing officials may be required.
- (b) Supporting documents. The application must be accompanied by the following:
 - (1) [Reserved]
 - (2) A blueprint of the area approved by the Board to be activated showing area measurements, including all openings and buildings; and all outlets, inlets, and pipelines to any tank for the storage of liquid or similar product, that portion of the blueprint certified to be correct by the operator of the tank;
 - (3) A gauge table, when appropriate, showing the capacity, in the appropriate unit, of any tank, certified to be correct by the operator of the tank;
 - (4) A procedures manual describing the inventory control and recordkeeping system that will be used in the zone, certified by the operator or grantee to meet the requirements of subpart B; and
 - (5) The written concurrence of the grantee, when the operator applies for activation, in the requested zone activation.
- (c) Inquiry by port director. As a condition of approval of the application, the port director may order an inquiry by a Customs officer into:
 - (1) The qualifications, character, and experience of an operator and/or grantee and their principal officers; and
 - (2) The security, suitability, and fitness of the facility to receive merchandise in a zone status.
- (d) Decision of the port director. The port director shall promptly notify the applicant in writing of his decision to approve or deny the application to activate the zone. If the application is denied, the notification will state the grounds for denial which need not be limited to those listed in §146.82. The decision of the port director will be the final customs administrative determination in the matter. On approval of the application, a Foreign Trade Zone Operator's Bond shall be executed on Customs Form 301, containing the bond conditions of §113.73 of this chapter.
- (e) Activation. Upon the port director's approval of the application and acceptance of the executed bond, the zone or zone site will be considered activated; and merchandise may be admitted to the zone. Execution of the bond by an operator does not lessen the liability of the grantee to comply with the Act and implementing regulations.

146.8 Seals, authority of operator to break and affix.

The port director may authorize an operator to break a Customs in-bond seal affixed under §18.4 of this chapter, or under any Customs order or directive, on any vehicle or intermodal container containing merchandise approved for admission to the zone upon its arrival at the zone; or to affix a Customs in-bond seal to any vehicle or intermodal container of merchandise for which an entry, withdrawal, or other approval document has been obtained for movement in-bond from the zone. The authorized affixing or breaking of that seal will be considered to have been done under Customs supervision. The operator shall report to the port director, upon arrival of the vehicle or

container at the zone, any seal found to be broken, missing, or improperly affixed, and hold the vehicle or container and its contents intact pending instructions from the port director. If the operator does not obtain the written concurrence of the carrier as to the condition of the seal or delivering conveyance, the port director shall deem the seal or delivering conveyance to be intact.

Subpart B - Inventory Control and Recordkeeping System

§146.21 General requirements.

- (a) Systems capability. The operator shall maintain either manual or automated inventory control and recordkeeping systems or combination manual and automated systems capable of:
- (1) Accounting for all merchandise, including domestic status merchandise, temporarily deposited, admitted, granted a zone status and/or status change, stored, exhibited, manipulated, manufactured, destroyed, transferred, and/or removed from a zone;
 - (2) Producing accurate and timely reports and documents as required by this part;
 - (3) Identifying shortages and overages of merchandise in a zone in sufficient detail to determine the quantity, description, tariff classification, zone status, and value of the missing or excess merchandise;
 - (4) Providing all the information necessary to make entry for merchandise being transferred to the Customs territory;
 - (5) Providing an audit trail to Customs forms from admission through manipulation, manufacture, destruction or transfer of merchandise from a zone either by zone lot or Customs authorized inventory method.
- (b) Procedures manual. The operator shall provide the port director with an English language copy of its written inventory control and recordkeeping systems procedures manual in accordance with the requirements of this part.
- (1) The operator shall keep current its procedures manual and shall submit to the port director any change at the time of its implementation.
 - (2) The operator may authorize a zone user to maintain its individual inventory control and recordkeeping system and procedures manual. The operator shall furnish a copy of the zone user's procedures manual, including any subsequent changes, to the port director. However, the operator will remain responsible to Customs and liable under its bond for supervision, defects in, or failures of a system.
 - (3) The operator's procedures manual and subsequent changes will be furnished to the port director for information purposes only. Customs receipt of a manual does not indicate approval or rejection of a system.
- (c) Liability of operator. Upon zone activation approval the operator remains liable for comp

§146.22 Admission of merchandise to a zone.

- (a) Identification. All merchandise will be recorded in a receiving report or document using a zone lot number or unique identifier. All merchandise, except domestic status merchandise for which no permit for admission is required under §146.43, will be traceable to a Customs Form 214 and accompanying documentation.
- (b) Reconciliation. Quantities received will be reconciled to a receiving report or document such as an invoice with any discrepancy reported to the port director as provided in §146.37.
- (c) Incomplete documentation. Merchandise received without complete Customs documentation or which is unacceptable to the inventory control and recordkeeping system will be recorded in a suspense account or record until documentation is complete or the system is capable of accepting the information, at which time it will be formally admitted to the zone under §146.32 or §146.40. The receiving report or document will provide sufficient information to identify the merchandise and distinguish it from other merchandise. The suspense account or record will be completely documented for Customs review to explain the differences noted and corrections made.
- (d) Recordation. Merchandise received will be accurately recorded in the inventory system records from the receiving report or document using the zone lot number or unique identifier for traceability. The inventory record will state the quantity and date admitted, cost or value where applicable, zone status, and description of the merchandise, including any part or stock number.
- (e) Harbor maintenance fee. When imported cargo is unloaded from a commercial vessel at a U.S. port and admitted into a foreign trade zone, the applicant for admission of that cargo into the zone may be subject to the harbor maintenance fee as set forth in §24.24 of this chapter.

§146.23 Accountability for merchandise in a zone.

- (a) Identification of merchandise:
- (1) General. A zone lot number or unique identifier will be used to identify and trace merchandise.
 - (2) Fungible merchandise. Fungible merchandise may be identified by an inventory method authorized by Customs, which is consistently applied, such as First-In-First-Out (FIFO) and using a unique identifier.
- (b) Inventory records. The inventory records will specify by zone lot number or unique identifier:

- (1) Location of merchandise;
 - (2) Zone status;
 - (3) Cost or value, unless operator's or user's financial records maintain cost or value and the records are made available for Customs review;
 - (4) Beginning balance, cumulative receipts and removals, adjustments, and current balance on hand by date and quantity;
 - (5) Destruction of merchandise; and
 - (6) Scrap, waste, and by-products.
- (c) Physical inventory. The operator shall take at least an annual physical inventory of all merchandise in the zone (unless continuous cycle counts are taken as part of an ongoing inventory control program) with prior notification of the date(s) given to Customs for any supervision of the inventory deemed necessary. The operator shall notify the port director of any discrepancies in accordance with §146.53.

§146.25 Annual reconciliation.

- (a) Report. The operator shall prepare a reconciliation report within 90 days after the end of the zone/subzone year unless the port director authorizes an extension for reasonable cause. The operator shall retain that annual reconciliation report for a spot check or audit by Customs, and need not furnish it to Customs unless requested. There is no form specified for the preparation of the report.
- (b) Information required. The report must contain a description of merchandise for each zone lot or unique identifier, zone status, quantity on hand at the beginning of the year, cumulative receipts and transfers (by unit), quantity on hand at the end of the year, and cumulative positive and negative adjustments (by unit) made during the year.
- (c) Certification. The operator shall submit to the port director within 10 working days after the annual reconciliation report, a letter signed by the operator certifying that the annual reconciliation has been prepared, is available for Customs review, and is accurate. The certification letter must contain the name and street address of the operator, where the required records are available for Customs review; and the name, title, and telephone number of the person having custody of the records. Reporting of shortages and overages based on the annual reconciliation will be made in accordance with §146.53. These reports must accompany the certification letter.

§146.37 Operator admission responsibilities.

- (a) Maintenance of admission documentation. The operator shall maintain either:
 - (1) Lot file. The operator shall open and maintain a lot file containing a copy of the Customs Form 214, the examination invoice, and all other documentation necessary to account for the merchandise covered by each Customs Form 214. The lot file will be maintained in sequential order by using the unique number assigned to each Customs Form 214 as the file reference number; or
 - (2) Authorized inventory method. Where a Customs authorized inventory method other than a lot system (specific identification of merchandise) is used, e.g., First-In-First-Out (FIFO), no lot file is required but the operator shall maintain a file of all Customs Form's 214 in sequential order.
- (b) Examination invoice. The operator shall give a copy of the examination invoice to the person making entry to transfer the merchandise from the zone upon request of that person or the port director.
- (c) Liability for merchandise. The operator will be held liable under its bond for the receipt of merchandise admitted in the quantity and condition as described on the Customs Form 214, except as modified by a discrepancy report:
 - (1) Signed jointly by the operator and carrier on the Customs Form 214 or other approved form within 15 days after admission of the merchandise, and reported to the port director within 2 working days thereafter; or
 - (2) Submitted on Customs Form 5931 under the provisions of subpart A, part 158, of this chapter within 20 days after admission of the merchandise. The operator may file a Customs Form 5931 on behalf of the person who applied for admission of merchandise to the zone.
- (d) Supervision of merchandise. The port director may authorize the receipt of zone status merchandise at a zone without physical supervision by a Customs officer (see §146.3). In that case, the operator shall supervise the receipt of merchandise into the zone, report the receipt and condition of the merchandise, and mark packages with the unique Customs Form 214 number so that the merchandise can be traced to a particular Customs Form 214. Packages that are accounted for under a Customs-authorized inventory method other than specific identification, need not be marked with a unique Customs Form 214 number but must be adequately identified so Customs can conduct an inventory count. The operator shall submit the Custom Form 214 to Customs at the location specified by the port direct.

§146.53 Shortages and overages.

- (a) Report required. The operator shall report, in writing, to the port director upon identification, as such, of any:
 - (1) Theft or suspected theft of merchandise;

- (2) Merchandise not properly admitted to the zone; or
 - (3) Shortage of one percent (1%) or more of the quantity of merchandise in a lot or covered by a unique identifier, if the missing merchandise would have been subject to duties and taxes of \$100 or more upon entry into the Customs territory. The operator shall record upon identification all shortages and overages, whether or not they are required to be reported to the port director at that time, in its inventory control and recordkeeping system. The operator shall record all shortages and overages as required in the annual reconciliation report under §146.25.
- (b) Certain domestic merchandise. Except in a case of theft or suspected theft, the operator need not file a report with the port director, or note in the annual reconciliation report, any shortage or overage concerning domestic status merchandise for which no permit is required.
- (c) Shortage.
- (1) Operator responsibility. The operator is responsible under its Foreign Trade Zone Operator's Bond for any loss of merchandise or for any merchandise which cannot be located or otherwise accounted for (except domestic status merchandise for which no permit is required), unless the port director is satisfied that the merchandise was:
 - (i) Never received in the zone;
 - (ii) Removed from the zone under proper permit;
 - (iii) Not removed from the zone; or
 - (iv) Lost or destroyed in the zone through fire or other casualty, evaporation, spillage, leakage, absorption, or similar cause, and did not enter the commerce of the U.S.
 - (2) Liability for duty and taxes. Upon demand of the port director, the operator shall make entry for and pay duties and taxes applicable to merchandise which is missing or otherwise not accounted for.
 - (3) Overage. The person with the right to make entry shall file, within 5 days after identification of an overage, an application for admission of the merchandise to the zone on Customs Form 214 or file a Customs entry for the merchandise. If a Customs Form 214 or a Customs entry is not timely filed, and the port director has not granted an extension of the time provided, the merchandise shall be sent to general order.
 - (4) Damage. The liability of the operator under its Foreign Trade Zone Operator's Bond may be adjusted for the loss of value resulting from damage to merchandise occurring in the zone. The operator shall segregate, mark, and otherwise secure damaged merchandise to preserve its identity as damaged merchandise.