Suite 704

BONDED WAREHOUSE

This section is dealing with the legalities offered by U.S. Bonded Warehouses.

704.01 U.S. CUSTOMS BONDED WAREHOUSE

A Customs bonded warehouse is a building or, other secured area in which dutiable goods may be stored, manipulated, or undergo manufacturing operations without payment of duty. Authority for establishing bonded storage warehouses is set forth in Title 19. United States Code (U.S.C.) section 1555. Bonded manufacturing and smelting and refining warehouses are established under Title 19, U.S.C., sections 1311 and 1312.

Upon entry of good into the warehouse, the importer and warehouse proprietor incur liability under a bond. The liability is canceled when the goods are:

- Exported;
- Withdrawn for supplies to a vessel or aircraft in international traffic;
- Destroyed under Customs supervision; or
- Withdrawn for consumption within the United States after payment of duty.

704.02 TYPES OF CUSTOMS BONDED WAREHOUSES

Nine different types or classes of Customs bonded warehouses are authorized under section 19.1, Customs Regulations (19 CFR 19.1):

1. Premises owned or leased by the government and used for the storage of merchandise that is undergoing Customs examination, is under seizure, or is pending final release from Customs custody. Unclaimed merchandise stored in such premises shall be held under "general order." When such premises are not sufficient or available for the storage of seized or unclaimed goods, such goods may be stored in a warehouse of class 3,4,or 5;

2. Importers' private bonded warehouses used exclusively for the storage of merchandise belonging or consigned to the proprietor thereof. A class 4 or 5 warehouse may be bonded exclusively for the storage of goods imported by the proprietor thereof, in which case it should be known as a private bonded warehouse;

3. Public bonded warehouse used exclusively for the storage of imported merchandise;

4. Bonded yards or sheds for the storage of heavy and bulky imported merchandise; stables, feeding pens, or corrals, or other similar buildings or limited enclosures for the storage of imported animals; and tanks for storage of imported liquid merchandise in bulk;

5. Bonded bins or parts of buildings or elevators to be used for the storage of grain;

6. Warehouses for the manufacture in bond, solely for exportation, of articles made in whole or in part of imported materials or of materials subject to internal revenue tax; and for the manufacture for home consumption or exportation of cigars made in whole of tobacco imported from one country;

7. Warehouses bonded for smelting and refining imported metal-bearing materials for exportation or domestic consumption;

8. Bonded warehouses established for the cleaning, sorting, repacking, or otherwise changing the condition of, but not the manufacturing of, imported merchandise, under Customs supervision, and at the expense of the proprietor;

9. Bonded warehouses, known as duty-free stores, used for selling conditionally duty-free merchandise for use outside the Customs territory. Merchandise in this class must be owned or sold by the proprietor and delivered from the warehouse to an airport or other exit point for exportation by, or on behalf of, individuals departing from the Customs territory for foreign destinations.

704.03 ADVANTAGES OF USING A BONDED WAREHOUSE

There are several advantages of using a bonded warehouse.

- No duty is collected until merchandise is withdrawn for consumption.

- An importer, therefore, has control over use of money until the duty is paid upon withdrawal of merchandise from the bonded warehouse. If no domestic buyer is found for the imported articles, the importer can sell merchandise for exportation, thereby canceling his obligation to pay duty.

- Many items subject to quota or other restrictions may be stored in a bonded warehouse. Check with the nearest Customs office before assuming that such merchandise may be placed in a bonded warehouse.

- Duties owed on articles that have been manipulated are determined at the time of withdrawal from the Customs bonded warehouse

704.04 MERCHANDISE: ENTRY, STORAGE, TREATMENT

All merchandise subject to duty may be entered for warehousing except perishables and explosive substances other than firecrackers.

- Full accountability for all merchandise entered into a Customs bonded warehouse must be maintained; that merchandise will be inventoried and the proprietor's records will be audited on a regular basis. Bonded merchandise may not be commingled with domestic merchandise and must be kept separate from un-bonded merchandise.

- Merchandise in a Customs bonded warehouse may, with certain exceptions, be transferred from one bonded warehouse to another in accordance with the provisions of Customs Regulations. Basically, merchandise placed in a Customs bonded warehouse, other than class 6 or 7, may be stored, cleaned, sorted, repacked, or otherwise changed in condition, but not manufactured (Title 19, U.S.C., section 1562).

- Articles manufactured in a class 6 warehouse must be exported in accordance with Customs Regulations. Waste or by product from a class 6 warehouse may be withdrawn for consumption upon payment of applicable duties.

- Imported merchandise may be stored in a Customs bonded warehouse for a period of five years (Title 19, U.S.C., section 1557(a)).

704.05 HOW TO ESTABLISH A BONDED WAREHOUSE

Application

An owner or lessee seeking to establish a bonded warehouse must make written application to his or her local Customs port director describing the premises, giving the location, and stating the class of warehouse to be established.

Except in the case of a class 2 or 7 warehouse, the application must state whether the warehouse is to be operated only for the storage or treatment of merchandise belonging to the applicant, or whether it is to be operated as a public bonded warehouse.

If the warehouse is to be operated as a private bonded warehouse, the application must also state the general character of the merchandise to be stored therein, with an estimate of the maximum duties and taxes that will be due on the merchandise at any one time.

Other Requirements

The application must be accompanied by the following:

- A certificate signed by the president or a secretary of a board of fire underwriters that the building is a suitable warehouse and acceptable for fire insurance purposes. At ports where there is no board of fire underwriters, certificates should be obtained and signed by officers of agents of two or more insurance companies.

- A blueprint showing measurements to be bonded.

If the warehouse to be bonded is a tank, the blueprint shall show all outlets, inlets, and pipelines and shall be certified as correct by the proprietor of the tank.

A gauge table showing the capacity of the tank in U.S. gallons per inch or fraction of an inch of height, shall be included and certified by the proprietor as correct. When a part or parts of the building are to be used as a warehouse, a detailed description of the materials and construction of all partitions shall be included.

Bonds Required

Bonds for each class of warehouse shall be executed on Customs Form 301. Duty-free shops (class 9) have specific requirements governing their establishment. These requirements include location, exit ports, record-keeping systems, and the approval of local governments.

Where are Customs Offices Located?

The U.S. Customs Service has more than 300 ports of entry in the United States, Puerto Rico, and the U.S. Virgin Islands. Please consult your local telephone directory under "U.S. Treasury Department, Customs Service."

704.06 FOREIGN SALES CORPORATIONS

One of the most important steps a U.S. exporter can take to reduce federal income tax on export-related income is to set up a foreign sales corporation (FSC). This tax incentive for U.S. exporters replaced the domestic international sales corporation (DISC), except the interest charge DISC. While the interest charge DISC allows exporters to defer paying taxes on export sales, the tax incentive provided by the FSC legislation is in the form of a permanent exemption from federal income tax for a portion of the export income attributable to the offshore activities of FSCs (26 U.S.C., sections 921-927). The tax exemption can be as great as 15 to 30 percent on gross income from exporting, and the expenses can be kept low through the use of intermediaries who are familiar with and able to carry out the formal requirements. A firm that is exporting or thinking of exporting can optimize available tax benefits with proper planning, evaluation, and assistance from an accountant or lawyer.

An FSC is a corporation set up in certain foreign countries or in U.S. possessions (other than Puerto Rico) to obtain a corporate tax exemption on a portion of its earnings generated by the sale or lease of export property and the performance of some services. A corporation initially qualifies as an FSC by meeting certain basic formation tests. An FSC (unless it is a small FSC) must also meet several foreign management tests throughout the year. If it complies with those requirements, the FSC is entitled to an exemption on qualified export transactions in which it performs the required foreign economic processes.

FSCs can be formed by manufacturers, non-manufacturers, or groups of exporters, such as export trading companies. An FSC can function as a principal, buying and selling for its own account, or as a commission agent. It can be related to a manufacturing parent or it can be an independent merchant or broker.

An FSC must be incorporated and have its main office (a shared office is acceptable) in the U.S. Virgin Islands, American Samoa, Guam, the Northern Mariana Islands, or a qualified foreign country. In general, a firm must file for incorporation by following the normal procedures of the host nation or U.S. possession. Some nations offer tax incentives to attract FSCs. To qualify, a company must identify itself as an FSC to the host government. Consult the government tax authorities in the country or U.S. possession of interest for specific information.

A country qualifies as an FSC host if it has an exchange of information agreement with the United States approved by the U.S. Department of the Treasury. As of September 17, 1996, the qualified countries were Australia, Austria, Barbados, Belgium, Bermuda, Canada, Costa Rica, Cyprus, Denmark, Dominica, the Dominican Republic, Egypt, Finland, France, Germany, Grenada, Guyana, Honduras, Iceland, Ireland, Jamaica, Korea, the Marshall Islands, Malta, Mexico, Morocco, Netherlands, New Zealand, Norway, Pakistan, Peru, the Philippines, St. Lucia, Sweden, and Trinidad and Tobago. Since the Internal Revenue Service (IRS) does not allow foreign tax credits for foreign taxes imposed on the FSC's qualified income, it is generally advantageous to locate an FSC only in a country where local income taxes and withholding taxes are minimized. Most FSCs are incorporated in the U.S. Virgin Islands or Guam.

The FSC (unless it is a small FSC) must have at least one director who is not a U.S. resident, must keep one set of its books of account (including copies or summaries of invoices) at its main offshore office, cannot have more than 25 shareholders, cannot have any preferred stock, and must file an election to become an FSC with the IRS. Also, a group may not own both an FSC and an interest charge DISC.

The portion of the FSC gross income from exporting that is exempt from U.S. corporate taxation is 30 percent for a corporate-held FSC if it buys from independent suppliers or contracts with related suppliers at an "arm's-length" price - a price equivalent to that which would have been paid by an unrelated purchaser to an unrelated seller. An FSC supplied by a related entity may also qualify to use the special administrative pricing rules to compute its tax exemption. Although an FSC does not have to use the two special administrative pricing rules, these rules may provide additional tax savings for certain FSCs.

Small FSCs and interest charge DISCs are designed to give export incentives to smaller businesses. The tax benefits of a small FSC or an interest charge DISC are limited by ceilings on the amount of gross income that is eligible for the benefits.

The small FSC is generally the same as an FSC, except that a small FSC must file an election with the IRS designating itself as a small FSC - which means it does not have to meet foreign management or foreign economic process requirements. A small FSC tax exemption is limited to the income generated by $5 million or less in gross export revenues.

An exporter can still set up a DISC in the form of an interest charge DISC to defer the imposition of taxes for up to $10 million in export sales. A corporate shareholder of an interest charge DISC may defer the imposition of taxes on approximately 94 percent of its income up to the $10 million ceiling if the income is reinvested by the DISC in qualified export assets. An individual who is the sole shareholder of an interest charge DISC can defer 100 percent of the DISC income up to the $10 million ceiling. An interest charge DISC must meet the following requirements: the taxpayer must make a new election; the tax year of the new

DISC must match the tax year of its majority stockholder; and the DISC shareholders must pay interest annually at U.S. Treasury bill rates on their proportionate share of the accumulated taxes deferred.

A shared FSC is an FSC that is shared by 25 or fewer unrelated exporter-shareholders to reduce the costs while obtaining the full tax benefit of an FSC. Each exporter-shareholder owns a separate class of stock and each runs its own business as usual. Typically, exporters pay a commission on export sales to the FSC, which distributes the commission back to the exporter.

States, regional authorities, trade associations, or private businesses can sponsor a shared FSC for their state's companies, their association's members, their business clients, customers, or for U.S. companies in general. A shared FSC is a means of sharing the cost of the FSC. However, the benefits and proprietary information are not shared. The sponsor and the other exporter-shareholders do not participate in the exporter's profits, do not participate in the exporter's tax benefits, and are not a risk for another exporter's debts.

For more information about FSCs, U.S. companies may contact the Office of the Associate Chief Counsel for International Commerce, U.S. Internal Revenue Service 202-622-3810; the Office of the Chief Counsel for International Commerce, U.S. Department of Commerce 202-482-0937; or a local office of the IRS.