CLIENT ALERTS & INSIGHTS

# Bonded Warehouses and FTZs as Tariff Mitigation Tools

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Authors: Jonathan R. Todd, Robert Naumoff

The threat of a looming trade war has left United States importers scrambling for tools to help ameliorate the impact of customs duties. In many ways we are entering a higher-cost operating environment. Some of the tools in the toolbox include confirming tariff classification codes, confirming countries of origin, negotiating volume and price with sellers and buyers, and seeking alternate markets for purchase or sale of goods.

**Considering Bonded Warehouses and FTZs**

All options must be on the table in this time of escalation. One time-tested tool in the toolbox that has received far less attention is the use of customs bonded warehouses and foreign trade zones (FTZs). These strategies help manage the timing of duty payments and as a result help manage cash flows. They can also eliminate the need to pay duties on goods that will ultimately be exported, which is particularly valuable since many of the proposed tariff actions eliminate the ability to use customs drawback to recover duties on subsequently exported goods. The net effect is more control over spend and the avoidance of unrecoverable spend in this period of off-and-on-again trade policy.

**Common Advantages and Limitations**

Bonded warehouses and FTZs are buildings or secured areas in which imported dutiable merchandise may be stored or manipulated or undergo manufacturing operations without the payment of duties for a period of time. The greatest legal distinction between bonded warehouses and FTZs is that products held in bonded warehouses are legally within the customs territory of the United States and subject to duties, while products held in FTZs are outside the customs territory despite their physical presence in the United States. The availability of favorable treatment in the application of United States duties is similar for each.

A key advantage of utilizing a bonded warehouse or FTZ is that merchandise can be manipulated therein. Product manipulation, including sorting and repackaging, is permitted in bonded warehouses without necessitating importation into the United States. However, bonded warehouses offer limited options for manufacturing operations and will generally require importation before any further manufacturing can take place. Conversely, FTZs permit product manipulation, as well as manufacturing and other substantial changes, without importation and the necessity for the payment of duties. The degree of manipulation or manufacturing is the single greatest factor in choosing between the two.

Another significant operational factor is the ease of withdrawal or removal of products. As a general rule, shipments entered into a bonded warehouse must be withdrawn from the warehouse *in their entirety*

and corresponding duties paid. In contrast, removal of products from FTZs does not generally require parity with the product entered. This allows for a piecemeal approach if the then-current trade environment is unfavorable, because FTZs are legally outside the customs territory of the United States and the corresponding imports are viewed as any other import entered into the United States at the discretion of the importer.

**Bonded Warehouse and FTZ Rules**

U.S. Customs and Border Protection (CB") oversees the establishment and operation of bonded warehouses. A shipper or its customs broker may enter its products into a bonded warehouse under an importer's bond. Product may be held in a bonded warehouse for a period up to five (5) years. Product manipulation is permitted in warehouses designated as a certain class upon application for a permit and approval by the Port Director. Permits may be granted on a blanket basis covering all warehouse entries for one (1) year, at the discretion of the Port Director, provided that the type of manipulation is identical for each of the covered entries. The shipper can then file an application to withdraw manipulated shipments from the bonded warehouse. Blanket permits to withdraw are granted only in limited circumstances.

The United States Foreign Trade Zones Board, which consists of the Secretary of Commerce and Secretary of Treasury or their designees, oversees the establishment and operation of FTZs in cooperation with CBP. A shipper or its customs broker may enter its products into an FTZ pursuant to Customs Form 214. Blanket permits for entry may be granted, limited to circumstances involving single transportation entries or for entries within a single business day. Product manipulation is permitted in any FTZ upon application for a permit, which may be granted for periods of up to one (1) year. Permits for removal from an FTZ may be granted on a weekly basis.

The transportation services required to move products from ports of entry in the United States, to the bonded warehouse or FTZ, and then to export, is the same under either scenario. A carrier will process an Immediate Transportation Entry for the initial leg and a Transportation and Exportation Entry for the final leg. The carrier will then haul the products under an in-bond manifest and bear liability to the United States under its custodial bond for any failure to deliver. These activities will be provided in compliance with the requirements of 19 CFR Part 18, of which carriers may be familiar if they have experience providing in-bond transportation within the United States.

**New Bonded Warehouses and FTZs**

Bonded warehouses are available from third parties, or new bonded warehouses may be established through an application and approval process that spans approximately six (6) months. Establishing a new bonded warehouse begins with filing a written application with the nearest Port Director. The application requires detailed information regarding the facility, including blueprints, the type of merchandise and its anticipated customs value, the existence of fire insurance coverage, financial statements, background information on company officers and relevant employees, and descriptions of inventory controls. The Port Director may grant or deny applications at his or her sole discretion following a physical survey of the facility for security compliance and a background investigation of the applicant and other parties involved. Upon approval, the applicant must post a bond on Customs Form 301 based on the estimated annual customs value of products held at the facility. Once a bonded warehouse is established, its proprietor is responsible for complying with all legal requirements, including supervision of the warehouse, safekeeping of the merchandise, inventory, and recordkeeping.

FTZs are available for use from public and private third-party entities, or new FTZs, including "sub-zones" within existing FTZs, may be established through an application and approval process of approximately three (3) to twelve (12) months. While private for-profit organizations are eligible to apply to establish FTZs, approval requires a special act of the state legislature specifically naming the organization and evidence that the entity was chartered for the purpose of establishing an FTZ. These stringent requirements are due to the role of FTZs as public utilities offered for economic development and advancement of United States trade policy.

Establishing an FTZ requires filing a written application with the Foreign Trade Zone Board. The application requires substantial and detailed information, including evidence of state enabling legislation, descriptions of the proposed site, analysis of the economic justification for the FTZ (including impact studies and an economic profile of the local community), and an explanation for how the FTZ will advance the trade-related goals and objectives of the United States. The nearest FTZ grantee receives notice of the application and an opportunity to object by demonstrating that public interest would not be served by approval. Details of the application are also published in the Federal Register for public comment and the possibility of a public hearing. If the application is approved by the Board, then the grantee must apply to the local Port Director to gain additional approval for activation of the FTZ. This final approval process may involve a background investigation and will be granted or denied with finality at the sole discretion of the Port Director.

Once an FTZ is established, the grantee must conduct its operations as if it were a public utility. All rates and charges must be published, uniform, fair, and reasonable. If any member of the public believes that it did not receive fair treatment from the FTZ, then he or she may submit a complaint to the Executive Secretary of the Board for review and investigation. Additionally, grantees are subject to annual reporting as well as stringent security, storage, and handling requirements.

**A Clear Choice Based on Domestic Activities**

Choosing between bonded warehouses and FTZs depends on operational goals. Bonded warehouses are available for repositioning, consolidation and deconsolidation, and light manipulation, although they are not appropriate for most manufacturing activities. FTZs are available to satisfy manufacturing needs in addition to the many benefits offered by bonded warehouses, and offer ease of withdrawal, although they are subject to greater regulation. The regulatory burden for launching new bonded warehouse or FTZ operations is significantly, and sometimes prohibitively, greater for FTZs. As with all decisions for supply chain engineering, the advantages of favorable duties and on-shore operations balance against the cost of time, expense, and effective compliance.

We must bear in mind that the landscape is changing every day. The current slate of Trump Administration tariffs provide that duties will be based upon the classification of the goods at the time of admittance into an FTZ such that importers may nonetheless bear responsibility for heightened duties if entered while tariffs are in effect, thereby negating some of the potential benefits of FTZs. Ultimately, importers must choose the import method that works best for them amid a constantly changing trade landscape.

**Jonathan R. Todd is Vice Chair of the Transportation & Logistics Practice Group at Benesch. His entire career has focused on supply chain management, transportation and logistics, and international trade. He brings unique perspective as a licensed customs broker with a graduate degree in Supply Chain Management, in addition to being an attorney. He knows the players in the game and mobilizes quickly for his clients. You may reach Jonathan at 216.363.4658 and jtodd@beneschlaw.com.**

**Robert Naumoff is Of Counsel with the Transportation & Logistics Practice. He is former in-house counsel in the industry, where he supported transportation, storage, and customs operations across the enterprise. You may reach Robert at 614.223.9305 and rnaumoff@beneschlaw.com.**