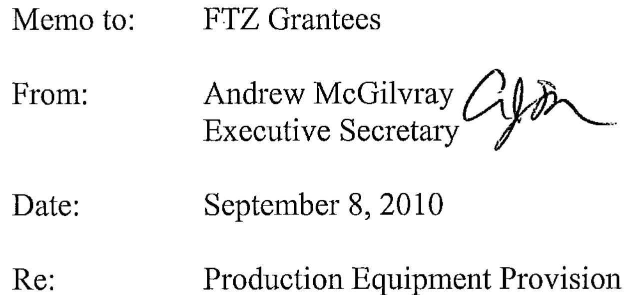
UNITED STATES DEPARTMENT OF COMMERCE
The Foreign-Trade Zones Board
Washington, D.C. 20230

Memo to: FTZ Grantees

From: Andrew McGilvray
Executive Secretary



Date: September 8, 2010

Re: Production Equipment Provision

Background:

In 1996, the FTZ Act (19 U.S.C. 81a-u) was amended to allow for the deferral and possible reduction of duties on production equipment imported into a Foreign-Trade Zone until such time as it is put into use as production equipment in the zone.

Clarification on the use of the production equipment provision, as it is known, was subsequently provided to CBP and FTZ grantees through a memo by the Acting Executive Secretary in 2000. The clarification provided in that memo concerned aspects of the provision where questions and issues had arisen up to that point. The memo indicated that the provision applied to production equipment for use in Board authorized activity, and that the equipment would be evaluated in its condition as completed production equipment for customs purposes when it was ready to be put into use.

Recently, questions have arisen on the applicability of the provision in certain instances as well as the general interpretation of the phrase "production equipment". This memo is intended to clarify and address those issues.

Production Equipment Provision in the FTZ Act (19 U.S.C. 81(c)(e))

"Production equipment
(1) In general
Notwithstanding any other provision of law, if all applicable customs laws are complied with (except as otherwise provided in this subsection), merchandise which is admitted into a Foreign-trade zone for use within such zone as production equipment or as parts for such equipment, shall not be subject to duty until such merchandise is completely assembled, installed, tested, and used in the production for which it was admitted."

Discussion:

Applicability of the Provision. On September 21, 2009, the National Association of Foreign-Trade Zones (NAFTZ) submitted a letter which argued, in part, that the legislation amending the FTZ Act did not preclude the use of the production equipment provision by companies located

within zone space "pending approval of manufacturing authority" (*i.e.*, prior to the Board's completion of its review of the applications from companies requesting such authority). In May 2010, NAFTZ further argued that – for a company for which manufacturing authority had not yet been approved by the FTZ Board – it should not be necessary for the company to have its application pending before the FTZ Board in order to begin to make use of the production equipment provision. These interpretations do appear to be consistent with both the language in the Act and the legislative history. The "Reason for Change" section of the Senate Report (No. 104-393, 10/1/1996) states:

> "The Committee believes that, by allowing a manufacturer to assemble, install, and test the equipment before duties would be levied, export production in the United States in FTZs will be encouraged."

There is no indication in the reports or in the statute itself that Congress intended to limit the provision to manufacturing operations that have already received approval from the Board to operate under FTZ procedures or that have an application pending requesting such approval. The FTZ Act does not mandate that manufacturing activity receive prior approval from the FTZ Board; the requirement for advance approval of manufacturing activity derives from the regulations put forth by the FTZ Board. In the statute, Congress established a general framework for the program while allowing for such operational requirements to be specified by the Board. As such, Congress would not necessarily have addressed the timing of manufacturing-related applications or approvals in amending the FTZ Act to include the production equipment provision (since no requirement exists in the Act for case-by-case advance approval of manufacturing operations). Therefore, in the context of the Act, the fact that Congress did not address the issue of timing does not seem to be indicative of Congressional intent with regard to timing.

This interpretation is also consistent with the analysis conducted in 2000. The 2000 memo indicated that, "The provision applies only to production equipment and equipment components that are for use in conducting FTZ Board authorized activity." The issue that led to the assessment in 2000 was the applicability of the provision to an operation located within an approved zone site that was not active or using zone procedures. The response, therefore, focused on Board authorization to address the fact that the provision is intended for companies using zone procedures and that authorization from the Board is generally required for manufacturing/processing activity.

The 2000 memo did not address the aspect of timing. A company that is building a plant within an existing zone site and applying (or preparing to apply) for FTZ manufacturing authority for that operation will often be admitting production equipment into the new facility for installation and testing prior to completion (or sometimes initiation) of the Board's manufacturing review. The intent of Congress was to encourage manufacturing operations through the use of zone procedures. The ability to admit production equipment to the zone while the manufacturing application is pending or under development appears to be consistent with this intent. However, if the application for zone manufacturing is subsequently denied or actual (*bona fide*) "production" under zone procedures does not follow the assembly of the "production equipment," the provision would not be applicable and the company would be responsible for the full payment

of duties on the production equipment that had been admitted to the zone in its condition as admitted.

Definition of "Production Equipment". The amendment to the FTZ Act in 1996 used the phrase "production equipment" to describe the merchandise at issue, but did not provide a definition of the phrase. The September 2009 NAFTZ letter also urged that the language of the provision be interpreted broadly to include equipment used in both manufacturing and warehousing activity. The letter argued that:

- The same type of equipment is used in both manufacturing and warehouse/distribution types of operations.
- The language in the legislation is broad; therefore, it applies to any and all machinery and equipment for use in any and all FTZ activities. The text of the bill did not explicitly limit the scope to manufacturing operations only.
- The phrase "production equipment" was intentionally chosen over "manufacturing equipment" to broaden the scope of the provision beyond manufacturing to include all activity that may occur within a zone.
- A dictionary definition of manufacturing is "to make (wares or other products) by hand, by machinery, or by other agency; to work as raw or partly wrought materials, into suitable forms for use; to fabricate, to invent, also to produce mechanically." The definition for production is, by contrast, "the act or process of producing, bringing forth or exhibiting to view…" Therefore, the term "production equipment" should include any merchandise used for purposes other than manufacturing, including warehousing, displaying, processing or exhibiting.
- There is no indication that Congress intended to limit the benefit to manufacturers.

Since the legislation amending the FTZ Act did not define the phrase "production equipment," this memo will examine the Congressional Report and Record and documents produced on this issue prior to the passage of the legislation to attempt to discern the intent of Congress.

The "Reason for Change" section of the Senate Report (No. 104-393, 10/1/1996) regarding the amendment to the Act to include the production equipment provision contains the following language:

> "The provision allows for the duty on imported production equipment and components installed in a U.S. FTZ or subzone to be deferred until use of the equipment ***for production*** begins. The Committee believes that, by allowing a ***manufacturer*** to assemble, install, and test the equipment before duties would be levied, export production in the United States in FTZs will be encouraged." [emphasis added]

The plain language interpretation of the above would indicate that the provision was intended to apply specifically to manufacturing operations. While the initial reference to production does not provide clarification on the meaning of the term, it is immediately followed by a reference to manufacturing. Similar language is also included in several instances in the Congressional Record. From this, it generally appears that the term "production" was used interchangeably with the word "manufacturing" to refer to the operations that would benefit from the provision.

Even assuming that the term "production" was deliberately chosen to broaden the scope from "manufacturing", it would appear from dictionary definitions of the term "production" that the intended definition was "to make or create an article". Under the assumption that the term "production" is broader than "manufacturing", the reasonable conclusion is that the term was chosen to include manufacturing and processing activities within a zone, both of which were defined in the FTZ Regulations in effect at the time and involve activities that result in the creation of new articles, at least as defined by HTSUS classification or eligibility for entry. Dictionary definitions of production that include phrases such as "exhibiting and bringing forth" apply to uses of the term in situations such as the theater, and not to commercial activities.

On January 4, 1995, Senator Inouye, advocating for the amendment to the FTZ Act, made the following statements (from the Congressional Record, Senate 293) (emphasis added):

> "This bill does not relieve any ***manufacturer*** operating in a U.S. foreign trade zone or subzone of its obligation to pay all applicable duties on such equipment, but rather it would allow these firms to defer the payment of duty until the equipment begins commercial operations."
>
> "This legislation provides several practical advantages for ***U.S. manufacturers***."
>
> "...it will remove an unnecessary economic burden on ***U.S. manufacturers***..."
>
> "Further, it will help preserve the American ***manufacturing*** base..."

Senator Inouye used the phrase "production equipment" to refer to the merchandise that receives the benefit from the legislation. However, he consistently describes the companies that could use the provision as "manufacturers" and appears to be supporting the provision as a means to assist the competitiveness of U.S. manufacturers. At the same time, there is no mention of other types of companies or activities that may benefit from the provision.

Further examination of the documents that preceded the legislation sheds additional light on the use and origins of the phrase "production equipment" in this context. In 1982, the U.S. Customs Service issued a ruling on this topic, which was later revisited in 1988. The latter ruling contains the following:

> "... under a ruling published as CSD 82-103, foreign manufactured production machinery to be brought into a zone, free of duty, to be used as production machinery to make other articles. That ruling allowed a manufacturer to defer the payment of duty until the machinery was used." (Revocation of CSD 82-103, 11/30/1988)

This language contains two points of note. First, as in the Congressional language, the types of companies affected are "manufacturers". Second, the term "production machinery" is used, and is further refined by the phrase "to make other articles." Combined with the word "manufacturer" in the second sentence, the implication seems to be that "production machinery" is used by manufacturers to make products. The legislation amending the FTZ Act to allow for a benefit on

"production equipment" was made, in part, in response to the ruling above, revoking a prior Customs ruling that had allowed companies to take the production equipment benefit in zones.

The revocation of CSD 82-103 cited above was triggered by a court case decided on August 16, 1988. In the decision, the court indicated that the issue involved, "...machinery and related capital equipment imported to produce merchandise in a foreign trade zone..." (Nissan Motor Mfg. Corp., U.S.A. v. United States). The court decision uses this phrase interchangeably with "production machinery" and "production equipment". It appears that the term "production" was being used to refer to machinery and equipment used to produce merchandise.

The NAFTZ letter also argued that the use of some of the same types of equipment in both manufacturing and distribution operations supports the broader interpretation of the phrase. While similar types of equipment may be used in the different operations, the ultimate use of that equipment will differ, and it appears that the focus of the legislation was on the use of the equipment and the operations conducted and not on the type of equipment itself.

The language in the Congressional Report and Record on the amendment to the FTZ Act, as well as earlier language on which the legislation was based, appears to support a conclusion that the intent of the production equipment provision was to benefit U.S. manufacturers. The record does not appear to suggest that the intention of Congress was to apply the term "production equipment" more broadly than to machinery/equipment which is used to make other articles. There is no indication that Congress intended to provide this benefit to warehouse and distribution operations, and the plain language in the Congressional Report and Record supports the interpretation that manufacturers producing merchandise were the intended target. To define production equipment more broadly would appear to go beyond what Congress intended.

Conclusion:

In summary, it appears from the language in the statute and legislative history that the intent of the production equipment provision in the FTZ Act was to encourage manufacturing through the use of zone procedures. As a result, it appears that the ability to admit production equipment to the zone while a manufacturing application is pending or under development is consistent with the intent of Congress. However, if an application for zone manufacturing is subsequently denied or actual (*bona fide*) "production" under zone procedures does not follow the assembly of the "production equipment," the provision would not be applicable and the company would be responsible for the full payment of duties on the production equipment that had been admitted to the zone in its condition as admitted.

With regard to the applicability of the provision to warehouse and distribution operations, a plain-language reading of the statute and legislative history provides no indication that Congress intended to extend this benefit to such operations. The language in the Congressional Report and Record support the interpretation that manufacturers were the intended target of the legislation. To define production equipment more broadly would appear to go beyond what Congress intended.