



World Customs Organization

(Draft) **Practical Guidance on Free Zones**

WORLD CUSTOMS ORGANIZATION

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I. EXECUTIVE SUMMARY

1. Introduction

- 1.1 The number of Free Zones (FZs) in the world is thought to amount to thousands and to be increasing. The Economist (2015) stated that there were 4,300 “free trade zones” as of 2015. This rapid expansion of FZs has been mainly driven by political decisions closely affiliated with national economic development strategies.
- 1.2 However, it has been pointed out in existing papers¹ that FZs attract not only legitimate business, but also illicit activities that take advantage of regulatory exemptions in FZs and also the lack of oversight therein.
- 1.3 Accordingly, many papers, such as those produced by the Financial Action Task Force (FATF) (2010), the International Chamber of Commerce (ICC) (2013), Interpol (2013), Viski et al. (2016), The Economist (2018), the Organization for Economic Co-operation and Development (OECD) (2018), and McKinsey & Company (2019), have urgently called for high levels of control over goods and activities inside FZs. Some have also stressed the need for Customs to be involved and to be empowered to control goods and activities inside FZs.
- 1.4 Since 2008, a series of discussions have been conducted at the World Customs Organization (WCO): more and more Customs have expressed the need for better Customs control; however, a concrete conclusion could not be reached, due to the difficulties of changing already established FZ regimes by influencing policy-makers. In December 2016, the WCO included FZs as an essential topic in the WCO Economic Competitiveness Package (ECP) Action Plan, with the aim of analysing the current situation and developing possible guidance to ensure adequate Customs control in FZs, while supporting the latter’s healthy expansion.
- 1.5 Since 2018, the WCO Secretariat has conducted research on the current situation related to FZs. This includes a literature review, an analysis of the WCO online survey on FZs in 2018, and workshops and field studies, the results of which were analysed and publicized in September 2019 as WCO Research Paper No. 47: *“Extraterritoriality’ of Free Zones: The Necessity for Enhanced Customs Involvement”*.
- 1.6 The FZ Research Paper outlines the definitions, characteristics and economic benefits of FZs; addresses the risks posed by FZs; describes the perceived “extraterritoriality” of FZs; and outlines Customs’ limited involvement and insufficient authority in the establishment and the operation of FZs. The FZ Research Paper can be accessed by the public at: http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/research/research-paper-series/47_free_zones_customs_involvement_omi_en.pdf?la=en.

2. Customs procedures in FZs

- 2.1 Considering that Customs procedures outside FZs have been substantially simplified through the use of technology (compared to the 1980s/1990s, when FZs became popular), and that FZs offer a variety of non-Customs related economic incentives, relaxed Customs procedures/control in FZs should not be the key advantage at the expense of safety and security of trade.
- 2.2 Furthermore, during the WCO workshops conducted in 2018/2019, it was repeatedly mentioned by FZ operating bodies and the private sector that if Customs were to become more involved in FZs, then the latter would be more likely to be competitive

¹The papers are referenced in WCO Research Paper No. 47, which the FZ Guidance goes on to summarize.

and succeed. Customs can play a significant role in contributing to the healthy and sustainable economic development of FZs by participating not only as a law enforcement agency, but also as a trade facilitator (McKinsey & Company (2019)).

- 2.3 Furthermore, the “Recommendation of the Council on Countering Illicit Trade: Enhancing Transparency in Free Trade Zones”² (OECD Recommendation), adopted by the OECD Council in October 2019, aims to assist governments and policy-makers in reducing and deterring illicit trade conducted through and inside FZs. Acknowledging that some economic operators may take advantage of inadequate oversight and a lack of transparency in FZs to commit illegal activities, the OECD Recommendation highlights the need to empower the competent authorities, including Customs administrations, to enforce necessary supervision of goods and activities in FZs.
- 2.4 Controlling illegal trade in FZs contributes to improving the business environment and competitiveness of FZs and to meeting the United Nation’s Sustainable Development Goals, such as Goal 3 (Good Health and Well-Being), Goal 8 (Decent Work and Economic Growth), and Goal 16 (Peace, Justice and Strong Institutions). It also contributes to enhancing the social responsibility of companies and governments.
- 2.5 Thus, as many WCO Members and many papers underline Customs’ important role in FZs’ development, as well as in surveillance of cargo movement, Customs should be deeply involved in FZs, with a view to planning and implementing adequate Customs procedures/control and thus contributing to the competitiveness and sustainability of FZs.

3. Practical Guidance on FZs

- 3.1 The Practical Guidance on FZs (hereafter “FZ Guidance”) aims at providing practical guidance, based on the findings and analysis of WCO Research Paper No. 47 and WCO Members’ best practice, to help Customs enhance the Customs procedures/control to be globally applied in FZs, while effectively supporting the healthy development and competitiveness of FZs. It is Members’ understanding that the FZ Guidance should be applied in a manner consistent with respective national laws.
- 3.2 The FZ Guidance consists of seven core elements, with practical guidance and associated best practice by WCO Members. The core elements are:
- Territoriality aspect of FZs;
 - Full Customs involvement in FZs;
 - Customs involvement in the company approval process and “Authorized Economic Operator” (AEO) concept;
 - Reporting to Customs and the use of data and IT systems;
 - Customs audit in FZs;
 - Customs control and surveillance: authority to seize illegal goods in FZs; on-site checks inside FZs; and use of technology for inspections in FZs; and
 - Cooperation.
- 3.3 The material contained in this FZ Guidance will provide Custom administrations with information to assist in the possible development and updating of FZs. It is understood that any guidance should be applied in a manner consistent with a Customs administration’s national laws, policies and practices and that there is no

²<https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0454>.

“one size fits all” approach. Where existing national laws are not consistent with the recommendation in this Guidance, deference shall be given to applicable national laws.

- 3.4 Each core element is briefly summarized below.

Territoriality aspect of FZs

- 3.5 The territorial definition of FZs is the core issue to be resolved in order to enhance Customs involvement and procedures in FZs. Chapter 2 (“Free zones”) of Annex D of the Revised Kyoto Convention (RKC) provides a definition of a FZ which indicates that a FZ itself falls within the Customs territory.
- 3.6 However, some countries regard the FZ itself as “being outside the Customs territory”, leading to the concept of an “extraterritorial free-area” which is free from the usual Customs control and which has relaxed Customs procedures, thus opening the way for higher risks of illegal trade.
- 3.7 It is essential that FZs be regarded as inside the Customs territory, or as special areas where all non-tariff Custom activities are properly enforced, unless national law indicates otherwise.

Full Customs involvement in FZs

- 3.8 Given its unique authority and expertise both in securing and in facilitating global trade, Customs should be a crucial player in the general development of national policies related to FZs, the establishment of each new FZ and the approval of FZ tenant companies³, including their admissible activities.

Customs involvement in the company approval process and AEO concept

- 3.9 Customs’ failure to conduct risk-based background checks on FZ applicant companies, their key employees, and compliance records could become a significant enabling factor for illicit trade related to FZs. Given the fact that organized crime and even terrorist organizations are involved in illicit activities inside some FZs, Customs involvement in due diligence and compliance record checks at the company approval stage is critical to keeping FZs safe and secure.
- 3.10 Relaxed Customs procedures/control in FZs should not be the key advantage of establishing FZs at the expense of safety and security of trade. On the other hand, further facilitation benefits within FZs could be provided to tenant companies meeting the globally established Authorized Economic Operator (AEO) criteria provided by the WCO SAFE Framework of Standards (SAFE), with the necessary adjustments to reflect FZ characteristics. Given its knowledge and expertise regarding AEO implementation, together with its intelligence on relevant risks and trade security, Customs should be the authority which conducts security risk assessments and AEO validation to grant tangible benefits in FZs, in close cooperation with FZ Authorities and FZ operating bodies.

Reporting to Customs and the use of IT systems

³For the purpose of this FZ Guidance, “FZ tenant company” means a company operating inside a FZ. Such operations include, but are not limited to, trading, processing (grading, repacking, labelling, distribution, manufacturing, etc.), logistics and other services related to trade/logistics. The tenant company normally needs to register and gets a licence from Free Zone Authorities.

- 3.11 Relaxed requirements on goods declarations and reporting open the door to potential illegal activities in FZs. Illicit drugs bound for consignees inside FZs were detected at entry to some FZs as a result of information on declarations and following Customs inspections. Cases of missing cargo are also often reported to the WCO. It is therefore essential for Customs to receive and analyse goods declarations at entry and exit, along with reports on cargo stored and placed in FZs.
- 3.12 Customs sometimes has limited access to the cargo management system of the FZ operating body⁴. A shortage of electronic data on cargo movements, inventories and company operations inside FZs will hinder Customs' risk management, which is reliant on data. Thus, it would be desirable for Customs to have full access to such data stored electronically in the FZ operating body's system.
- 3.13 From the perspective of FZ operating bodies, simplifying and expediting Customs procedures by digitalization may be one of the key advantages for FZs in attracting clients. Providing Customs with access to the FZ operating body's IT system and obtaining data provided by tenant companies could play a significant role in terms of allowing adequate Customs control (including entry/exit and inventory controls), while expediting Customs procedures.

Customs audit in FZs

- 3.14 Considering the unlimited period for manufacturing and storing goods in FZs, a Customs audit of companies operating in FZs is one of the most suitable and important tools for Customs to supervise activities there. A Customs audit allows Customs to effectively and efficiently control not only the movement of cargo at entry and exit points on a transaction basis, but also during the storage and processing stages for a certain period of time on a contract or periodic basis.

Customs control and surveillance

- 3.15 As the FZ Research Paper points out, in general terms, FZs have not been explicitly captured by existing international conventions which substantively regulate illicit trade. In order to combat illegal activities in the FZs, any kind of illicit trade in goods should be prohibited by related international conventions and national regulations on the same basis as for goods outside FZs. Customs should have the competence to inspect goods in FZs, as well as to detect and seize goods, regardless of whether the intended transactions are storage, manufacturing, transit/transshipment or domestic consumption.
- 3.16 However, some Customs have very limited authority to conduct examinations and investigations inside FZs: they are allowed to enter FZs and company premises only if there is suspicion of illicit activity therein, backed up by concrete evidence. This also applies in cases where the declarations and data are submitted to the FZ Authority and/or operating body, and not to Customs, making it much more difficult for Customs to show evidence in order to enter FZs to inspect cargo.
- 3.17 Since the main use of FZs is manufacturing and the storage of goods for longer than usual or unlimited storage periods, it is essential that Customs control not only the movement of cargo at entry and exit points, but also during the storage and processing stages, via periodic on-site visits or visits at any time which they consider necessary.

Cooperation

⁴For the purpose of this FZ Guidance, "FZ operating body" means a corporation, partnership, or person that operates a FZ under agreement and authorization by Free Zone Authorities.

- 3.18 Cooperation mechanisms with operators and companies, such as periodic dialogue and reporting, and the provision of adequate training, are necessary alongside the company approval process. Such periodic dialogue and sharing of information would enable Customs and the private sector to work together to solve any issues and challenges in FZs.
- 3.19 As FZs originally focused on manufacturing for export, and as they are often used for transit purposes, any illegal activities also may involve smuggling to other countries. Thus, the issue of proper Customs procedures/control in FZs is crucial, not only for countries with FZs, but also for those without them; possible solutions require international action and cooperation to combat illegal activities which exploit weaknesses in Customs procedures/control in FZs.

4. Implementation

- 4.1 Proper Customs procedures/control in FZs are issues not only for countries maintaining FZs, but also for those countries without them. Even though FZs are set up under national development policies, the current situation goes beyond ownership of FZs by individual countries as the impact of criminal activities in FZs is being felt worldwide.
- 4.2 In order to develop robust Customs regimes in FZs, coordination among relevant governmental bodies and a policy dialogue are essential. Customs administrations are encouraged to implement this FZ Guidance along with a national implementation plan, in coordination with all FZ-related authorities, as a means of taking global action to enhance the competitiveness and safety of FZs around the world.
- 4.3 [Furthermore, this FZ Guidance could serve as practical guidance for Customs, as well as other relevant stakeholders, endeavouring to implement the OECD Recommendation, as discussed with the OECD.]

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II. INTRODUCTION

1. Background

- 1.1 The number of Free Zones (FZs) in the world is thought to amount to thousands and to be increasing. The International Labour Organization (ILO) (2014) reported that there were more than 3,500 “export processing zones” in the world as of 2014, and The Economist (2015) stated that there were 4,300 “free trade zones” as of 2015. The WCO online survey, conducted in 2018 with 61 WCO Member respondents, showed that the number of Free Zones adds up to over 2,300 in respondents’ countries.
- 1.2 The establishment and operation of FZs, typically accompanied by economic incentives, including limited regulatory oversight of goods, special arrangements for Customs and other duties, and regulatory exemptions, have played an important part in the economic/industrial development policy of many countries. The rapid expansion of FZs has been mainly driven by political decisions closely affiliated with national economic development strategies.
- 1.3 However, it has been pointed out in existing literature⁵ that FZs attract not only legitimate business, but also illicit activities that take advantage of regulatory exemptions in FZs and also the lack of oversight therein. Numerous papers⁶ have dealt with illicit activities perpetrated by exploiting the characteristics of FZs. Such illicit activities include money laundering, tax evasion and trade in counterfeit goods or other illicit goods, such as drugs, weapons, cultural heritage, fake medicines and even environmental waste.
- 1.4 Accordingly, many papers, such as those produced by the FATF (2010), the ICC (2013), Interpol (2013), Viski et al. (2016), The Economist (2018), the OECD (2018), and McKinsey & Company (2019), have urgently called for high levels of control over goods and activities inside FZs. Some have also stressed the needs for Customs to be involved and to be empowered to control goods and activities inside FZs.
- 1.5 Since 2008, a series of discussions have been conducted at the World Customs Organization (WCO). These have raised awareness of illegal activities conducted in FZs; however, it has not been possible to reach a concrete conclusion, due to the difficulties involved in influencing policy-makers to change already established FZ regimes to ensure adequate Customs procedures/control. Nevertheless, through such discussions, more and more Customs administrations have expressed the need for better Customs procedures/control in FZs, while effectively contributing to the competitiveness of FZs.
- 1.6 In December 2016, the WCO consequently included FZs as an essential topic in the WCO Economic Competitiveness Package (ECP) Action Plan, with the aim of developing possible guidance to ensure adequate Customs control in FZs, while supporting the latter’s healthy expansion.
- 1.7 In 2018, the Permanent Technical Committee (PTC) (219th/220th Sessions), the Enforcement Committee (EC) (37th Session) and the Policy Commission (December 2018 Session) held intensive discussions on FZs and agreed to produce a study report and guidance materials based on an analysis of the current situation (including the economic benefits of FZs), and possible solutions through an online survey, field studies and workshops.

2. WCO Research Paper on Free Zones

⁵The literature is referenced in WCO Research Paper No. 47.

⁶Idem.

- 2.1 In accordance with the WCO ECP Action Plan, the WCO Secretariat conducted research on the current situation related to FZs. This included a literature review, an analysis of the online survey on FZs in 2018, and workshops and field studies in six WCO regions during financial year 2018/2019, the results of which were analysed in WCO Research Paper No. 47: *“‘Extraterritoriality’ of Free Zones: The Necessity for Enhanced Customs Involvement”*.
- 2.2 The FZ Research Paper:
- outlines the definitions, characteristics and economic benefits of FZs;
 - addresses the risks posed by FZs, which primarily relate to illicit activities perpetrated by exploiting FZs, such as illicit trade or money laundering, and describes their global and interregional nature;
 - describes the perceived “extraterritoriality” of FZs, which is a misinterpretation of the definition under the Revised Kyoto Convention (RKC), and then outlines the resulting limited involvement by Customs in the operation of FZs, and Customs’ insufficient authority; and
 - explains that, within the meaning of the definition of FZs under the RKC, “goods” located in FZs are considered as being outside the Customs territory only for the purpose of applying duty/tax and that a FZ itself forms part of the Customs territory.
- 2.3 The FZ Research Paper can be accessed by the public at:

http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/research/research-paper-series/47_free_zones_customs_involvement_omi_en.pdf?la=en.

3. Customs procedures and Customs involvement in Free Zones

- 3.1 The establishment and operation of FZs is typically accompanied by additional economic incentives. For instance, FZs have certain advantages directly related to Customs procedures/controls, such as Customs warehousing and inward processing benefits of unlimited duration of cargo storage; streamlined administrative services (e.g. single window or one-stop services), and simplified Customs procedures, including fewer reporting requirements and limited Customs inspections.
- 3.2 Nevertheless, the characteristics of FZs which provide economic incentives are often not directly related to Customs procedures/controls. These include: corporate income tax reductions; tax holidays; unrestricted repatriation of capital and profits; unrestricted management of foreign exchange earnings; relaxed requirements on foreign ownership, labour, environment, foreign exchange, and lease/purchase of land; as well as enhanced physical infrastructure, including enhanced access to logistical networks, telecommunications networks and utility services, residential housing, and service institutions.
- 3.3 Considering that Customs procedures outside FZs have been substantially simplified through the use of technology (compared to the 1980s/1990s, when FZs became popular), and that FZs offer a variety of non-Customs related economic incentives, relaxed Customs procedures/control in FZs should not be the key advantage at the expense of safety and security of trade.
- 3.4 Furthermore, during the WCO workshops conducted in 2018/2019, it was repeatedly mentioned by FZ operating bodies and the private sector that if Customs were to become more involved in FZs, then the latter would be more likely to be competitive

and succeed. Ill-conceived or poorly implemented FZs can have a significant negative impact on FZ competitiveness, and Customs can play a significant role in contributing to the healthy and sustainable economic development of FZs by participating not only as a law enforcement agency, but also as a trade facilitator (McKinsey & Company (2019)).

- 3.5 Furthermore, the “Recommendation of the Council on Countering Illicit Trade: Enhancing Transparency in Free Trade Zones” (OECD Recommendation) was adopted by the OECD Council in October 2019. It aims to assist governments and policy-makers in reducing and deterring illicit trade conducted through and inside FZs. Acknowledging that some economic operators may take advantage of inadequate oversight and a lack of transparency in FZs to commit illegal activities, the OECD Recommendation highlights the need to empower competent public authorities, including Customs administrations, to enforce necessary supervision of goods and activities in FZs.
- 3.6 Controlling illegal trade in FZs contributes to improving the business environment and competitiveness of FZs and to meeting the United Nation’s Sustainable Development Goals, such as Goal 3 (Good Health and Well-Being), Goal 8 (Decent Work and Economic Growth), and Goal 16 (Peace, Justice and Strong Institutions). It also contributes to enhancing the social responsibility of companies and governments.
- 3.7 However, discussions during WCO workshops and observations during the course of field studies revealed the actual situation in terms of limited Customs authority inside FZs. As WCO Research Paper No. 47 highlights, in several countries, Customs officers cannot enter FZs without obtaining prior approval from a FZ operating body. Furthermore, in several countries, Customs officers cannot even enter FZs without concrete suspicion of illicit trade.
- 3.8 WCO Research Paper No. 47 summarizes some examples of weak Customs procedures/controls in FZs as follows:
- No, or fewer, reporting requirements imposed on cargo entries coming from abroad to FZs, or on cargo exiting FZs and going abroad. This is the case in several countries, as the entry of cargo from abroad to FZs does not yet constitute importation;
 - Customs has no authority to request periodic reports from tenant companies in FZs;
 - Customs has no authority to audit companies inside FZs;
 - Customs has authority to inspect cargo only at entry to and exit from FZs. It has no authority to inspect cargo movements inside FZs or to monitor companies’ activities inside FZs.
- 3.9 Thus, as many WCO Members and many of the papers mentioned earlier underline Customs’ important role in FZs’ development, as well as in surveillance of cargo movement, Customs administrations should be deeply involved in FZs, with a view to planning and implementing adequate Customs procedures/control and thus to contributing to the competitiveness and sustainability of FZs.

4. Objectives

- 4.1 The FZ Guidance aims to:
- Raise awareness of the role, functions and capability of Customs to meet the challenges in FZs faced by Customs and the private sector, as well as to contribute to the competitiveness and sustainability of FZs;

- Provide practical guidance, based on the findings and analysis of WCO Research Paper No. 47 and derived from WCO Members' best practices;
 - Help Customs enhance the Customs procedures/control to be globally applied in FZs, while effectively supporting the healthy development and competitiveness of FZs; and
 - Strengthen intergovernmental cooperation, as well as Customs/Business cooperation in FZs.
- 4.2 It is Members' understanding that the FZ Guidance should be applied in a manner consistent with respective national laws.

5. Core elements of the FZ Guidance

- 5.1 The FZ Guidance consists of seven core elements, based on the key findings of the Research Paper. The core elements are:
- Territoriality aspect of FZs;
 - Full Customs involvement in FZs;
 - Customs involvement in the company approval process and "Authorized Economic Operator" (AEO) concept;
 - Reporting to Customs and the use of data and IT systems;
 - Customs audit in FZs;
 - Customs control and surveillance: authority to detect/seize illegal goods in FZs; on-site checks inside FZs; and use of technology for inspections in FZs; and
 - Cooperation.
- 5.2 The core elements involve practical guidance and associated best practices by WCO Members, collected through the WCO online survey on FZs in 2018 and the WCO workshops conducted during financial year 2018/2019, in order to help Customs enhance the Customs procedures/control to be applied in FZs, while effectively supporting the healthy development and competitiveness of FZs.

6. Implementation

- 6.1 Recognizing the significant role that Customs can play for healthy and sustainable economic growth of FZs, it is essential for Customs to participate in all stages of their implementation – not only for compliance purposes, but also to facilitate trade.
- 6.2 Customs may face certain challenges in implementing this Guidance due to the difficulties in changing already established FZ regimes by influencing policymakers. However, as stressed in many academic papers, the need for a high degree of Customs involvement and better Customs control inside FZs is widely recognized and highlighted. There is a critical need to ensure that the operational environment of FZs is safe and secure, procedures are efficient and transparent, operators are law-abiding, and commodities, people and vehicles entering and passing through the FZs are legal. It is Customs' responsibility to ensure the above.
- 6.3 Now is the time to raise the profile of Customs as major players in securing trade in FZs in order to contribute to sustainable development of FZs. As more WCO Members develop robust Customs regimes in their FZs, other WCO Members are likely to follow. Even though FZs are set up under national development policies, the current situation goes beyond ownership of FZs by individual countries as the impact of criminal activities in FZs is being felt worldwide. Accordingly, proper Customs procedures/control in FZs are issues not only for countries maintaining FZs, but also for those countries without them.

- 6.4 In order to develop robust Customs regimes in FZs, coordination among relevant governmental bodies and a policy dialogue are essential. Customs administrations are encouraged to implement this FZ Guidance along with a national implementation plan, in coordination with all FZ-related authorities, as a means of taking global action to enhance the competitiveness and safety of FZs around the world.
- 6.5 [Furthermore, this FZ Guidance could serve as practical guidance for Customs, as well as other relevant stakeholders, endeavouring to implement the OECD Recommendation, as discussed with the OECD.]
- 6.6 The practical guidance in each chapter has been listed under the Checklist in Annex III to this Guidance to facilitate its implementation.

III. PRACTICAL GUIDANCE ON FREE ZONES

1. Territoriality aspect of FZs

Are FZs outside or inside the Customs territory?

Explanation

- 1.1 The territorial definition of FZs is the core issue to be resolved in order to enhance Customs involvement and procedures in FZs, as it significantly affects the applicability of Customs procedures and controls, and also defines the role of Customs in FZs.
- 1.2 Chapter 2 (“Free zones”) of Annex D to the RKC defines a FZ as: *“a part of the territory of a Contracting Party where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs territory”*.

The RKC also defines “Customs territory” as the territory in which the Customs law of a Contracting Party applies (Chapter 2 of the General Annex to the RKC).

- 1.3 As pointed out in the WCO Research Paper, this definition in the RKC does not state that FZs are geographically outside the Customs territory. In fact, the definition means that a FZ itself falls within the Customs territory. “Goods” located in FZs are considered as being outside the Customs territory only for duty/tax purposes.
- 1.4 However, owing to the main characteristics of FZs, such as duty/tax exemption without actual exportation abroad and without provision of financial security, some countries regard the FZ itself as “being outside the Customs territory”. Consequently, the concept of FZs’ “extraterritoriality” from the Customs territory seems to be leading to the concept of an “extraterritorial free-area” which is free from the usual Customs controls, resulting in reduced Customs involvement in monitoring cargo movements inside FZs, as well as relaxed Customs procedures/controls therein, thus opening the way for higher risks of illegal trade.
- 1.5 Furthermore, the concept of an “extraterritorial free-area” is also resulting in the use of FZs to avoid any counter-measures to combat illegal trade, or to “free-ride” on preferential tariff treatment through false declarations or by disguising the origin of goods.
- 1.6 The various territorial definitions of FZs and their application in WCO Member countries can be roughly categorized into four types, as described in Table 1 below.

[Table 1]

<i>Pattern</i>	<i>Territorial definition of FZs</i>	<i>Application of Customs procedures/control</i>
1	FZs are regarded as inside the Customs territory	Customs procedures/control are applicable to FZs
2	FZs are regarded as outside the Customs territory only insofar as duties are concerned	Customs procedures/control are applicable to FZs
3	FZs are regarded as outside the Customs territory	Customs procedures/control are applicable to FZs, supported by clear provisions in related national laws.
4	FZs are regarded as outside the Customs territory	Usual Customs procedures/control do not apply to FZs

- 1.7 It should be noted that there are countries which recognize FZs as being outside the Customs territory, though application of adequate Customs procedures/control in FZs is legally safeguarded by national laws (Pattern 3). However, such patterns usually occur in those countries where the Customs authority has relatively strong power inside government to influence national legislation. There is a greater number of countries facing difficulties in ensuring the adequate application of Customs procedures/control because the territorial definition of FZs is that they are “outside” the Customs territory.
- 1.8 To sum up, it is essential that FZs be regarded as geographically inside the Customs territory, or as special areas where all non-tariff Customs activities, such as Customs procedures and border control functions (including inspections and seizures), are applied and properly enforced. FZs should be regarded as geographically outside the Customs territory only if national legislation ensures that all necessary Customs procedures and border controls are applied and enforced properly.

National experience

Example 1: European Union (EU)

- 1.9 The Union Customs Code (UCC) defines and treats FZs as being inside the Customs territory. Article 243 in Section 3 (“Free zones”) of the UCC states that “Member States may designate parts of the customs territory of the Union as free zones” and that “Persons, goods and means of transport entering or leaving free zones may be subject to Customs controls”.

Example 2: United States (US)

- 1.10 As stated in the Foreign Trade Zone Act (FTZ Act), the purpose of establishing FZs is to “expedite and encourage foreign commerce and other purposes”. The FTZ Act is administered in the context of evolving U.S. economic and trade policy and economic factors relating to international competition. FZs are considered to be outside the Customs territory of the United States for the purposes of payment of duty. A FZ is a secure area under the supervision of Customs and Border Protection (CBP).

Guidance for territoriality aspect of FZs

- ✓ FZs should, from a geographical perspective, be regarded as a part of the Customs territory or of other special areas where Customs’ authority to control the goods and persons is legally safeguarded, and where the necessary Customs procedures and control are applied to secure and facilitate the movement and placement of cargoes in FZs.

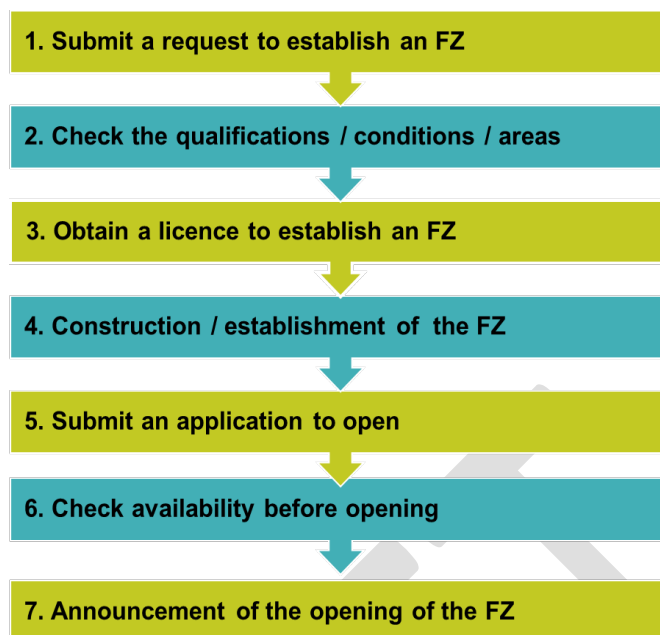
2. Full Customs involvement in FZs

Why is Customs less involved in FZs? How can full involvement be achieved?

Explanation

- 2.1 Many existing academic papers, such as those produced by the FATF (2010), the ICC (2013), The Economist (2018), the OECD (2018) and McKinsey & Company (2019), have urgently called for a high level of Customs involvement and for Customs to be empowered to control goods and activities inside FZs.
- 2.2 FZs are established and operated from an economic/industrial policy perspective. Typically, ministries governing economic development, or the zone authorities answerable to such ministries, play a leading role in establishing the FZ or approving the companies starting to operate therein, and Customs is usually less involved. According to the WCO online survey, almost 40% of Customs administrations are not involved in establishing FZs. This result may suggest a lack of political will to secure Customs involvement.
- 2.3 Customs has important powers that exist nowhere else in government, namely, the authority to inspect cargo and goods shipped into, through and out of a country. Customs also has the authority to refuse entry or exit, and the authority to expedite entry, based on information about goods. Given its unique authority and expertise in both securing and facilitating global trade, Customs should be a crucial player in the general development of national policies related to FZs, the establishment of each new FZ and the approval of FZ tenant companies, including admissible activities by FZ tenant companies.
- 2.4 Some Customs administrations reported that Customs is represented as a main member on a governmental board to decide national policies related to FZs, the establishment of FZs, and to review applications for FZs. Another example shows that such governmental boards could authorize Customs to review and examine applications for, and the establishment of, FZs. It seems that being a formal member of a governmental board would provide greater opportunities to play a part in all decisions related to FZs and would also ensure smooth communication with the relevant bodies.
- 2.5 Furthermore, in response to the WCO online survey and during workshops, several Members stressed the importance of defining construction standards which enable the appropriate Customs procedures/control to be carried out in FZs. Standard 3 of Chapter 2 of Specific Annex D to the RKC requires Customs to lay down the arrangements for Customs control, including appropriate requirements as regards the suitability, construction and layout of FZs. Well-designed layout/construction of FZs contributes to smooth legitimate cargo flows, and at the same time to proper monitoring of cargo movements and companies' activities.
- 2.6 An example of an approval process is described in Chart 1 below. Within this process, Customs should be involved in checking qualifications/conditions/areas; examining the application to establish the FZ; approving goods to be admitted into the FZ, together with admissible operations; approving the construction plan; and examining implementation of each qualification and condition before any new FZs are opened.

[Chart 1] (Source: Thailand Customs)



National experience

Example 1: United States (US)

- 2.7 The FTZ Act created a Foreign-Trade Zones Board (FTZ Board) to review and approve applications to establish, operate, and maintain such FZs. The FTZ Board may approve any FZ which it deems necessary to adequately serve “the public interest”. CBP must approve activation of the FZ before any merchandise is admitted under the Act.
- 2.8 CBP is responsible for the transfer of merchandise into and out of the FZs and for matters involving the collection of revenue. The Port Director of CBP, in whose port a FZ is located, is charged with overseeing FZ activity as the local representative of the FTZ Board. The Port Director controls the admission of merchandise into the FZ, the handling and disposition of merchandise therein, and the removal of merchandise from the FZ. In addition to the FTZ Act, the Port Director enforces all laws normally enforced by CBP that are relevant to FZs.

Example 2: China

- 2.9 China Customs is responsible for reviewing applications to establish FZs. Every provincial and municipal government may apply to the State Council in order to establish FZs, based on actual development needs. It is within the administrative power of the State Council to give final approval to FZ applications, and it also authorizes China Customs to review the application during the process.
- 2.10 When reviewing an application, China Customs asks the opinion of seven other ministries, including the Ministry of Natural Resources and the Ministry of Finance. China Customs has established an evaluation system for setting up a FZ, which includes assessment criteria covering foreign trade and processing trade volumes; the degree of support for Customs supervision; industrial support conditions; and logistical convenience.
- 2.11 With respect to the construction of FZs, China Customs has developed basic construction standards covering the check-points, enclosed fencing surrounding the

FZ, Customs inspection areas, and interfaces between computer systems and the Customs system, etc.

Example 3: Dominican Republic

2.12 In order to ensure smooth communication between Customs and FZ operating bodies, as well as tenant companies located therein, an Agreement on Services was developed. Two committees were also set up to meet on a monthly basis and discuss all matters related to the services and requirements of the parties involved:

- A National Committee, composed of the National Council of Free Trade Zones, Customs, and the Dominican Association of Free Trade Zone Companies; and
- An Internal Committee, which must be established at each Free Zone Park, composed of a representative of the Free Zone Park operating company, a representative of the Dominican Association of Free Trade Zone Companies, and the Head of the Customs Office located in the Park.

2.13 In the Dominican Republic, the National Council of Free Trade Zones is responsible for issuing FZ licences and regulating operations in FZs; however, it is not responsible for Customs control arrangements, the responsibility for which rest with Customs.

Example 4: Singapore

2.14 Singapore Customs administers and enforces the Free Trade Zones Act (FTZ Act), which governs the establishment of a FZ, appointment of FZ operating bodies, and the responsibilities of a FZ operating body.

2.15 There are Customs examination stations at all FZ entrances and exits. In addition, as part of the regulatory checks, Singapore Customs also performs the following duties in FZs:

- conducting checks on premises, examining packages and taking action against any offence committed, including violations of Customs law;
- instructing FZ operating bodies to prevent unauthorized persons or goods from entering/leaving FZs;
- ensuring that FZ operating bodies are aware of their responsibilities under the FTZ Act and other legislation enforced by Singapore Customs; and
- approving the perimeter fencing around FZs.

Example 5: Republic of Azerbaijan

2.16 The Law of the Republic of Azerbaijan on “Alyat Free Economic Zone” was adopted on 18 May 2018. It is envisaged that Alyat Free Economic Zone (FEZ) will be established in the near future. Alyat FEZ will act as a major logistics hub in the Caspian region, serving both the European and Asian markets, as well as be part of an extensive international logistics network linking Europe and Asia, and act as a multimodal transit logistics hub.

2.17 According to national legislation, Azerbaijan Customs has the following responsibilities regarding FZs:

- perimeters, entrance and exit points, and persons entering and exiting FZs should be under Customs surveillance;
- activities related to goods brought into FZs, including their preservation, packaging, marking etc., are subject to Azerbaijan Customs’ permission; and
- construction work in a FZ should be carried out with the approval of Azerbaijan Customs.

- 2.18 Azerbaijan Customs is involved in permission procedures for commercial and other activities in FZs.

Example 6: European Union (EU)

- 2.19 In the EU, Customs authorities are involved in the approval of the construction of any building and in the establishment of any activity in a FZ. Controls must be implemented not only at the perimeter and at the exit and entry points, but also inside FZs, as they are a part of the Customs territory. Customs authorities may prohibit persons who do not demonstrate the trustworthiness required from carrying out activities in FZs.

Guidance for Customs involvement in FZs

- ✓ Customs should be represented on the relevant governmental board to develop the overall national policy on FZs, decide on the establishment of FZs and review applications to establish FZs.
- ✓ Customs should establish basic construction standards and other standards to be implemented in FZs for Customs control. This covers Customs check-points, enclosed fencing surrounding the FZ, Customs inspection areas, video surveillance system, installation of non-intrusive inspection (NII) equipment, the information network to be interfaced with Customs, etc.

3. Customs involvement in the company approval process

A Company approval process without Customs involvement may enable illegal activities in FZs

Explanation

a. Less involvement in the company approval process

- 3.1 In response to the WCO online survey, some Customs administrations underlined the need for awareness-raising on the responsibilities and obligations of companies in FZs with respect to Customs procedures, as well as the importance of full Customs involvement in the company approval process. However, the same survey also revealed that almost half of Customs administrations are not involved in the process of company approval. Furthermore, in some countries, Customs has no authority to revoke companies' rights to operate in FZs, particularly those companies accused of perpetrating smuggling activities within FZs.
- 3.2 As stated in WCO Research Paper No. 47, the FATF report (2010) outlined several cases whereby bank accounts belonging to tenant companies operating inside FZs were used for laundering the proceeds of drug trafficking, etc., with involvement by companies inside FZs. The FATF report identified several factors as enabling FZ-related money laundering, such as lack of integration between FZ operating bodies' and Customs' IT systems (including cash transactions inside FZs), and lack of due diligence and compliance record checks during the initial phase of admitting companies into FZs.
- 3.3 In order to provide the benefits, including simplified Customs procedures, offered as one of the main characteristics of FZs, it is crucial that FZ operating bodies and tenant

companies operating inside FZs demonstrate high compliance standards and a high degree of responsibility to ensure their activities are secure. In addition, they should have no record of illegal activities, serious infringements or violations of laws.

3.4 Customs' failure to conduct risk-based background checks on FZ applicant companies, their key employees, and compliance records could become a significant enabling factor for illicit trade related to FZs. Given the fact that organized crime and even terrorist organizations are involved in illicit activities inside some FZs, Customs involvement in due diligence and compliance record checks at the company approval stage is critical to keeping FZs safe and secure.

3.5 Customs should conduct risk-based background checks to prohibit legal or national persons convicted of illegal activities from operating within FZs, and take appropriate action to revoke permits if they observe any non-compliance, illegal activities or loss of goods.

b. Applying the "Authorized Economic Operator" (AEO) concept

3.6 Limited resources and staffing mean that Customs administrations are now facing various challenges in managing increasing volumes of cargoes and adapting to new types of business – including the growing use of FZs – while adequately responding to the developing need to secure global trade. As a consequence, Customs' perspective of companies has changed from seeing them as entities paying duties or possibly involved in illegal activities, to seeing them as trusted partners to achieve effective and efficient border procedures in a rapidly changing environment.

3.7 Consequently, one possible method of efficiently managing cargoes and companies inside FZs, while providing benefits, could be to apply the AEO concept. The AEO is a model programme that many Customs administrations are pursuing as a means to secure and facilitate global trade. At the same time, it provides incentives that benefit both Customs and traders who have decided to work in partnership. The WCO SAFE Framework of Standards (SAFE) is a document that provides overall guidance for this purpose.

3.8 The SAFE provides a set of international Customs standards on conditions and requirements for AEO status, namely with respect to:

- demonstrated compliance with Customs requirements;
- satisfactory system for management of commercial records;
- financial viability;
- consultation, cooperation and communication;
- education, training and awareness;
- information exchange, access and confidentiality;
- cargo security, conveyance security, premises security, personnel security and trading partner security;
- crisis management and incident recovery; and
- measurement, analyses and improvement.

3.9 Together with a list of specific benefits for each category of economic operator, application, validation and authorization procedures are also provided by the SAFE in order to establish and maintain an effective AEO programme.

3.10 The WCO online survey shows that Customs administrations which apply the AEO concept in FZs amount to less than half of the respondents. In one country which took part in a workshop, Customs had not granted AEO status to tenant companies inside

FZs because the Ministry of Commerce had jurisdiction in this area and Customs had less involvement in the company approval process.

- 3.11 Considering that Customs procedures outside FZs have been substantially simplified through the use of technology (compared to the 1980s/1990s, when FZs became popular), relaxed Customs procedures/control in FZs should not be the key advantage at the expense of safety and security of trade.
- 3.12 However, further facilitation benefits within FZs could be provided to tenant companies meeting the globally established AEO criteria. Given its abundant knowledge and expertise regarding AEO implementation, together with its intelligence on relevant risks and trade security, Customs should be the authority which conducts security risk assessments and AEO validation procedures to grant further facilitation measures in FZs, and monitor compliance in close cooperation with FZ Authorities and operating bodies.
- 3.13 Through Customs' active involvement in the company approval process and possible granting of AEO status, FZs can utilize Customs administrations' experience and intelligence to confirm whether a company meets high standards of compliance and has no record of any offences, thus preventing any possible illegal activities in FZs, while ensuring that companies enjoy the benefits.

National experience

Example 1: Singapore

- 3.14 The FZ operating body conducts screening of businesses and persons wishing to operate in a FZ, with relevant agencies including Singapore Customs, before giving the applicant approval to operate in the FZ. FZ operating bodies regularly update Singapore Customs on the list of companies operating in FZs.
- 3.15 Singapore Customs only permits limited activities in FZs. Should companies wish to carry out manufacturing activities within FZs, they need to seek permission from Singapore Customs. Additionally, if companies want to be involved in importing or exporting activities, including acting as declaring agents, they need to be registered with Singapore Customs.
- 3.16 Singapore's AEO Programme is applicable to all eligible companies along the supply chain, including port operators and companies that operate inside FZs.

Example 2: China

- 3.17 China Customs is involved in the process of approving companies if the latter's business is related to Customs matters. China Customs reviews whether or not the applicant companies have any record of smuggling.
- 3.18 Any company in a FZ needs to obtain a registered commercial licence from the Market Supervision Administration. After this registration, the company is required to register with Customs and obtain Customs approval before starting its business in a FZ. The Customs registration process includes: 1) submission of an application for registration and recording; 2) Customs verification; and 3) Customs inspection on-site.
- 3.19 Companies need to meet the following basic requirements to be registered with Customs:

- be an independent legal entity, with the ability to pay taxes to Customs and meet other legal obligations;
- be equipped with a computer management system comprising terminal equipment for data access by Customs and software-based interfaces with Customs computer systems, in accordance with Customs authentication and data networking standards;
- demonstrate adequate financial management and, in particular, accurate records of inventory, assignment, transfer, sale, processing and use of goods, and required book-keeping and accounting; and
- not produce commodities requiring high energy consumption and which are highly polluting/resource-dense, or process commodities listed in the "prohibition catalogue", in line with national industrial development requirements.

3.20 Customs categorizes companies into three groups for corporate credit conditions: 1) certified enterprise (AEO); 2) general credit enterprise; and 3) non-accredited enterprise, based on information collected and analysed by China Customs.

Example 3: South Africa

3.21 In South Africa, Special Economic Zones (SEZs) are geographically designated areas set aside for specifically targeted economic activities to promote national economic growth and export by using support measures to attract foreign and domestic investments and technology.

3.22 A SEZ is sub-divided into a general zone open to all industries, and a separate Customs Controlled Area (CCA) reserved for export-oriented, CCA-registered enterprises. A CCA is a designated area approved by the South African Revenue Service (SARS) and the Ministry of Industry and Trade located in a SEZ. A Customs Controlled Area Enterprise (CCAEE) is an approved business holding a SEZ permit, situated in a CCA and entitled to be a storage warehouse or manufacturer.

3.23 A decision was also taken to adopt a whole-of-SARS approach in dealing with SEZs by establishing a Working Group between SARS and SEZ Operators. This creates synergy in SARS and strengthens relations with SEZ Operators. Although still in the initial stages, it has proven effective in enhancing communication and cooperation. The Preferred Trader Programme, the precursor to the AEO Programme, is promoted to all companies in the CCA.

Guidance for Customs approval of FZ operators and companies operating in FZs

- ✓ Customs should be involved in and be responsible for reviewing applications by companies wishing to operate in FZs as tenants.
- ✓ Customs should be involved in the permission procedure for commercial and other activities related to Customs procedures and controls in FZs.

- ✓ Customs should use Authorized Economic Operator (AEO) validation criteria to verify compliance levels, as well as check for records of any infringements and monitor compliance, in close cooperation with FZ Authorities and FZ operating bodies.
- ✓ Customs should provide periodic training to companies on responsibilities and compliance in FZs, and provide opportunities to exchange and share the necessary information.
- ✓ In addition, Customs should take any appropriate actions to revoke approval if non-compliance, illegal activities or losses of goods are observed.

4. Reporting to Customs and the use of data and IT systems

a. Declaration and reporting requirements

Declaration and reporting requirements are fundamental to ensuring the proper movement of cargoes

Explanation

- 4.1 Declaration and reporting requirements are the fundamental Customs scheme for ensuring the proper movement of cargoes coming from and going to foreign countries. Instead of conducting 100% physical inspections of goods, Customs have developed a risk management system based on the data submitted via declarations and reporting. Accordingly, timely and accurate declarations and reporting are essential for ensuring that cargoes in the FZs are compliant with national and international legal requirements for fair, safe and secure international trade, as well as possible facilitation.

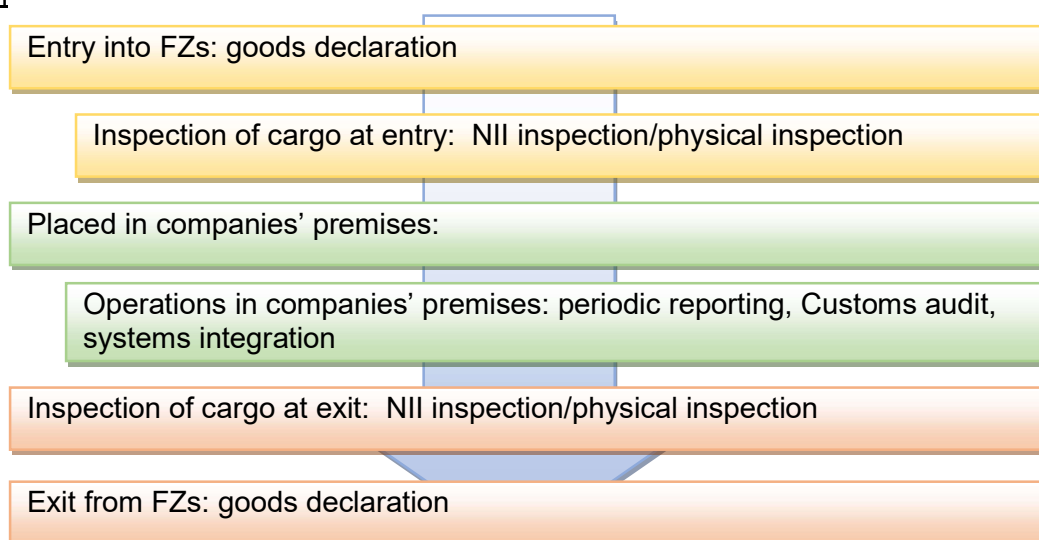
Goods declarations for entry to and exit from FZs

- 4.2 Goods declarations or other documents for entry to and exit from FZs should be required and submitted to Customs, so that Customs can judge whether the goods are admissible to FZs and verify full compliance with all applicable laws and regulations.
- 4.3 However, in some cases – mainly in countries where the entry of cargo from abroad to FZs does not constitute importation – a goods declaration for such cargo movements is not even required. Several countries reported that the utilization of data to control the movement of cargo for entry/exit, transit/transshipment, import and export falls under the jurisdiction of the Free Zone Authority and not Customs.
- 4.4 Since a characteristic of FZs is that duties and taxes are not normally imposed, such goods declarations of FZs to be submitted to Customs could exclude data elements related solely to calculation of duties and taxes, but would need to include the data elements necessary for conducting risk assessment. In addition, as simplified Customs procedures may be one of the benefits of FZs, simplified goods declarations could be permitted for companies demonstrating a high level of compliance, such as those certified as AEOs.
- 4.5 Furthermore, it should be noted that such declarations may generate necessary statistics on FZs which are important in order to gain an understanding of trade related to FZs. As recommended by the United Nations' *"International Merchandise Trade Statistics: Concepts and Definitions 2010"*, goods imported into and exported from FZs should be covered by trade statistics.

Reporting/filing requirement for goods placed in FZs

- 4.6 In addition, as the main use of FZs is the processing, manufacturing and storing of goods for longer or unlimited storage periods, it is essential to ensure that Customs also captures and controls cargoes during the storage and processing stages.
- 4.7 One possible way of controlling the movement and status of goods placed in FZs is to require periodical reporting, as is the case in Customs warehouses or during inward processing procedures. Another way would be to connect a FZ's inventory and book-keeping system to the Customs system so that the Customs side can access the system and obtain the data periodically and whenever necessary.
- 4.8 However, some countries explained during the WCO workshops that such reporting is expected to FZ Authorities or FZ operating bodies, but not to Customs, and that the systems for storing information on goods placed in FZs are not connected to Customs.
- 4.9 Relaxed requirements on goods declarations and reporting open the door to potential illegal activities in FZs. As reported in WCO Research Paper No. 47, illicit drugs bound for consignees inside FZs were detected at entry to some FZs as a result of information in declarations and following Customs inspections. Cases of missing cargo are also often reported to the WCO. It is therefore essential for Customs to receive and analyse goods declarations at entry and exit, along with reports on cargoes stored and placed in FZs.
- 4.10 The ideal declaration and reporting procedures are set out in Chart 2 below:

[Chart 2]



National experience

Example 1: Singapore

- 4.11 As with all businesses registered in Singapore, companies operating in FZs are required to maintain documents, including sales, accounting, bank, inventory and other relevant records of all transactions, for a minimum of five (5) years. Singapore Customs and other law enforcement agencies in Singapore can demand these records for the purpose of enforcement or investigation. Singapore Customs also has direct access to cargo data stored in FZ operating bodies' systems.

- 4.12 It is also a requirement for businesses, including companies operating in FZs, to file a suspicious transaction report if they know or have reasonable grounds to suspect that property may be linked to criminal conduct.

Guidance for submission of declarations and reporting

- ✓ Goods declarations or other forms of declaration at entry to and exit from FZs should be requested and submitted to Customs in order to conduct risk assessment of cargoes.
- ✓ Goods declarations could exclude elements related solely to duty declarations but should include the elements necessary for risk assessment.
- ✓ Simplified declarations should be permitted for companies which demonstrate a high level of compliance, such as those certified as AEOs.
- ✓ Companies operating in FZs should be required to keep inventory books and other records on operations conducted in FZs as accurately as possible. Companies operating in FZs or FZ operating bodies should report such inventory information and other records periodically to Customs.
- ✓ If required by Customs, FZ companies or FZ operating bodies need to submit the necessary reports, including the balance of cargoes, raw materials and a list of inventories, etc. to the Customs, upon request.

b. Use of data and IT systems in FZs

Insufficient IT integration/utilization could hinder facilitation and security of FZs

Explanation

- 4.13 Customs have developed risk management systems based on the data submitted via declarations and reporting. There is a fundamental assumption that data submission and reporting take place via an IT system in order to conduct risk assessments based on data analysis. The IT system may also be able to ensure the traceability of commercial and financial transactions.
- 4.14 However, there are FZs where such declarations and reporting are conducted on a paper basis, rather than through an IT system. During the course of the WCO workshops and field studies, the emphasis was placed by both Customs and traders on the need to process, and keep records of, declarations and to submit trade-related documents in electronic formats.
- 4.15 FZs are normally governed by FZ Authorities and FZ operating bodies other than Customs. FZ operating bodies develop their own systems for storing data on cargo movements and company operations inside their FZs, by connecting their IT system to the company's IT system. On occasion, FZ operating bodies may authorize a tenant company to have its own inventory control and record-keeping system.
- 4.16 In such cases, Customs sometimes has limited access to the FZ operating body's cargo management system. A shortage of electronic data on cargo movements, inventories and company operations inside FZs will hinder Customs' risk management,

which is reliant on data. Thus, it would be desirable for Customs to have full access to such data stored electronically in the FZ operating body's system.

- 4.17 From the perspective of FZ operating bodies, simplifying and expediting Customs procedures by digitalization may be one of the key advantages for FZs in attracting clients. Providing Customs with access to the FZ operating body's IT system and obtaining data provided by tenant companies could play a significant role by allowing adequate Customs control, including entry/exit and inventory controls, while expediting Customs procedures. Furthermore, such access could improve the accuracy of data and of reporting, which is critical for effective risk management.

National experience

Example 1: China

- 4.18 Customs control of enterprises and business is conducted by China Customs through the IT system. Companies in FZs must run their computer systems in accordance with standards set by Customs for adequate Customs control, and provide Customs with terminal equipment for data access and a software interface for computer applications, to be connected with Customs in accordance with the authentication method and data standards prescribed by Customs. Customs monitors enterprises through their account books, checks and audits. It also carries out classified credit management of companies, both inside and outside FZs.

Example 2: Thailand

- 4.19 Companies operating FZs are required to submit in an electronic format an importation and exportation report, balance report, cargo movement report, and scrap and losses report, in the form prescribed by the Customs Department, to the Duty Free Zone Audit Section, Tax Incentives Division, within 30 days of the end of the specified period. These reports should be submitted twice a year, along with the annual financial statements certified by the Customs auditor.

Example 3: Jordan

- 4.20 Zarqa Free Zone is located near the border with Iraq, Syria and Saudi Arabia. It is controlled strictly through the following measures:
- companies need to produce three account books for products, materials, and waste, which need to be submitted to two authorities (FZ Authority under the Ministry of Finance, and the Customs Administration);
 - the IT system is connected between Customs (under the Ministry of Finance) and the FZ Authority (also under the Ministry of Finance), so that Customs can see all the information which companies submit to the FZ operating body;
 - companies submit declaration information (via brokers) to Customs using the ASYCUDA system. The IT connection between Customs and the FZ Authority was created based on ASYCUDA.

Example 4: Georgia

- 4.21 The Customs Service is present 24/7 in the Zones, and has the right to perform scheduled or random checks of the premises and inventory of companies located therein. Goods entering the Zones must belong to a registered company. Imports and exports, as well as transit operations between the Zones, are managed through the Customs automated system and through the Tax Administration Information System.

Specific risk indicators designed to target the risks most common to Free Industrial Zones have been input into the Customs risk engine.

- 4.22 Incoming and outgoing transport operations and Customs clearance processes are processed according to the “one-stop shop” principle, and services such as the electronic submission of Customs documents, remote acceptance of electronic signatures, and the payment of duties, taxes and service fees via online banking services, are provided to importers and exporters. As a result, importers and exporters do not need to be physically present during the Customs clearance process or during other Customs procedures.

Guidance for data and IT systems in FZs

- ✓ The person concerned should lodge an electronic goods declaration in respect of goods introduced into or exiting from a FZ by using IT systems.
- ✓ The FZ operating body's IT system and/or company's IT system storing the data on cargo movements, inventories and company operations inside FZs should be connected to the Customs IT system. Failing that, Customs should have full access to such a system whenever necessary for the purpose of Customs procedures and control.
- ✓ By utilizing the data submitted or obtained through IT systems, Customs should facilitate trade in FZs to the greatest extent possible.

5. Customs audit in FZs

Customs audit is necessary to control companies' activities and cargoes stored in FZs over an unlimited period

Explanation

- 5.1 According to the WCO online survey, many Customs administrations have the authority to conduct a Customs audit on goods in FZs, as well as an audit of the inventory books and of other records on operations and processing conducted in FZs.
- 5.2 Considering the unlimited period for manufacturing and storing goods in FZs, a Customs audit of companies operating in FZs is one of the most suitable and important tools for Customs to supervise activities there. A Customs audit allows Customs to effectively and efficiently control not only the movements of cargo at entry and exit points on a transaction basis, but also during the storage and processing stages for a certain period of time on a contract or periodic basis.
- 5.3 Such a Customs audit may be exercised through, but is not limited to, audits of records, quantity counts of goods in an inventory, compliance reviews of selected transactions or procedures, and reviews of record-keeping, security or storage conditions.
- 5.4 It should be stressed that the FZ operating body's cooperation and assistance is necessary to ensure an effective and efficient Customs audit. Such assistance includes permission to access FZs' and companies' premises/factories, an explanation of operations and the record-keeping system, and the necessary access to computer systems which store relevant data.

National experience

Example 1: United States (US)

- 5.5 CBP manages FZs under an audit-inspection method whereby CBP does not maintain inventory records and CBP personnel are not routinely physically assigned to the premises. The FZ Operator exercises physical supervision of FZs, while CBP exercises general supervision through the audit-inspection programme, which includes the following principles:
- CBP determines the identity and nature of merchandise before or upon its deposit in the FZs so that the initial responsibility of the Operator for the merchandise can be reliably determined;
 - CBP issues a prior permit by CBP to the Operator for receipt, delivery from the zone, and any processing in the FZ; and
 - the Operator has a responsibility for the merchandise in the FZ, including physical supervision, security, record-keeping, storage conditions, and processing (including quantities of merchandise received or delivered).
- 5.6 CBP has the authority to suspend activated status for a period not to exceed 90 days, or by FTA Board order, to continue suspension of activated status of any zone operation that cannot or does not comply with the laws and regulations for zones. CBP may at any time recommend to the Board that the grant of authority be revoked for wilful and repeated violations of the FTZ Act.
- 5.7 CBP supervision may be exercised through, but is not limited to, audits of records, quantity counts of merchandise in an inventory, compliance reviews of selected transactions or procedures, or reviews of record-keeping, security, or storage conditions.
- 5.8 An audit is a systematic and thorough check of the Operators' (and sometimes tenant companies') inventory and financial records against zone lot numbers or unique identification numbers, and against the actual quantity of merchandise in the zone. Audits may generally be expected to last from a week to several months, depending on the size of the inventory, initial problems disclosed, kinds of merchandise in the zone, and many other factors. Auditors may be expected to look at all kinds of zone transactions, conditions and requirements, not only for the current year, but also for past years.

Example 2: Dominican Republic

- 5.9 The General Directorate of Customs has established a Free Trade Zones Deputy Directorate, whose main role is to supervise, control and authorize all imports, exports, transfers of goods, and other regimes that companies operating in a FZ may use.
- 5.10 The Free Trade Zones Deputy Directorate, along with the Customs Intelligence, Audit and Post Clearance Audit Departments, rigorously and continuously analyses, controls and supervises all operations that FZ-based companies must execute, in order to avoid potential illicit acts or the misuse of benefits and exemptions granted to FZ participants. Similarly, the Ministry of Finance monitors financial transactions, with the support of the General Directorate of Internal Revenue.

Example 3: Thailand

- 5.11 Thai Customs conducts Customs audits in FZs in cases where it has reasonable grounds to suspect a violation of Customs regulations, by the Post Clearance Audit

Division or Investigation and Suppression Division. Thai Customs, via the Duty Free Zone Audit Section, also conducts periodical Customs audits by auditing accounts and all documents related to importations and exportations in FZs.

5.12 For periodical audit in FZs, Thailand Customs applies a risk management concept by categorizing companies into three levels:

- Platinum level – audit every three years (including AEO companies);
- Gold level – audit every two years;
- Silver level – audit every year.

Guidance for Customs audit in FZs

- ✓ The Customs administration should adopt and conduct Customs audits for companies operating in FZs to examine and control not only movements of cargoes at entry and exit points, but also during the cargo storage and processing stages.
- ✓ The Customs administration should select a company or consignment for a Customs audit in a risk-based manner, which may include appropriate selectivity criteria.
- ✓ The FZ operating body should permit Customs access to the FZ and provide assistance to the Customs administration when conducting a Customs audit, including access to available computer systems, and an explanation of operations and record-keeping systems.

6. Customs control and surveillance

Explanation

- 6.1 Inherent risks associated with the establishment of FZs are now making headlines internationally, as civil society, and international and commercial organizations have repeatedly claimed that FZs are not only utilized by legitimate economic actors for legal economic activities, but also occasionally misused for illicit activities.
- 6.2 WCO Research Paper No. 47 points out that, between January 2011 and August 2018, some 48 WCO Members reported over 600 seizures in relation to FZs (over 1,300 when including an outlier), ranging from duty fraud to drugs, IPR infringements, origin fraud, arms, money laundering and cultural heritage smuggling.
- 6.3 Similarly, the results of the WCO online survey reveal various types of detection and seizure in FZs. Members also reported certain cases which may be related to terrorist activities, such as the detection and seizure of small arms and light weapons, explosives and cultural heritage goods, as well as money laundering and IPR infringements.
- 6.4 FZ operating bodies should be responsible for maintaining the FZs and establishing adequate procedures for ensuring the security of cargoes located therein, in accordance with applicable national security standards. Customs should play a role in monitoring FZ operating bodies' and tenant companies' maintenance of security standards and requirements, and conduct the necessary Customs surveillance, including inspection, detection and seizure of illicit goods in FZs, as described below.

a. Authority to detect/seize illicit goods in FZs

“Extraterritoriality” of FZs leads to difficulties in applying general regulations

Explanation

- 6.5 It should be noted that, according to the WCO FZ survey, several Members do not have the authority to detect/seize illicit goods in FZs. In addition, several cases reported during the WCO workshops described how FZs were exploited to disguise the origin of goods and to dispatch prohibited or illicit goods to other countries, rather than for domestic consumption.
- 6.6 Therefore, Customs should also be granted competence to detect and seize goods intended not only for domestic consumption, but also for transit and transshipment.
- 6.7 Furthermore, as WCO Research Paper No. 47 clearly points out, in general, FZs have not been explicitly covered by existing international conventions which substantively regulate illicit trade. This tendency leads to the lower-level regulation of illicit trade, both at global and national level, and it is worth stating that some countries' conceptions of the "extraterritoriality" of FZs may also lead to difficulties in applying general regulations on illicit trade to FZs.
- 6.8 In order to combat illicit activities in FZs, firstly, any kind of illicit trade in goods should be prohibited by related international conventions and national regulations on the same basis as for goods outside FZs. Secondly, Customs should have the competence to inspect goods in FZs, as well as to detect and seize goods, regardless of whether the intended transactions are storage, manufacturing, transit/transshipment or domestic consumption.

National experience

Example 1: Singapore

- 6.9 Local authorities, including Singapore Customs, have the legal power to enter into FZs and conduct checks on goods in FZs. If goods are found to have breached domestic laws, international conventions or treaties, the local authorities can seize the goods.

Example 2: Malaysia

- 6.10 In Malaysia, the power to seize goods intended for transit and transshipment is provided under the Customs Act 1967 and Free Zone Act 1990.

Example 3: Turkey

- 6.11 In Turkey, the Customs Administration has the authority to detect or seize all types of goods defined under anti-smuggling legislation. Customs has the authority to detect or seize any illicitly traded goods intended for transit or transshipment.

Example 4: Jordan

- 6.12 The following goods are prohibited under the Customs Law from entering the FZs:
- Goods prohibited in relation to public order infringements, such as weapons and drugs, determined by the competent authorities;
 - Strong-smelling or inflammable goods (other than fuels required for investment activities, which are permitted by the investing body and under its conditions);
 - Drugs and psychotropic substances of all kinds and their derivatives;
 - Goods originating in a country against which there is an economic boycott; and

- Goods protected under intellectual property law (trademarks and copyrights).

Example 5: United States (US)

- 6.13 CBP laws are applicable to prohibited merchandise in a FZ, vessels and aircraft entering or leaving a FZ, and merchandise which has been brought into a FZ for purposes not specified in the FTZ Act.

Guidance for authorities on detecting/seizing illegal goods in FZs

- ✓ National law should clearly specify that any prohibitions on importation of particular articles also apply in the case of entry into FZs.
- ✓ Such articles should include, but not be limited to, narcotic drugs, IPR-infringing goods, goods linked to duty or origin fraud, light arms and small weapons, explosives, goods linked to money laundering, and smuggled cultural heritage.
- ✓ Customs should establish and maintain a system to detect consignments suspected of containing such illicit goods, regardless of whether the goods are intended for domestic consumption, transit/transshipment or other purposes.

b. Authority to enter FZs to conduct on-site checks and inspections

Some Customs administrations have very limited authority to conduct examinations and investigations inside FZs

Explanation

- 6.14 It is worth reiterating that since the main use of FZs is manufacturing and the storage of goods for longer than usual or unlimited storage periods, it is essential that Customs control not only the movement of cargo at entry and exit points, but also during the storage and processing stages.
- 6.15 However, some Customs administrations have very limited authority to conduct examinations and investigations inside FZs: they are allowed to enter FZs and company premises only if there is suspicion of illicit activity therein, backed up by concrete evidence. In such cases, the burden of proof for such suspicion is on the Customs side. This also applies in cases where the declarations and data are submitted to the FZ Authority and/or operating body, and not to Customs, making it much more difficult for Customs to show evidence in order to enter FZs to inspect cargo.
- 6.16 As can be seen in several cases described in WCO Research Paper No. 47, instances of “missing cargo” inside FZs are frequently observed. Therefore, ex-officio/on-site visits by Customs, together with audit procedures and periodic reporting, are essential to prevent and detect illegal activities conducted inside FZs, and in particular, on company premises.

National experience

Example 1: Jordan

- 6.17 In Jordan, an on-site visit and comparison between the account book and physical inventory resulted in the detection of missing inventory for which tax exemption inside the FZ had been exploited.

Example 2: Thailand

- 6.18 In Thailand, Customs offices/houses are located in FZs. Customs officers conduct inspections of cargoes in FZs according to a risk management scheme, at the last port of destination where tax incentives are applied, as well as at the first port.
- 6.19 Customs also conducts on-site checks and inspections. It conducts Customs audit on-site periodically, and also in cases where there are reasonable grounds to suspect that the provisions of the Customs Act or other laws related to Customs are being violated. A Customs technical officer has the power to enter into premises of companies whose business relates to importation and exportation in FZs.

Example 3: United States (US)

- 6.20 The FZ Operator must permit CBP personnel access to the FZ. To permit proper access, the Operator must furnish CBP personnel with special equipment (and, where applicable, the personnel to properly use the equipment) for conducting compliance reviews or audits, such as weighing, gauging, and measuring equipment; protective clothing (for cold storage, hazardous substances, safety hard hat, etc.); and provide access to available computers and peripheral equipment.
- 6.21 Providing proper access also includes the explanation by the Operator of procedures and transactions in the Operator's or User's inventory and record-keeping system. The Operator should cooperate in any compliance review, audit, or other lawful CBP action, including the location of records and merchandise, so as to achieve its prompt completion and assure a rapid return to normal zone operation. CBP should respect Operator and User security health, safety, and union work rule procedures, to the extent that they do not interfere with a proper audit or compliance review of the zone.
- 6.22 The Port Directors are required to conduct compliance reviews based on the port's risk assessment of the individual zone. A compliance review is a visit by CBP personnel from a port office to physically observe or examine transactions, records, procedures, or conditions in the zone. The purposes of compliance reviews include to determine whether the Operator and Users are in compliance with applicable laws, regulations, and CBP procedures; and to determine the risk associated with each zone within the port's jurisdiction.
- 6.23 Compliance reviews are made without advance notification to the Operator or User, except when prior notification is in the interest of CBP. However, the personnel shall announce their arrival to the manager or person in charge at the zone and at the User's premises before the compliance review is started.
- 6.24 A compliance review will generally be limited to a day or two, to allow the widest possible CBP presence at zones. However, a compliance review may be extended in duration, at the discretion of the Port Director, for a further check on the basis of initial findings.

Guidance for on-site checks and inspections by Customs

- ✓ All persons carrying out an activity involving the storage, working, processing, or sale or purchase of goods in FZs should keep appropriate records in a form approved by the Customs.
- ✓ Customs should monitor the movement of goods and persons in FZs and inspect incoming, placed and outgoing cargoes and baggage based on risk management techniques.
- ✓ Customs should have the authority to conduct on-site checks and inspections on companies' premises, both periodically, and at any time when considered necessary by Customs.

c. Use of technology for inspections in FZs

Explanation

- 6.25 Given Customs' limited human resources and the increase in FZs around the globe, it is not an easy task to conduct surveillance in respect of every aspect of FZs. However, since FZs are unique areas, where new procedures and incentives have been applied experimentally, they also offer opportunities for Customs to take advantage of that special FZ environment and to apply, on an experimental basis, innovative Customs procedures/control by utilizing data and modern technologies.
- 6.26 The installation of a fence, wall, or barbed wire fences is a basic requisite for FZs. Non-intrusive inspection (NII) equipment should be put in place, together with well-planned flows of trucks and cargoes to facilitate and secure the movement of cargoes at the construction stage. Many FZs are equipped with a camera surveillance system which should cover all parts of the FZ and be linked to the Customs office therein.
- 6.27 The use of electronic locks on doors to companies' premises, and the use of electronic tracking systems for the transportation of cargoes between a port and a FZ, also appears to be effective.
- 6.28 In any event, full use can be made of such technologies and equipment by linking the data or records to the existing Customs office inside or near the FZ.

National experience

Example 1: Jordan

- 6.29 In Jordan, the following development and modernization work has been done to facilitate and secure cargoes in FZs:
- application of an electronic payment system to pay Customs duties;
 - an electronic archiving system for most transactions;
 - installation of wireless computer networks to implement an electronic sampling system;
 - electronic link mechanism between the Customs Department system and the systems of private and public FZs;
 - camera surveillance systems covering all FZ areas;
 - electronic gates for the empty exit door;
 - application of an electronic lock system to doors of companies' premises; and

- use of a Global Positioning System (GPS), especially for selected transit cargoes: if selected as GPS-traced cargo, the IT system can monitor the cargo from headquarters and it is escorted by Customs officers.

Guidance for inspection technologies

- ✓ Customs should establish and maintain surveillance systems at FZ entry and exit control points, as well as inside FZs. For this purpose, Customs should use non-intrusive inspection (NII) equipment, surveillance cameras and other technologies to monitor cargoes and people.
- ✓ NII equipment should be installed according to a well-planned flow line of lorries and cargoes developed by Customs and other authorities at the construction stage.
- ✓ Customs should explore the possibility of utilizing advanced technologies, such as electronic tracking systems and e-seals, to monitor cargo movements inside and outside FZs.

7. Cooperation

a. Cooperation with the private sector and other governmental agencies

Working together to solve any issues and challenges in FZs

Explanation

- 7.1 Enhancing cooperation with operators and companies in FZs is key to enhancing facilitation and safety/security within them. It is essential for Customs to participate not only in controlling goods, but also in facilitating trade, recognizing the significant role that Customs can play in the healthy and sustainable economic growth of FZs.

To that end, cooperation mechanisms with operators and companies, such as periodic dialogue and reporting, and the provision of adequate training, are necessary alongside the company approval process. Such periodic dialogue and sharing of information would enable Customs and the private sector to work together to solve any issues and challenges in FZs. The assignment of a Customs officer responsible for each company and zone might be another possible mechanism for sustainable cooperation. Customs could also request FZ operators and tenant companies to assign their own contact point to Customs.

- 7.2 Furthermore, Customs should make FZ operating bodies, tenant companies, the public and other stakeholders aware of the regulatory requirements, risks and responsibilities associated with FZs through awareness-raising, communication, education and outreach programmes. For this purpose, Customs should publish details of the requirements and criteria to be met by tenant companies operating in FZs so that FZ operating bodies can monitor these companies and their activities with a view to maintaining the safety and security of trade in FZs.

- 7.3 In particular, Customs, together with the relevant ministries, should make an effort to encourage the business community to conduct business with “clean FZs” only – i.e. FZs that are legally compliant and “clean” by meeting the following criteria, based on the “Code of Conduct for Clean Free Trade Zones” (OECD Recommendation):

- provide unconditional access to Customs to enter into FZs to carry out ex-officio on-site checks in support of investigations into illegal activities;

- ensure that FZ operating bodies that are allowed to operate within FZs are physically located within the FZ, and that they communicate to the Customs the identity of the tenants and clients in their operations;
- prohibit FZ operating bodies and tenant companies which do not provide the necessary assurance of compliance with applicable Customs procedures and control;
- ensure tenant companies maintain digital records of all shipments of goods entering and leaving the FZ, as well as all goods produced or stored therein, and submit the information to Customs in a timely manner;
- ensure the traceability of any commercial or financial transaction of the economic operators active in the FZ, occurring inside or originating from the FZ;
- report suspicious illegal behaviour to the Customs; and,
- participate in peer learning and dialogues with Customs to resolve compliance challenges.

7.4 The establishment of cooperation frameworks between and among various national agencies, including law enforcement agencies, is also essential in order to provide a cohesive and coordinated response to safety and security risks stemming from FZs.

National experience

Example 1: Georgia

- 7.5 As one of the key players in FZs, Customs is fully aware of the importance of building a strong partnership with FZ stakeholders. Thus, industry outreach is one of the key components of Customs' work, the objective being to enable Customs and business entities to share information and work together towards solving any problems and challenges.
- 7.6 Whenever companies registered in a FZ wish to make a transaction, but are unsure of the regulation applying to the operation or need further information, they know that they can approach Customs for guidance. Within its scope of competence, Customs is able to provide solutions and guide companies on how they should proceed. This is considered to be a Customs "preventive analysis" approach, where problems are solved before they occur. Such an approach has become an integral part of the Customs and business working environment.
- 7.7 By developing a professional relationship with companies operating in FZs, as well as with the administrators, Customs has been able to prevent infringements of the law and increase compliance. In practice, this endeavour has made it possible to develop smooth and effective workflows within FZs and has reduced the number of irregularities and infringements.

Example 2: Dominican Republic

- 7.8 The General Directorate of Customs has established a Free Trade Zones Deputy Directorate, whose main role is to supervise, control and authorize all imports, exports and transfers of goods, and other regimes that companies operating in a FZ may use. Customs' assistance contributes to time-saving with respect to imports and exports, which impacts positively on the competitiveness of participating companies.
- 7.9 The Free Trade Zones Deputy Directorate, along with the Customs Intelligence, Audit and Post Clearance Audit Departments, rigorously and continuously analyses, controls and supervises all operations that FZ-related companies must execute, in order to avoid potential illicit acts or the misuse of benefits and exemptions granted to FZ

participants. Similarly, the Ministry of Finance monitors financial transactions, with the support of the General Directorate of Internal Revenue.

Example 3: Singapore

- 7.10 Singapore Customs has regular meetings with FZ operating bodies and has established a contact point with FZ operating bodies. If the latter have any suspicion of, or detect, any illicit activities in FZs, they are to report to Customs in a timely manner for effective enforcement. FZ operating bodies also provide a monthly report to Singapore Customs. The report contains information relating to a list of business entities operating in FZs, as well as information on any security incidents that have occurred in FZs.
- 7.11 In addition, Singapore Customs works with FZ operating bodies to conduct joint inspections, incident and contingency drills and exercises. It also has access and system linkages to FZ operating body systems. Singapore Customs performs regular outreach with FZ operating bodies and companies operating in FZs to remind them of the requirements to be met, as well as to brief them on the latest cases detected of illicit activities in FZs.

Guidance for cooperation with the private sector and other governmental agencies

- ✓ Customs should establish and maintain cooperation mechanisms with operators and companies, including measures such as periodic dialogue, reporting/information-sharing, and the provision of adequate training.
- ✓ Through such periodic dialogue and information-sharing, Customs, the private sector and other governmental agencies should work together to solve any issues and challenges in FZs.
- ✓ Customs, together with the relevant ministries, should make an effort to encourage the business community to conduct business with “clean FZs” only – i.e. FZs that are legally compliant and “clean” by meeting the relevant criteria based on the Code of Conduct for Clean Free Trade Zones (OECD Recommendation).

a. Cooperation among Customs administrations

Explanation

- 7.12 As FZs originally focused on manufacturing for export, and as they are often used for transit purposes, any illegal activities also involve smuggling to other countries. Thus, the issue of proper Customs procedures/control in FZs is crucial, not only for countries with FZs, but also for those without them; possible solutions require international action and cooperation to combat illegal activities which exploit weaknesses in FZs.
- 7.13 Indeed, WCO Research Paper No. 47 presents several cases where three or more countries were involved in the chain of transit/transshipment operations for illegal activities by utilizing FZs. This underscores both the complexity and global nature of this issue, and the necessity for intelligence-sharing and international cooperation among Customs administrations.
- 7.14 During the WCO workshops on FZs, several countries highlighted the effectiveness of international information exchange among Customs along transit routes, which can be done by making use of international agreements, such as Customs Mutual Assistance

Agreements (CMAAs). It is therefore important for these agreements to cover information exchange related to FZs by having an appropriate definition of FZs, without invoking a concept of a FZs' "extraterritoriality" from the Customs territory.

- 7.15 One country also mentioned that global operations led by international organizations had resulted in the seizure of goods evading duties, proving the effectiveness of global cooperation focused on illegal activities in FZs. Thus, regional or global operations could be conducted among Customs and other law enforcement agencies. One possible outcome of such operations could be to consider revoking the licence to operate in a FZ.
- 7.16 Sharing seizure data and best practice to combat illegal activities in FZs through the WCO Customs Enforcement Network (CEN), and among Customs' respective national contact points, could be beneficial in enhancing the safety and security of FZs.
- 7.17 Furthermore, several cases of origin fraud were reported during the workshops. One involved the placing in a FZ of cargoes whose transport documents were falsified in an attempt to hide the origin country and to mis-declare the cargoes in the destination country. Additional repacking and other light operations in a FZ may be exploited to change or remove the origin mark or to obtain a certificate of origin from the country where the FZ is located. To track these cargoes and ensure that the origin is accurate, cooperation among Customs and other governmental agencies en route is vital, together with Customs' on-site checks and inspections in each FZ.

National experience

Example 1: Singapore

- 7.18 Singapore Customs receives and shares intelligence with its network of partners. This network includes both local and foreign law enforcement authorities, relevant international organizations, such as the WCO, and foreign Customs administrations. Singapore Customs collaborates with local law enforcement agencies and other Customs administrations to conduct joint enforcement operations.

Example 2: Vietnam

- 7.19 Vietnam Customs exchanges information with other Customs administrations through mutual bilateral agreements. If there is a suspicion of illicit trade, Customs in one country immediately informs Customs in the other, providing all related information so that together they can track the routes taken by the goods and seize any illegal goods.

Guidance for cooperation among Customs administrations

- ✓ Customs should cooperate with each other by sharing appropriate information, including where relevant in the course of activities under Customs Mutual Assistant Agreements (CMAAs) for the purpose of combating illegal activities which utilize FZs.
- ✓ Customs should establish contact points to facilitate such cooperation among Customs.
- ✓ Appropriate controls should be exercised on documentation, as well as on the goods themselves, so as to identify and check the true origin of goods in FZs through cooperation with other governmental agencies and also through cooperation with Customs, by tracking the routes taken by cargoes.

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ANNEX I

Free Zones and Rules of Origin

1. Rules of origin and the territorial definition of FZs

Explanation

- 1.1 Rules of origin are a set of rules to determine the origin of goods and implement corresponding measures and instruments of commercial policy, such as whether imported products should receive most-favoured-nation (MFN) or preferential treatment.
- 1.2 Many of the world's Free Trade Agreements (FTAs) grant originating status to FZs and have a clear provision on inclusion of FZs in the FTA, as it is generally understood that goods manufactured in FZs are eligible to benefit from a preferential tariff treatment as they are originating goods in the territory of the FTA contracting parties (CPs) and meet the applicable origin criteria.
- 1.3 Nevertheless, it should be noted that the territorial definition of a FZ may impact on eligibility to benefit from a preferential tariff treatment. For example, without a clear provision in the FTA, products originating from the FZs of the CP might be excluded from a preferential treatment if national legislation in that CP defines FZs as being outside the Customs territory. This is because FTAs generally apply to the Customs territory of CPs.
- 1.4 Thus, Customs should be aware of the following elements regarding rules of origin and the territorial definition of FZs:
 - the national definition of FZs may affect the applicability of preferential tariff treatment under FTAs, which could lead to different treatment among goods produced in CPs;
 - ensuring equal treatment in FTAs for goods produced in FZs among all CPs would help standardize the procedures and control pertaining to the origin of goods, and to reduce the possibility of tax evasion; and
 - the exemption of goods manufactured in certain FZs from preferential treatment would require robust cargo management among Customs, the competent issuing authority⁷ and the designated FZ authority, alongside a high compliance awareness of stakeholders. This could increase costs for both Customs and stakeholders.

2. Exclusion of products manufactured in FZs from FTA rules of origin and preferential tariff treatment

- 2.1 It should be noted that some FTAs include a unique provision which excludes products obtained in the FZs from gaining the origin status to be eligible for preferential tariff treatment.
- 2.2 A technical paper by the United Nations Conference on Trade and Development (UNCTAD) (December 2018, "The treatment of goods originating in Special Economic Arrangements / Zones in the African Continental Free Trade Area") suggests that the rationale behind excluding goods produced in FZs from preferential treatment is that they benefit from tax and other investment incentives, therefore the cost of

⁷"The competent issuing authority" is the government authority or body empowered to issue a certification of origin. In most cases, this is the Customs administration, Chamber of Commerce, Ministry of Commerce or Ministry of Industry (depending on national legislation).

manufacture is lower and such goods can be sold at a lower price than goods manufactured outside FZs.

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Annex II

Checklist

Territoriality aspect of FZs

- ✓ FZs should, from a geographical perspective, be regarded as a part of the Customs territory or of other special areas where Customs' authority to control the goods and persons is legally safeguarded, and where the necessary Customs procedures and control are applied to secure and facilitate the movement and placement of cargoes in FZs.

Customs involvement in FZs

- ✓ Customs should be represented on the relevant governmental board to develop the overall national policy on FZs, decide on the establishment of FZs and review applications to establish FZs.
- ✓ Customs should establish basic construction standards and other standards to be implemented in FZs for Customs control. This covers Customs check-points, enclosed fencing surrounding the FZ, Customs inspection areas, video surveillance system, installation of non-intrusive inspection (NII) equipment, the information network to be interfaced with Customs, etc.

Customs approval of FZ operators and companies operating in FZs

- ✓ Customs should be involved in and be responsible for reviewing applications by companies wishing to operate in FZs as tenants.
- ✓ Customs should be involved in the permission procedure for commercial and other activities related to Customs procedures and controls in FZs.
- ✓ Customs should use Authorized Economic Operator (AEO) validation criteria to verify compliance levels, as well as check for records of any infringements and monitor compliance, in close cooperation with FZ Authorities and FZ operating bodies.
- ✓ Customs should provide periodic training to companies on responsibilities and compliance in FZs, and provide opportunities to exchange and share the necessary information.
- ✓ In addition, Customs should take any appropriate actions to revoke approval if non-compliance, illegal activities or losses of goods are observed.

Submission of declarations and reporting

- ✓ Goods declarations or other forms of declaration at entry to and exit from FZs should be requested and submitted to Customs in order to conduct risk assessment of cargoes.
- ✓ Goods declarations could exclude elements related solely to duty declarations but should include the elements necessary for risk assessment.
- ✓ Simplified declarations should be permitted for companies which demonstrate a high level of compliance, such as those certified as AEOs.

- ✓ Companies operating in FZs are required to keep inventory books and other records on operations conducted in FZs as accurately as possible. Companies operating in FZs or FZ operating bodies should report such inventory information and other records periodically to Customs.
- ✓ If required by Customs, FZ companies or FZ operating bodies need to submit the necessary reports, including the balance of cargoes, raw materials and a list of inventories, etc. to the Customs, upon request.

Use of data and IT systems in FZs

- ✓ The person concerned should lodge an electronic goods declaration in respect of goods introduced into or exiting from a FZ by using IT systems.
- ✓ The FZ operating body's IT system and/or company's IT system storing the data on cargo movements, inventories and company operations inside FZs should be connected to the Customs IT system. Failing that, Customs should have full access to such a system whenever necessary for the purpose of Customs procedures and control.
- ✓ By utilizing the data submitted or obtained through IT systems, Customs should facilitate trade in FZs to the greatest extent possible.

Customs audit in FZs

- ✓ The Customs administration should adopt and conduct Customs audits for companies operating in FZs to examine and control not only movements of cargoes at entry and exit points, but also during the cargo storage and processing stages.
- ✓ The Customs administration should select a company or consignment for a Customs audit in a risk-based manner, which may include appropriate selectivity criteria.
- ✓ The FZ operating body should permit Customs access to the FZ and provide assistance to the Customs administration when conducting a Customs audit, including access to available computer systems, and an explanation of operations and record-keeping systems.

Detecting/seizing illegal goods in FZs

- ✓ National law should clearly specify that any prohibitions on importation of particular articles also apply in case of entry into FZs.
- ✓ Such articles should include, but not be limited to, narcotic drugs, IPR-infringing goods, goods linked to duty or origin fraud, light arms and small weapons, explosives, goods linked to money laundering, and smuggled cultural heritage.
- ✓ Customs should establish and maintain a system to detect consignments suspected of containing such illegal goods, regardless of whether the goods are intended for domestic consumption, transit/transshipment or other purposes.

On-site checks and inspections by Customs

- ✓ All persons carrying out an activity involving the storage, working, processing, or sale or purchase of goods in FZs should keep appropriate records in a form approved by the Customs.

- ✓ Customs should monitor the movement of goods and persons in FZs and inspect incoming, placed and outgoing cargoes and baggage based on risk management techniques.
- ✓ Customs should have the authority to conduct on-site checks and inspections on companies' premises, both periodically, and at any time when considered necessary by Customs.

Inspection technologies

- ✓ Customs should establish and maintain surveillance systems at FZ entry and exit control points, as well as inside FZs. For this purpose, Customs should use non-intrusive inspection (NII) equipment, surveillance cameras and other technologies to monitor cargoes and people.
- ✓ NII equipment should be installed according to a well-planned flow line of lorries and cargoes developed by Customs and other authorities at the construction stage.
- ✓ Customs should explore the possibility of utilizing advanced technologies, such as electronic tracking systems and e-seals, to monitor cargo movements inside and outside FZs.

Cooperation with the private sector and other governmental agencies

- ✓ Customs should establish and maintain cooperation mechanisms with operators and companies, including measures such as periodic dialogue, reporting/information-sharing, and the provision of adequate training.
- ✓ Through such periodic dialogue and information-sharing, Customs, the private sector and other governmental agencies should work together to solve any issues and challenges in FZs.
- ✓ Customs, together with the relevant ministries, should make an effort to encourage the business community to conduct business with "clean FZs" only – i.e. FZs that are legally compliant and "clean" by meeting the relevant criteria based on the Code of Conduct for Clean Free Trade Zones (OECD Recommendation)

Cooperation among Customs administrations

- ✓ Customs should cooperate with each other by sharing appropriate information, including where relevant in the course of activities under Customs Mutual Assistant Agreements (CMAA) for the purpose of combating illegal activities which utilize FZs.
- ✓ Customs should establish contact points to facilitate such cooperation among Customs.
- ✓ Appropriate controls should be exercised on documentation, as well as on the goods themselves, so as to identify and check the true origin of goods in FZs through cooperation with other governmental agencies and also through cooperation with Customs, by tracking the routes taken by cargoes.