THE ACTIVATION PROCESS

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Establishing a viable Foreign-Trade Zone operation requires the successful completion of two processes: application to the Foreign-Trade Zones Board, and activation by the U.S. Customs Service. The activation process, if properly undertaken, should prove less complex and troublesome than the application process. However, the activation process may well require every bit as much thought and planning as the application process. Otherwise, the future Zone operation may prove cumbersome, expensive, or ineffective.

There are two kinds of Foreign-Trade Zone environments, the General Purpose Zone, and the Subzone. General Purpose Zones are usually multi-user facilities that involve distribution operations. Sometimes manufacturing and processing occur within General Purpose Zones but generally such activity occurs within Subzones. Many issues surrounding the activation of a particular Zone site will arise out of the nature of the site and the proposed Zone operations. This essay will address the various considerations involved in activating both General Purpose Zone sites and Subzone sites.

Selecting or Becoming an Operator

General Purpose Zone
Prior to activating a General Purpose Zone, the Grantee must make a number of decisions. The first of these is, who will serve as the Operator. Naturally, there is more than one choice:

Grantee
Some Grantees operate their General Purpose Zones themselves. This directly exposes the Grantee to Customs liability, but also affords the Grantee maximum administrative control. In many cases it also affords the Grantee more flexibility than can be obtained in many typical Grantee/Operator relationships.

Other Party
Many Grantees contract with one or more other parties to conduct General Purpose Zone operations. Again, there are several options from which to choose when selecting the kind of firm that will operate the Zone.

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Administrator
An administrative type of firm manages the Zone in much the same manner as the Grantee might if it served as its own operator. The firm would manage the paperwork involved in the admission and transfer of merchandise from the Zone, monitor inventory control and record keeping, monitor user compliance, deal directly with Customs, and conduct all reporting functions. This kind of firm is useful if the Zone seeks to serve multiple Zone users.

Developer
This kind of firm manages or develops real estate as part of its management and development of the Zone. Often this kind of firm provides infrastructure, such as buildings and roads, for the benefit of both Zone and non-Zone users. This kind of firm is useful if the Zone seeks to develop infrastructure without outlays of capital by the Grantee.

Warehouseman
A warehousing firm provides the facilities to handle and store merchandise. Sometimes, the firm provides value-added services for its customers. Additionally, the firm may be involved in logistics management and transportation. This kind of firm is useful if the Zone seeks to serve a new transportation and logistics market segment.

User
Some General Purpose Zone users want to use the Zone to conduct their own business operations. This could be the distribution of their own products, or could involve manufacturing, processing, or other incidental operations.

Subzone
Without exception, the Subzone user (or its contractee) serves as the Operator of the Subzone. As with General Purpose Zone Operators, the Subzone conducts its Zone operations under the terms of a contractual agreement with the Grantee. Both parties must undertake Grantee/Operator Agreements of every nature with the greatest of care. Each party must know what it, and the other party, is about. Both the goals of the Grantee and the Operator must be considered when crafting the Agreement.

Given the different kinds of Zone and Subzone operations, one might ask the question, "Just what is a Zone Operator?" The answer is simple: "The party that directly accepts Customs liability for Zone operations."

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Even though this answer seems simple, the Zone Grantee must address five areas of consideration before deciding who will operate its General Purpose Zone. It must ask itself:

1. **What are the goals of our Foreign-Trade Zone project?**
   - Enhancement of cargo related activities;
   - Development of commercial and industrial real estate; or,
   - Enhancement of area trade and economic development.

2. **What are the responsibilities that have to be met within the total scope of the project and who will be responsible for meeting each of those responsibilities?**

3. **What are the capabilities and resources of the Grantee and the potential Operator?**
   - Can both parties meet their respective responsibilities based on considerations identified in question number two?

4. **How will Zone users pay for services?**
   - Will/can either the Grantee or Operator sustain financial losses in the early stages of operations?

5. **How will the way in which we address questions one through four affect our Zone's Long term development?**
   - How can we correct mistakes?
   - Do we want a single General Purpose Zone Operator or more than one General Purpose Zone Operator?

**Operator's Bond**
The next obvious question is how does the Operator directly accept Customs liability for its Zone operation. The answer is, by maintaining a continuous bond with the U.S. Customs Service. The type of bond is a Foreign-Trade Zone Operator's Bond. A Bond must be in force before foreign status merchandise can be received at the Zone site.

What is a Foreign-Trade Zone Operator's Bond? First of all, it is **NOT Insurance!**

Instead, the bond is assurance to Customs that assessments against the bond will indeed be paid. The Surety Company who underwrites the bond provides this assurance. If Customs assesses liquidated damages against the bond, the Surety Company will take action against the Operator to collect any amounts it may forfeit to Customs as a result of those damages.

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The Port Director of Customs will establish the face amount of the bond. The face amount shall not be less than $50,000. Often, the face amount of the bond depends on the scale and nature of the anticipated activity. It is often the subject of negotiation between Customs and the Operator. The bond is executed on Customs Form 301. Zone and Subzone users who already have importers bonds on file with Customs sometimes simply add "Foreign-Trade Zone Operator" to the list of items checked on the bond. This, however, should be done only with due consideration, for the face amount on the existing bond may well exceed the amount of liability obtainable under a separate Foreign-Trade Zone Operator's bond.

Background Check
One of the requirements of activation is that Customs conducts a background check of key employees. It should be noted that the background check typically involves:

- Management Personnel
- Cargo Handling Personnel
- Personnel executing Customs Documents

The Operator must provide Customs with a list of employees listing each employee's:

- Name
- Address
- Date of Birth
- Place of Birth
- Social Security Number

Keep in mind that although Customs may in the future ask for information about additional employees, the requirement for activation is for information about key employees. As key employees change during the Zone's operation, the list of key personnel should be updated.

The background check will seek so-called "Derogatory Information" about key employees. Customs defines derogatory information as:

- Fraud or misstatement of material fact
- Failure to furnish, upon request, a complete and accurate list of persons
- Presence of a person who has been convicted of theft, smuggling, fraud or similar property crimes
- Employment of persons of crimes that would jeopardize security of merchandise

Consideration should be given to revealing certain information about employees to Customs prior to the Background Check, however, other legal considerations must be addressed before any such prior disclosure of personal information.

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Procedures Manual

One of the requirements of activation is that the Operator, prior to activation, submit to Customs a written FTZ Procedures Manual. The manual describes the systems and procedures that will be employed in the Zone’s operation. During the Zone’s operation, the Procedures Manual must be updated to reflect any changes that are made in systems and procedures. The following subjects should be discussed in the Procedures Manual:

Inventory Control and Record Keeping System

Procedures

Activities
Admission of Merchandise
Storage
Manipulation
Manufacture or other activities involving merchandise
Shipment of Merchandise
  For Domestic Consumption
  For Export
  Shipments to other Zones
Security Procedures
Reporting Procedures

Keep in mind that Customs neither approves nor disapproves the Procedures Manual. The Zone Operator is responsible for compliance of the systems and procedures described in the Procedures Manual.

Besides meeting a Customs requirement, the Procedures Manual should serve as the Operator or user’s tool in conducting its Zone activities. It should not reside on some forgotten shelf.

Inventory Control

The Zone’s Inventory Control and Record Keeping System (or Systems) is a vital part of the operation. It is through the System and its methodology that Customs will test the claims made by the Operator when merchandise is transferred from the Zone. In order to protect the revenue of the United States, Customs auditors will audit the Zone’s systems to assure that proper methodology is used in relating the value of what leaves the Zone to the value of what is admitted to the Zone. Customs requires that the Zone’s Inventory Control and Record Keeping Systems must perform the following:

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Systems must account for all merchandise:

- Receipt
- Zone Admission
- Granted a Zone Status
- Stored, Exhibited, Manipulated, Manufactured, or Processed
- Destroyed, Transferred or removed from the Zone
- Produce accurate and timely reports
- Identify overages and shortages
- Provide information necessary to make Customs Entry
- Provide Audit trail to relate value of merchandise entered from Zones to value of merchandise admitted to Zone

Naturally, the Zone’s Inventory Control and Record Keeping System will be designed to fit the business activity involved. The Systems required for large-scale manufacturing activity will be more complex than those required for small-scale warehousing. Nevertheless, the principles that Customs applies in evaluating each are the same. These must be thoroughly understood before the System is designed or adapted for Zone use. Standards for FTZ Inventory Control and Record Keeping Systems are published in 19 CFR, Section 146, Subpart B.

Security
Prior to activation, Customs will conduct a Cargo Security Survey. Customs security standards are published in TD 72-56, however, these standards are expensive to meet, and in most cases constitute security overkill. Generally, the Zone’s security standards are established by the Port Director of Customs, and, in most cases, require only minimal enhancement by the Operator. One must keep in mind that there are Special High Security standards for firearms. Normal Security Measures may include physical security measures such as walls, fences, doors, and locks, and monitoring measures such as guards, electronic security devices and monitoring systems, as well as access control systems. Customs should always be made aware of the Operator’s interest in protecting the total value of the Zone merchandise in addition to that which may be due Customs.

Customs Orientation and Inspection
For the User, this is as important as anything it will ever do. Strategy and Coordination between Grantee, and User/Operator is a must if future Zone environment is to be User Friendly.

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There are several things the Operator and Grantee can do to maximize your opportunity to create a user-friendly Zone environment:

- Introduce Customs to the nature of the Zone activity. Explain the competitive problems Zone status will solve (e.g. relief from inverted tariffs).
- Explain how FTZ cost savings will serve the Public Interest.
- Let the Grantee serve as spokesperson. Make sure the Grantee thoroughly understands the Zone operation, and the need for any special Zone procedures. Remember, as a public entity, the Grantee has the most leverage in dealing with any and all government agencies. However, make sure that the Grantee is never put in a position of representing anything other than genuine public interests.

Once Customs becomes familiar with the Zone operation, discussion of special Zone procedures is in order. There are several procedures which can enhance the user-friendliness of your Zone operation. These include:

- Direct Delivery
- Weekly Entry
- Extension of five day removal time limit
- Breaking and affixing Customs Seals

Familiarize yourself with the benefits and requirements of these procedures. Keep in mind that the Port Director of Customs has discretionary authority to approve or deny the use of special procedures. Therefore, make sure that requests are driven by real User needs. Remember, the establishment of your Zone or Subzone was the result a policy decision made by the Foreign-Trade Zones Board. It was demonstrated that Your Zone or Subzone was deemed to be in the national interest. Be prepared to demonstrate to the Port Director how certain user-friendly Zone procedures will help your Zone project better serve the purposes for which it was established. If you can do this, there is no good reason why your requests should be denied.

**Activation Procedures**

Activation procedures and requirements are published in 19 CFR Part 146.6. Written application to activate must be submitted to the Customs Port Director in the Port in which the Zone is located. The Operator submits this application, whether the Operator is the Grantee, or another firm. The Operator has the option of activating either all, or a part of, the
Zone area which was approved by the Foreign-Trade Zones Board. The application to activate must include a description of all Zone sites requested for activation, and a description of the general character of the operations to be conducted therein. If operations will include the manipulation, manufacture, or processing of merchandise, the Operator may want to submit a blanket CF 216, which will provide Customs' permit for that activity, with the application to activate. A statement of the general character of merchandise to be admitted to the Zone must be included.

Additionally, the application to activate must include certain supporting documents. These include:

- The written concurrence of the Grantee.
- A blue print of the area to be activated, showing the area's measurements, including all openings and buildings, and all outlets, inlets, and pipelines to any tank for the storage of liquids.
- A gauge table, when appropriate, showing the capacity of any tank, with certification by the operator of the tank that the table is correct.
- The Zone procedures manual which describes the inventory control and record keeping system(s) and Zone procedures. The Operator must certify that the Zone inventory control and record keeping system(s) satisfy the requirements of 19 CFR, Section 146, and Subpart B.
- The list of key employees.

In processing the application to activate, the Port Director may then order the inquiry into the background of key employees, and conduct a security survey. The Port Director must then notify the applicant of his or her decision to approve or deny the activation. On approval of the application, the Foreign-Trade Zone Operator's Bond is executed on a CF 301. Upon acceptance by Customs of the executed bond, the Zone site is considered activated. Foreign status merchandise may then be admitted to the Zone, and the Operator can then congratulate itself on finally being in business. Whew!

The smart Operator often makes arrangements to have certain activities related to activation conducted while the Foreign-Trade Zones Board is evaluating its Zone or Subzone application. Administrative items like background checks can sometimes take quite a while. Additionally, giving Customs time to familiarize itself with your proposed Zone operation benefits everyone. Finally, getting everyone ready for your activation reduces the time -- and pressure -- in getting activated after the Foreign-Trade Zones Board approves your Grant. With proper planning, and a coordinated effort between the Grantee, Operator, and Customs, a user-friendly Zone operation which meets Customs' requirements can be established with a minimum of difficulty.

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Foreign-Trade Zone System Requirements

For a Foreign-Trade Zone inventory control system to be compliant and be capable of readily providing the necessary reports and information, the system must contain the following information:

♦ Unique Identification Number (sku or part number)
♦ Description
♦ Annual Balance Information by Status (Foreign, Domestic, Total)
♦ Foreign Trade Zone Status (NPF, PF, ZR, DOM)
♦ Customs Form 214 Number
♦ Internal Tracking Number
♦ Date Admitted
♦ Country of Origin
♦ Unit Value
♦ Harbor Maintenance Indicator
♦ Vessel Name
♦ Export Date
♦ Export Port
♦ Bill of Lading
♦ Import Date
♦ Unloading Port
♦ Customs Form 7512 Document Number
♦ Customs Form 7512 Date
♦ Customs Form 7512 Port
♦ Purchase Order Data
♦ Weight
♦ Customs Transaction Number and Date
♦ Entry Reference Number
♦ Entry Release Date

When Foreign-Trade Zone merchandise, including manufactured or processed merchandise, is removed from the zone, the system must be able to relate the merchandise removed back to the Customs form 214 on which it was admitted to the zone. The following information must be included in the system:

♦ Value of the foreign content in the merchandise

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Specific Customs Form 214 number the foreign parts were admitted on
Overall Value
Country of Origin of the foreign status parts in the merchandise
Zone status of every part in the merchandise
Duty Rate of every part in the merchandise
Harmonized Number of every part in the merchandise

In addition there are two reports that must be produced annually: the Annual Reconciliation for U.S. Customs, and the Annual Report to the Foreign-Trade Zones Board. The Reconciliation for U.S. Customs must contain the following information:

A description of the merchandise for each part number and zone status
Quantity on hand at the beginning of the year
Quantity on hand at the end of the year
Cumulative receipts and transfers by part number
Negative and positive adjustments during the year

The Annual Report for the Foreign-Trade Zones Board must contain the following:

The value of merchandise forwarded into the U.S. market
The value of merchandise forwarded to foreign countries
The value of merchandise forwarded to other Foreign-Trade Zones
The five main foreign status items received at the zone, classified by value

During the day-to-day operation of zones, it is also very helpful if the system prints out the following Customs Forms.

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