



MEMORANDUM

Date: January 3, 2017

To: The Honorable Chair and Members
Pima County Board of Supervisors

From: C.H. Huckelberry
County Administrator

A handwritten signature in black ink, appearing to be "CHH", is written over the printed name "C.H. Huckelberry".

Re: **Foreign Trade Zone – Frequently Asked Questions**

During the November 22, 2016 Call to the Audience at which the Monsanto facility was addressed by members of the public, there was some confusion regarding a Foreign Trade Zone designation versus a Free Trade Zone designation. Because of this confusion, which arises relatively frequently, I asked our Economic Development staff to develop a Frequently Asked Questions Fact Sheet regarding Foreign Trade Zones, their designation and approval processes. This information is attached to this memorandum.

Please contact me if you have any further questions regarding this subject.

CHH/anc

Attachment

c: Dr. John Moffatt, Director, Economic Development Office
Patrick Cavanaugh, Deputy Director, Economic Development Office

Foreign Trade Zone – Frequently Asked Questions and Fact Sheet

(1) What is a Foreign Trade Zone?

A foreign trade zone (FTZ), as defined by the International Trade Administration of the United States Department of Commerce¹, is a designated location in the United States where companies can use special procedures that help encourage US trade activity. In essence, FTZs allow delayed or reduced duty payments on foreign merchandise and provide for other savings on trade-related costs for approved companies. The zones are considered to be outside the customs territory of the United States.

Goods within these federally designated and highly regulated zones may be landed, handled, manufactured or reconfigured, and re-exported without the intervention of customs authorities. Only when the goods are moved to consumers within the country in which the zone is located do they become subject to the prevailing customs duties. If the merchandise never enters commerce in the U.S, then no duties or taxes are paid on those items.

(2) Are FTZ s common and where are they located?

The FTZ program began in 1934 when it was created by an act of the US Congress² and new zones have been created and used consistently in the subsequent 81 years of the program's existence. There were 186 FTZs active in 2015 and the 2,900 companies that used these FTZs employed an estimated 420,000 people in the United States. Arizona's FTZs include FTZ 60 (Grantee: Nogales-Santa Cruz County Economic Development Foundation), FTZ 75 (Grantee: City of Phoenix), FTZ 219 (Grantee: Greater Yuma Economic Development Corporation), FTZ 277 (Grantee: Western Maricopa County/ Greater Maricopa Foreign Trade Zone, Inc.) and FTZ 139 (Grantee: Sierra Vista/Arizona Regional Economic Development Foundation).

The designation in Pima County is FTZ 174, which covers all of Pima County and the southern portion of Pinal County; and the designated Port of Entry that allows for the operation of the FTZ is located at Tucson International Airport.³

¹ Commerce Department, see: www.trade.gov/enforcement

² FTZ Act; United States Code: *19 USC. 81a-81u*

³ CBP, see: <https://www.cbp.gov/contact/ports/Tucson>

(3) Who governs FTZ?

The federal Foreign Trade Zones Board has broad authority for establishment of FTZ sites, approval of grantees, regulation of the zones and approval of the usage driven zones where specific companies are allowed to operate for a specific use. Of the different types of zone operating uses, FTZ 174 utilizes an Alternative Site Framework (ASF) model, which uses magnet sites and usage driven sites and not general zones and subzones. The ASF approach allows greater flexibility and responsiveness to serve single operator or single user locations. The FTZ Board consists of the Secretary of Commerce and the Secretary of Treasury or their designated alternates. The daily operations of the FTZ Board are run by the Executive Secretary and the FTZ Board's staff, who are Department of Commerce employees. Once a zone or subzone site is approved by the FTZ Board, an application must then be made to the US Customs and Border Protection (CBP), with the concurrence of the FTZ grantee, to operate the zone or subzone (or a portion thereof) under FTZ procedures. This CBP process is known as activation and generally includes steps such as background checks, a written procedures manual, posting a bond with CBP, and a review of the security of the site(s) and the inventory control methods.⁴ CBP monitors the day-to-day operation of the zones and is consulted on every FTZ application.

(4) What is the role of the FTZ Grantee?

In general, the grantee is the public or private corporation to which the privilege of establishing, operating or maintaining a zone project has been given. The principal responsibilities of a grantee are to: (1) provide and maintain facilities in connection with a zone; (2) operate the zone as a public utility with fair and reasonable rates and charges for all zone services and privileges and afford to all who apply for use of the zone and its facilities and provide uniform treatment under like conditions; (3) make annual reports (and at other such time as it may prescribe) to the FTZ Board containing such information as the FTZ Board may require; (4) maintain books, records and accounts; (5) apply to the FTZ Board for a grant of authority to establish a subzone or expand or otherwise modify its zone project; (6) permit the erection of buildings necessary to carry out approved zone projects; (7) operate, maintain and administer the zone project under the FTZ Act and the laws and regulations administered by CBP for other agencies or administered directly by other agencies, and the schedules of rates and charges made and fixed by the

⁴Commerce Department, see: <http://enforcement.trade.gov/ftzpage/grantee/glossary.html>

grantee; (8) make written application to the Port Director for approval of a new operator; and (9) if acting as the operator, make application or provide concurrence to a request for activation, deactivation or reactivation.⁵

In Pima County, the grantee for FTZ 174 is Sun Corridor Inc. Sun Corridor Inc. does not operate or maintain any zones, but uses its grantee privileges to establish magnet and usage driven sites. Locally, the primary objectives in the establishment of a new site are the generation of business, the development of capital investment and the creation of primary jobs.

(5) What is the State of Arizona's role in FTZ?

The FTZ program is primarily a federal function, but some states have added additional benefits or requirements related to the zones. In 1991, the State of Arizona enacted a law that provides a property tax benefit to companies operating in activated FTZs. The legislative intent was to provide a business incentive and to stimulate foreign trade in the state.

Arizona Revised Statutes provide for the classification of properties in the state.⁶ Although the rate of property taxation is uniform in Arizona, taxes will vary based on the classification of a particular property. These nine different property tax classifications⁷ range from 1 percent to 28 percent of the assessed valuation of the property in the differing classifications. Normally a manufacturing or distribution facility would fall within Class 1 and would be taxed at the current commercial property tax rate of 18 percent of assessed valuation. However, real property and personal property located within the boundaries of an activated FTZ are considered Class 6 and are taxed at the rate of 5 percent of assessed valuation.⁸

(6) What is Pima County's role?

Pima County views both the federal duty relief of FTZs and the associated property tax reduction offered by the state law as incentives to be actively marketed for business attraction and job creation in Pima County. The county works with Sun Corridor Inc. to evaluate a company's potential for qualifying for FTZ activation and conducts financial impact analysis to determine the benefit to the citizens of Pima County that accrue in the form of capital

⁵ National Association of Foreign Trade Zones; see www.naftz.org/

⁶ A.R.S. Title 42, Chapter 12, Article 1

⁷ Arizona Department of Revenue; see <https://www.azdor.gov/Portals/0/Property/2016Part3Chapter1.pdf>

⁸ A.R.S. 42-12006

investment, the number of jobs created and the wages and benefits provided by the companies.

If a qualified company seeking FTZ designation pursues the property tax abatement as allowed per state statute, then the company and a grantee's application process with the FTZ Board in Washington, D.C. begins. As part of that process, local governments with taxing authority impacted by a potential FTZ activation will submit "letters of no objection" indicating the individual jurisdiction's concurrence with the tax revenue reduction or indicating the jurisdiction does not object to the potential FTZ activation because a Payment In-Lieu of Taxes (PILOT) agreement has been reached with the company. These PILOT agreements are generally for 10-year or 15-year terms. The PILOT provides direct payments that offset the property tax impacts to the local jurisdiction or the jurisdiction may negotiate some other financial offset to the property tax reduction.

As the regional government, Pima County has traditionally served to coordinate the negotiation between companies seeking FTZ activation within the boundaries of the county and the impacted taxing entities. Pima County encourages the other taxing entities to conduct their own independent negotiations for PILOT agreements, which are then compiled in a Pima County regional PILOT agreement that is signed by the taxing entities and the company seeking FTZ activation. The county agreement is then presented to the Pima County Board of Supervisors for consideration and a public discussion and vote.

Due to the significant decline in tax funding for school districts (and other educational entities such as Pima Community College and the Pima County Joint Technical Educational District, or JTED) Pima County encourages PILOT agreements for these educational entities that would see reduced funding through the state-mandated FTZ property tax reduction. To encourage these PILOT agreements with the educational entities and to maintain the incentive for companies to provide investment and jobs in our region, Pima County will consider providing a letter of no objection to a proposed FTZ activation without a PILOT agreement and consent to a loss of property tax revenue to the county General Fund, as well its secondary taxing entities such as the Pima County Regional Flood Control District and Pima County Library District.

The regional FTZ PILOT agreements are becoming more common due to an increase in business activity in Pima County. The most recent agreements

approved by the Board of Supervisors include Raytheon (November 22, 2016⁹) and HomeGoods (January 13, 2015¹⁰.) These FTZ PILOT agreements operate under the same principles and procedures as the FTZ PILOT agreement currently proposed for Monsanto, which is scheduled to be considered by the Pima County Board of Supervisors on February 21, 2017.

(7) Can Pima County or Sun Corridor Inc. deny a company from operating in a Foreign Trade Zone?

Pima County cannot deny a company FTZ status. The county simply conducts the initial negotiations, coordinates the local regional FTZ PILOT agreement and provides the county's letter of no objection (or objection) to the FTZ Board during its consideration of FTZ or subzone activation. The letter of no objection from local taxing entities is one of many criteria considered by the FTZ Board when considering whether to approve a site activation for a company¹¹ and does not in itself ensure denial. However, failure to provide a letter of no objection places Pima County at a disadvantage in seeking PILOT agreements for educational entities or from gaining other concessions such as the requirement of a Memorandum of Understanding that is being proposed for the Monsanto facility and which would require regular disclosure and reporting requirements by the company.

As previously noted, Sun Corridor Inc. as the grantee is required by federal regulation¹² to operate as a utility and "afford all who apply to make use or participate in the FTZ uniform treatment under like conditions." The grantee must ensure fair treatment to all applicants and cannot single out companies for unequal treatment. As the grantee, Sun Corridor Inc. can deny FTZ status but must be fair in its denial.

(8) What are the benefits of an FTZ for companies?

The primary benefit for a company operating in an activated FTZ is duty relief. In Arizona, as previously noted, state law provides for potentially significant property tax reductions. Less tangible benefits, such as increased security and

⁹Pima County Board of Supervisors agenda item, see <https://pima.legistar.com/View.ashx?M=F&ID=4799630&GUID=D97B775F-F66F-4C65-9459-D5DBFEE60E3B>

¹⁰ Pima County Board of Supervisors agenda item, see <https://pima.legistar.com/View.ashx?M=F&ID=3441893&GUID=82010B40-D22C-4730-8186-669A0D1889DA>

¹¹US Foreign Trade Zones Board, see: <http://enforcement.trade.gov/ftzpage/>

¹² 15 CFR part 400/FTZ regulations 440.4

increased trade efficiencies in company operations, are also generally experienced by companies in activated FTZs.

(9) What are the benefits of FTZs for the local and national economies?

Pima County has successfully utilized FTZ 174 as an incentive that allows for capital investment into our regional economy and as a method for creating jobs. For example, the approval of the HomeGoods regional FTZ PILOT agreement is intended to facilitate the creation of 895 jobs, and the expected FTZ PILOT for Raytheon was one of several incentives that are expected to create almost 2,000 new jobs in Pima County. In addition to direct employment, financial infusions in to the local economy are also seen in the form of construction jobs and supply chain opportunities.

For the nation's economy, FTZs provide a competitive advantage for US-based manufacturing and distribution operations. As a result, jobs that might otherwise be located overseas are created and retained in the US. The elimination of duties on exported merchandise makes US-based companies more competitive in global export markets. FTZs also encourage multinational firms to establish US-based operations, attracting foreign investment to the United States. These firms are also more likely to utilize US-made components, providing additional stimulus to local and regional economies¹³.

(10) Is the property tax benefit conveyed by the State of Arizona for companies operating in an activated FTZ in the state a violation of the Gift Clause of the Arizona Constitution?

No, the state law providing for the tax classification change related to private companies operating in Arizona has been legally vetted and implemented many times and has been found to be constitutional. The most relevant case law seems to be the 1997 suit brought against the state by the Arizona Center for Law in the Public Interest representing a taxpayer and focusing on the Uniformity Clause of the Arizona Constitution. The case centered on the property tax reduction provided to an Intel manufacturing facility operating in an activated FTZ in Chandler. The Arizona Court of Appeals ruled in favor of the state in 1999.¹⁴

¹³ NAFTAZ, see: <http://www.naftz.org/get-involved/advocacy/>

¹⁴ Bahr v. Arizona, Intel Corp. intervener/appellee, see <http://caselaw.findlaw.com/az-court-of-appeals/1039506.html>

(11) What is the difference between a Free Trade Zone and a Foreign Trade Zone?

Free Trade Zone is a designation used in nations besides the United States. Although similar in practice and also intended to facilitate duty free manufacturing and distribution, the regulations and actual operations vary from country to country and can differ substantially to Foreign Trade Zones in the US.¹⁵

¹⁵ See http://www.bizftz.com/faq/what-are-the-differences-between-free-zones-export-processing-zones-enterprise-zones-duty-free-shops-and-US-foreign-trade-zones-and-http://www.integrationpoint.com/documents/KPMG_FTZ_ComparativeReview_FactSheet.pdf