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I. INTRODUCTION

Two foreign trade zones recently have been established in Florida. The first zone, the Port Everglades Foreign Trade Zone, is located adjacent to the deep water harbor of Port Everglades, Florida. The second zone, the Miami Free Zone, is located in proximity to the Miami International Airport. Consideration is being given to establishing additional zones in Orlando, Tampa, and Jacksonville.

The creation of these zones has generated inquiries from foreign business interests. Most inquiries relate to the possibility of sending goods from Japan or Europe to one of the Florida zones for manufacture and then forwarding the goods on to South America, Central America, or the Caribbean. Other inquiries relate to the possibility of forwarding goods from Latin America to Florida for storage and eventual distribution in the United States.

This article will briefly discuss several of the more commonly raised legal points and will attempt to provide attorneys for foreign traders and investors with a basic background in foreign trade zone law.

II. DEFINITION OF A FOREIGN TRADE ZONE

A foreign trade zone has been defined as:

> An isolated, enclosed, and policed area, operated as a public utility, in or adjacent to a port of entry, furnished with facilities for lading, unlading, handling, storing, manipulating, manufacturing, and exhibiting goods, and for reshipping them by land, water, or air. Any foreign and domestic merchandise, except such as is prohibited by law or such as the Board may order to be excluded as detrimental to the public interest, health, or safety, may be brought into a zone without being subject to the customs laws of the United States governing the entry of goods or the payment of

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> duty thereon; and such merchandise permitted in a zone may be stored, exhibited, manufactured, mixed, or manipulated in any manner, except as provided in the act and other applicable laws or regulations. The merchandise may be exported, destroyed, or sent into customs territory from the zone, in the original package or otherwise. It is subject to customs duties if sent into customs territory, but not if reshipped to foreign points.[1]

The last sentence of this definition, which provides that goods sent to a zone are dutiable if they leave the zone for entry into United States customs territory, but are not dutiable if they leave the zone for foreign points, is of key significance. The ability to defer or eliminate payment of customs duties is the traditional incentive for sending goods to a foreign trade zone for storage or manufacture.

III. HISTORY OF FOREIGN TRADE ZONES

The idea of establishing a distinct geographical area into which goods can be imported without an immediate need to pay customs duties is of ancient origin. Prior to the creation of the Roman Empire, certain European cities had already begun extending various tariff privileges to international traders.[2] The present pattern of a free port located within a larger municipal unit had become entrenched in Europe by the late nineteenth century.[3] Today, free ports are located throughout the world, the largest one in the Caribbean region being in Colon, Panama.

Despite the widespread distribution of the free port phenomenon, no free ports existed in this country until 1937 when Foreign Trade Zone No. 1 commenced operations in New York City.[4]

The New York zone was established pursuant to the Foreign Trade Zone Act of 1934.[5] This Act provided for the establishment of a Foreign Trade Zone Board consisting of the Secretary of Commece, Secretary of the Treasury, and the Secretary of War, later changed to Secretary of the Army.[6] The Board was granted the authority to issue permits to public and private corporations for the purpose of creating and operating foreign trade zones.[7] The term "foreign trade zone" as opposed to "free port" was apparently chosen, at least in part, to win political support from those opposed

1. 15 C.F.R. § 400.101.
2. R. Thoman, Free Ports and Foreign Trade Zones 11-12 (1956).
3. *Id.* at 17.
4. *Id.* at 137.
5. 19 U.S.C. § 81a-u.
6. 19 U.S.C. § 81a; 15 C.F.R. § 400.103
7. 19 U.S.C. § 81b.

to "free" trade policy of any sort.[8] In addition to the power of granting foreign trade zone permits, the Board was given broad power to regulate zone operations.[9] The Secretary of the Treasury was given power to supervise and control those operations occuring in zones that would affect the collection of customs revenue.[10] Today, zones are operating in all regions of the United States.[11]

IV. ALTERNATIVES TO FOREIGN TRADE ZONES

The benefits obtainable by importing goods into a foreign trade zone, specifically the ability to defer or eliminate the payment of customs duties, can be partially obtained in other ways. 19 U.S.C. § 1313 provides for the return of duties paid on imported merchandise when that merchandise has been combined with domestic merchandise and exported. 19 U.S.C. § 1555[12] allows importers, on posting of a customs bond, to place imported merchandise in warehouses and to defer payment of customs duties if and until the goods are actually imported into the United States customs territory.

When operating under either of these provisions, however, sums must be expended as soon as goods arrive in the United States, either for customs duties which can ultimately be refunded or for bond premiums. The charge required when goods are deposited in a foreign trade zone is merely the fee for utilizing the space leased for the required period of time. Thus, it has been said that utilization of a zone can reduce the amount of required expenditure when goods are initially imported.[13] For this and other reasons zone use has continued in spite of the existence of these other methods of duty avoidance or deferral.[14]

V. CONSIDERATIONS FOR THE STORAGE OF GOODS IN A ZONE

As indicated, a key advantage in shipping goods to a trade zone as opposed to a non-zone location in the United States is the ability to defer payment of customs duties until goods actually leave the zone and enter the United States customs territory. Another advantage of importation into a zone is that goods may be stored in a zone indefinitely. This contrasts with the

8. Comment, *Foreign Trade Zones: A Means By Which the Businessman May Avoid Import Duties*, 29 U. Pitt. L. Rev. 89, 95 (1967).

9. 19 U.S.C. § 81h.

10. 19 U.S.C. § 81c.

11. 38th Annual Report of the Foreign Trade Zones Board to the Congress of the United States 76, 77 (1976):

12. *See also*, 19 C.F.R. §§ 19, 113, 144.

13. W. Dymsza, Foreign Trade Zones and International Business 138 (1964). The author notes, however, that in practice the reduction is often not as significant as it might appear.

14. *See*, Dymsza at 140, 141.

three-year restriction placed on goods stored in bonded warehouses.[15] Thus, utilization of a zone as a parts or inventory distribution center may be more practical than utilization of a bonded warehouse for a similar purpose.

Other benefits of zone utilization are the lack of quotas[16] and United States Customs Service protection.[17] In addition, subject to obtaining a permit from the District Director of Customs, goods can be exhibited in a zone to potential purchasers.[18] This ability to exhibit merchandise without first having to pay a duty is a potentially significant incentive for foreign producers to utilize Florida zones. Florida has traditionally been the market place for American purchasers and Latin American sellers, and the ability to expose prospective buyers to a variety of goods without requiring them to travel to Latin America could conceivably enhance the demand for these goods.

Despite the above advantages obtainable by zone use, certain problems exist. Specific goods are not permitted into foreign trade zones.[19] More importantly, although there is no law on point, it seems that goods which are prohibited by state or federal statute from entering the United States will also be denied admission into zones.[20]

As a final consideration, given the fact that the key advantage of zone use is the ability to defer or eliminate payment of customs duties, it must be realized that zones will be of significant utility only to those parties transporting high duty goods to the United States. A cursory reading of the United States tariffs reveals that flashlights are dutiable at 35 percent of value,[21] television picture tubes at 15 percent of value,[22] and infrared lamps at 4 percent of value.[23] Other, often unexpected, items are subject to high duties, and dealers in these items should be especially aware of the advantages of utilizing a zone.[24]

15. 19 U.S.C. § 1557(a); 19 C.F.R. § 144.5.

16. 19 C.F.R. § 146.11.

17. 19 U.S.C. § 81d; 19 C.F.R. § 146.3.

18. 19 U.S.C. § 81c; 15 C.F.R. § 400.803.

19. 19 C.F.R. § 146.11 lists items such as treasonous or obscene reading material and lottery matter.

20. See the discussion of applicability of federal and state law in foreign trade zones, *infra* note 35 through 42.

21. 19 U.S.C. § 1202, item 683.70.

22. 19 U.S.C. § 1202, item 687.50.

23. 19 U.S.C. § 1202, item 686.40.

24. The New York zone is used by an importer of high duty French perfume as a storage center for distribution to Latin America. Note, *Foreign Trade Zones: Holes in the Tariff Wall or Incentive for Development?* 2 Law & Policy in Int'l Bus. 190, 205 (1970).

VI. CONSIDERATIONS FOR THE MANUFACTURE OF GOODS IN A ZONE

On receipt of a permit from the District Director of Customs, manufacturing is permitted in zones.[25] As was the case with goods stored in a zone, manufactured items are only subject to United States customs duty when they are imported into the United States customs territory.

When goods which have been imported into a zone and then further manufactured or combined with United States materials are moved from the zone into the United States customs territory, duty can be levied in one of two ways. If proper application has been made, duty can be levied on only those parts of the finished product which are of foreign origin.[26] Alternatively, duty will be assessed on the finished product actually entering the United States as though the entire finished product had come directly from a foreign country.[27]

Significantly, in light of the second method of duty assessment, it is possible to transport dutiable goods into a zone, manipulate and manufacture these goods so that they constitute a new product no longer subject to duty, and then send the product into the United States free of any customs duty. This procedure was followed by a shipbuilder in *Armco Steel Corporation v. Stans.*[28] The shipbuilder imported steel from Japan into a sub-zone of the New Orleans zone and thereby deferred payment of the 7½ percent ad valorum duty. In the sub-zone, barges were manufactured with the imported steel and later imported into the United States. Under the applicable tariff regulations, the barges were duty free. Thus, by utilizing a zone, the shipbuilder was able to utilize foreign materials in the construction of the barges and yet eliminate the payment of duty. This result was upheld by the Second Circuit Court of Appeals.

Other advantages can be obtained by manufacturing in a foreign trade zone. Because duty need only be paid when manufactured goods actually enter the United States customs territory, any waste material, loss, or shrinkage arising out of the manufacturing process and remaining in the

25. 19 U.S.C. § 81c; 15 C.F.R. § 400.803. *See generally,* Miller *Foreign-Trade Zone Manufacturing: The Emergence of a Free Trade Instrument,* 9 Va. J. Int'l Law, 444 (1969).

26. *See,* 19 U.S.C. § 81c; 19 C.F.R. §§ 146.21 (c) (3) (d). Review of these provisions does not reveal completely unambiguous authority for the above proposition. Apparently, however, these provisions have traditionally been read to mandate the above basis for duty. DaPonte, *Need a Competitive Edge? Try a Zone Defense.* (Publication of the Foreign Trade Zones Board); *A Guide to Using a Foreign Trade Zone No. 13* (Publication of the Port Everglades Foreign Trade Zone); *Miami Free Zone 3* (Publication of Miami Free Zone).

27. *Id.,* 19 C.F.R. § 146.48 (e).

28. 431 F.2d 779 (2d Cir. 1970). *See generally,* Recent Decisions, *Customs-Foreign Trade Zones Act-Domestic Steel Manufacturer Has Standing to Challenge Order of Foreign-Trade Zones Board Authorizing Foreign-Trade Sub-Zone in which Imported Duty-Free Steel Can Be Used to Manufacture Barges For Sale in United States,* 10 Va. J. Int'l Law 179 (1969).

zone is not as dutiable as it would have been had the material been taxed on entry into the zone.[29] In addition, it has been stated that goods manufactured in a foreign trade zone can be labeled "Made in U.S.A."[30] While the precise basis for this statement is unclear, 19 C.F.R. § 134.13(b)(3) indicates that if foreign goods are sent to a zone, manufactured, and then sent into the United States, there is no need to mark the finished products with the name of the foreign country from which the original goods came.

More importantly, it is likely that a foreign government would permit goods to be admitted into its customs territory bearing the label "Made in U.S.A.", if these goods were actually manufactured in a United States foreign trade zone. Thus, for example a manufacturer of denim in Colombia could transport the denim to a Florida zone, manufacture blue jeans with the material, then transport the finished blue jeans back to Colombia bearing the prestigious "Made in U.S.A." label.

As a final point, even though manufacturing is generally permitted in zones, the manufacture of certain items is expressly prohibited. The provisions prohibiting manufacture of items are complex,[31] but appear to prohibit manufacture of items such as narcotics, white phosphorous matches, distilled spirits, and certain types of butter. Because of both the existence of these prohibitions and the cryptic manner in which they are described in the statutes, it may be advisable to obtain a statement from United States Customs that manufacture of a desired item is permitted before plans to manufacture such an item in a zone are made.

VII. APPLICABILITY OF FEDERAL AND STATE LAW TO OPERATIONS IN A FOREIGN TRADE ZONE

The creation of the Florida zones has prompted inquiries as to the applicability of federal and state law to zone-based operations. Specifically, questions have been raised as to whether federal anti-trust, fair trade, and environmental legislation can be avoided if the prohibited acts occur in a zone, and whether personal property (inventory) taxes, ordinarily leviable by Florida counties, can be avoided if goods are placed in a zone.

As to the first question, it appears that general federal law does apply to activities in zones. This reading is supported by the fact that, while the Foreign Trade Zones Act of 1934 set up a mechanism by which customs duty could be avoided, the Act did not by its terms alter the application of other federal law. 19 U.S.C. § 81c specifies that, "foreign and domestic merchandise . . . may without being subject to *the customs laws of the United States* . . . be brought into a zone and may be stored . . . ." (emphasis

29. *See, Foreign Trade Zones, supra* note 8 at 100.

30. *See, Foreign Trade Zone Manufacturing, supra* note 25 at 459.

31. 19 U.S.C. § 81c; 19 C.F.R. § 146.32 (b).

added). There is no mention in the Act of any relief from the application of non-customs law.

The Act's legislative history is consistent with its terms. In 1934, the Act's sponsor, Congressman Emmanuel Celler, declared zones to be, "subject a little within [sic] adjacent regions to all the laws relating to public health, vessel inspection, postal service, labor conditions, immigration, and indeed everything except the customs."[32]

This interpretation of the law was adopted in *G. D. Searle & Co. v. Byron Chemical Co.*[33] This case held that, based on the Act's legislative history, United States patent laws applied in foreign trade zones. Similarly, the Internal Revenue Service has taken the position that transactions occurring in a foreign trade zone are not necessarily exempted from the federal income tax laws.[34] On the basis of these authorities, it would seem that operation in a Florida zone cannot be used as a means to escape the reach of otherwise applicable federal law.[35]

Whether goods in Florida zones will be subject to personal property tax is less clear.[36] The Florida Department of Revenue has not yet spoken to the issue and there is no reported case law on point. Two decisions, however, both of which turn on the Commerce Clause of the United States Constitution,[37] are relevant in this context.

In *McGolderick v. Gulf Oil Corp.*,[38] the Supreme Court held that a state sales tax on oil located in a New York bonded warehouse violated the commerce clause. The oil in question had been originally shipped to the warehouse from abroad and had been processed there for sale exclusively to foreign bound vessels.

32. 78 Cong. Rec. 9853 (1934) quoted in *Foreign Trade Zones, supra* note 8 at 104. According to the author of the note, the phrase "a little within" should be construed to mean "equally with." *Id.*

33. 223 F. Supp. 172 (E.D.N.Y. 1963).

34. Rev. Rule 76-161, 1976-18 I.R.B. 10. *But see*, Rev. Rul. 59-318, 1959-2 Cum. Bull. 310 in which goods sent from the United States to a zone are viewed as exported and therefore exempt from federal manufacturer's excise taxes.

35. *Cf.*, Fountain v. New Orleans Public Service, Inc., 387 F.2d 343 (5th Cir. 1967), in which it was held that federal as opposed to state jurisdiction over a wrongful death action was not mandated because the action arose in a zone.

36. The question of whether zone-based goods in California will be subjected to California personal property tax is being litigated now. Lilli-Ann Corp. v. City & County of San Francisco, No. 726-271 (Super. Ct. of San Francisco County, filed July 29, 1977). In Florida, even if zone-based inventory is taxable, it will generally be assessed at only 10 percent of just valuation or less. Fla. Stat. § 193.511, Ch. 77-476 (1977).

37. U.S. Const. art. I, § 8, cl. 3.

38. 309 U.S. 414 (1940).

The court noted that federal legislation exempted this particular oil from United States taxation.[39] The court further noted that this exemption was intended to foster oil import and re-export and was thus a valid exercise of Congress power to regulate foreign commerce.[40] Because the state tax would thwart Congressional intent by making commerce in oil more costly, the tax was held to, "fail as an infringement of the Congressional regulation of the commerce."[41]

The *McGolderick* decision was cited in *During v. Valente.*[42] In *During*, the defendant retained the plaintiff to obtain purchasers for foreign liquor stored in the New York zone for re-export, but did not pay the plaintiff when purchasers were located. Defendant asserted as a defense the fact that the plaintiff had not obtained a permit to sell liquor as was required under the statutes of New York. The court held that the failure to obtain such a permit was no defense and reversed the lower court's dismissal of the plaintiff's complaint. The court reasoned that to require a permit for the sale of the liquor in question would burden foreign commerce and impede Congress purpose in passing the Foreign Trade Zone Act.

Several observations can be made about the above cases. First, they both stand for the loose proposition that state or local taxation must fail if it thwarts a legislatively expressed Congressional policy regarding commerce. Because the success of foreign trade zones could be adversely affected by taxation of zone-based goods, the above cases can be read to prohibit such taxation.

On the other hand, both of the discussed cases deal exclusively with foreign goods temporarily in zones or bonded warehouses prior to export. Zone-based goods in general, United States goods in zones prior to export, and foreign goods in zones prior to United States distribution, are all unmentioned. Similarly, unmentioned are subsequent cases that hold goods subject to taxation if they have been removed from commerce.[43] It is at least arguable that goods in Florida zones bound for Florida markets are no longer in interstate or foreign commerce and are thus unaffected by the commerce clause.

Given the unclear authoritative value of *McGolderick* and *During*, foreign business interests cannot confidently be advised that placement of their goods in Florida zones will result in immunity from personal property

39. 309 U.S. at 424.

40. 309 U.S. at 427, 428.

41. 309 U.S. at 429.

42. 46 N.Y.S. 2d 385 (S. Ct. 1944).

43. Independent Warehouses v. Scheele, 331 U.S. 70 (1947); Pan Am. World Airways, Inc. v. Morgan, 82 Wash. 2d 706, 513 P.2d 278 (1973); Consolidation Coal Co. v. Porterfield, 267 N.E. 2d 304 (1971).

taxation. While ultimately it may be decided that these goods are immune, the decision does not appear to be required by the commerce clause.[44]

VIII. FLORIDA'S GOODS-IN-TRANSIT ACT

Even if a constitutional basis for tax exemption of all zone-based goods is not held to exist, Florida's new Goods-In-Transit Act,[45] Section 196.0011 of the Florida Statutes, may provide a statutory basis of exemption for certain goods whether or not they are in zones. The new Act provides that goods from other states or countries, bound for destinations other than Florida, are exempted from personal property taxes while in Florida.[46] Under the Act, a finding that property is not destined for Florida will be supported if the property remains in its "individual unit packaging device."[47]

The Act does not exempt property which is subjected to manufacture in Florida or which is used to manufacture other property.[48] The Act further provides that even though the final destination of goods is out of state, once goods are broken down, labeled, and repackaged tax exempt status lasts for only 180 days.[49]

Under the terms of the Act, a Japanese television manufacturer could store products destined for Latin America in a Florida zone, or elsewhere in Florida, and not be subjected to personal property tax, providing the sets remained in their original packages. The Act, however, would not exempt a

44. This conclusion is reached even in light of the comment of one author that goods in zones, "have always been recognized as exempt . . ." from at least state inventory taxes. *Traders Seeking Relief from Michelin Setback,* Commerce America 16 (March 28, 1977). While this may be true, the previous discussion has raised doubts as to whether this traditional exemption has actually been required by the commerce clause. Rather, the exemption might be explained by noting that many zones are owned by state agencies and could be free from state taxation for that reason.

Alternatively, it might have been felt that zone based goods from foreign countries, most of which were stored in their original containers, were exempted from state taxation by the import clause of the Constitution, Article I, Section 10. Significantly, however, even if the past basis for exemption was the import clause, that clause was recently reinterpreted and it is now unclear whether any exemption is afforded. In Michelin v. Wages, 423 U.S. 276 (1976) the court held that only those imports still in "import transit" are exempted from state taxation by the import clause. Given the *Michelin* formulation, it is open to question whether mere storage of goods in a zone will result in tax exemption for two reasons. First, it is not clear that goods in zones can be imports to begin with given their location outside the United States Customs territory. *See generally, Traders Seeking Relief, supra.* Secondly, there is no present law indicating that merchandise in zones is "in transit" simply because of zone situs. Thus, even if the import clause has provided a basis for exemption in the past, it is questionable as to whether such a basis exists now.

45. Chapter 77-305, effective December 31, 1977.

46. §§ 196.0011(1) and (2).

47. § 196.0011(2).

48. § 196.0011(3).

49. *Id.*

Venezuelan merchant engaged in forwarding products to Florida for manufacture. It is hoped that the terms of the statute will be administratively clarified so that its applicability to specific situations can be more easily predicted.

IX. CONCLUSION

In conclusion, utilization of Florida foreign trade zones can provide foreign business interests with certain benefits not otherwise obtainable. Additionally, while transactions occurring in zones are subject to otherwise applicable federal law, it is possible that zone-based goods will be exempt from personal property taxation by operation of the commerce clause. Even if this exemption is not found to exist, the Goods-In-Transit Act exempts many imports from taxation regardless of whether or not they are located in a zone. In light of the above considerations, the possibility of operating through Florida zones might profitably be considered by foreign business interests.