A CRITICAL REVIEW OF THE FREE TRADE ZONES IN NIGERIA AND THE IMPLICATIONS TO THE NIGERIAN TAX SYSTEM*

Abstract
Free trade zones (FTZs) present both opportunities and challenges for national development and enhanced globalised trade between foreign investors and local businesses. A Free Trade Zone is any area in a country where goods may be imported/exported without any barrier imposed by the host's customs authorities. It could also refer to a particularly chosen area within a country where regular trade barriers like quotas and tariffs are removed and the administrative restricted access is lessened in order to attract new businesses and foreign investments. At their best, the FTZs facilitate frictionless trade and manufacturing, creating jobs and economic growth for local communities. At their worst, they enable illicit trade and the laundering of criminal proceeds. In this paper, the author examines the legal framework of the free trade zones in Nigeria and the implications to the Nigerian Tax System. Over the years since the establishment of the FTZs in Nigeria, there have been lots of challenges and contentious issues with respect to the compliance of the Nigerian Tax laws and obligations by companies and individuals that claim to work within the FTZs. While the FTZ legislation has been in place for about two decades, the implementation and administration of the FTZs has left a lot to be desire on both the objectives of the zone and the revenue that should be accruable to the government. Finally, the paper examine how the tax administration and management of FTZs could be improved by implementing existing and emerging initiatives and highlight where new thinking is required to raise global standards to protect the country's revenue capacity.

Keywords: Free Trade Zone, Nigerian Tax System, Implications, Nigeria

1. Introduction

A free trade zone (FTZ) is a specific class of special economic zone. They are a geographic area where goods may be landed, handled, manufactured or reconfigured, and re-exported without the intervention of the customs authorities. Only when the goods are moved to consumers within the country in which the zone is located do they become subject to the prevailing customs duties. Free-trade zones are organized around major seaports, international airports, and national frontiers—areas with many geographic advantages for trade.[1] Free trade zones can also be labour-intensive manufacturing centers that involve the import of raw materials or components and the export of factory products. An FTZ can also be a region where a group of countries has agreed to reduce or eliminate trade barriers.[2] The primary purpose of a free-trade zone is to remove from a seaport, airport, or border those hindrances to trade caused by high tariffs and complex customs regulations. Among the advantages of the system are the quicker turnaround of ships and planes through the reduction in formalities of customs examinations and also the ability to fabricate, refinish, and store goods freely.[3] Free trade zones (FTZs) present both opportunities and challenges for national development and enhanced globalised trade between foreign investors and local businesses. At their best, the FTZs facilitate frictionless trade and manufacturing, creating jobs and economic growth for local communities. At their worst, they enable illicit trade and the laundering of criminal proceeds. In this paper, the author examines the legal framework of the free trade zones in Nigeria and the implications to the Nigerian Tax System. Over the years since the establishment of the FTZs in Nigeria, there have been lots of challenges and contentious issues with respect to the compliance of the Nigerian Tax laws and obligations by companies and individuals that claim to work within the FTZs. While the FTZ legislation has been in place for about two decades, the implementation and administration of the FTZs has left a lot to be desire on both the objectives of the zone and the revenue that should be accruable to the government. Finally, the paper examines how the tax administration and management of FTZs could be improved by implementing existing and emerging initiatives and highlight where new thinking is required to raise global standards to protect the country's revenue capacity.

2. History and Evolution of Free Trade Zones

Free Trade Zones date back to medieval times when towns around the Baltic in Asia began to exploit the concept of the free port. As other modes of international transport evolved, FTZs also appeared near airports and border crossings. FTZs subsequently shed their purely trading nature becoming ideal location for processing of raw and intermediate materials into finished products, thereby increasing local value added, generate more

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[1] Definition of Free Trade Zone-Source-Britannica

[2] Arthur O' Sullivan; Steven M. Sheffrin (2003). *Economics: Principles in action*. Upper Saddle River, New Jersey 07458: Pearson Prentice Hall. p. 454

[3] http://www.britannica.com/EBchecked/topic/218417/free-trade-zone

employment, industrial development and productive investment. Many emerging economies are active participants: research shows that most FTZs are located in developing countries.[4]

The world's first Free Trade Zone was established in Shannon, Ireland (Shannon Free Zone).[5] This was an attempt by the Irish Government to promote employment within a rural area, maximise the use of a small regional airport and generate revenue for the Irish economy. It was hugely successful, and is still in operation today. The number of worldwide free-trade zones proliferated in the late 20th century. In the United States free-trade zones were first authorized in 1934. Today there are approximately 3,000 zones in 135 countries worldwide. In 2007, total exports from FTZs were estimated at USD 400 billion. The Colon Free Zone in Panama, the world's second largest FTZ, generated USD 8.6 billion in exports and re-exports in 2008.[6] Free trade zones in Latin America date back to the early decades of the 20th century. The first free trade regulations in this region were enacted in Argentina and Uruguay in the 1920s. The Latin American Free Trade Association (LAFTA) was created in the 1960 Treaty of Montevideo by Argentina, Brazil, Chile, Mexico, Paraguay, Peru, and Uruguay. However, the rapid development of free trade zones across the region dates from the late 1960s and the early 1970s. Latin American Integration Association is a Latin American trade integration association, based in Montevideo. Free Trade Zones are also known as *Special Economic Zones* in some countries. Special Economic Zones (SEZs) have been established in many countries as testing grounds for the implementation of liberal market economy principles. SEZs are viewed as instruments to enhance the acceptability and the credibility of the transformation policies and to attract domestic and foreign investment. In 1999, there were 43 million people working in about 3000 FTZs spanning 116 countries producing clothes, shoes, sneakers, electronics, and toys. The basic objectives of EPZs are to enhance foreign exchange earnings, develop export-oriented industries and to generate employment opportunities.

3. Types of Free Trade Zones

Today the range of zones generally falls into one of the following categories.[7]

Free trade zones (FTZs): These are typically general purpose fenced in, duty-free areas offering warehousing, storage and distribution facilities for trade, transhipment, and re-export of products. These are located in most ports around the world.[8]

Export Processing Zones (EPZs): They are industrial areas focusing on assembly and manufacturing of intermediate imports aimed primarily but not exclusively at foreign markets. Particular sectors include labour-intensive, light manufacturing such as garment production and the assembly of electronics. EPZs also promote linkages with the domestic economy by encouraging technology transfer and innovative industrial strategies. Certain types of EPZs are sometimes called Hybrid Export Processing Zones because they combine the traditional export focus of an EPZ with a sub-divided area in which non-export oriented activities can take place.[9]

Enterprise zones are economic development areas intended to revitalize specific urban or rural areas where they are located through tax incentives and financial grants. These are most often found in the developed world.[10]

Free ports: These are typically the largest of the zones, accommodate all types of activities including tourism, retail sales, and on-site residence, and accompany a broader set of incentives and benefits. Freeports are different from traditional FTZs as they are not seen as export drivers but areas promoting overall economic growth linking the zones with the overall economy of the nation. This has also resulted in greater expansion and liberalization of the core set of policies present in most free zone programs. The European Union allows inward processing relief and other customs schemes that produce some of the benefits of free zones without requiring formal zone definition. In the UK, for example, free ports do not offer significant benefits beyond inbound

[4] http://www.templars-law.com/media/citn_presentation.pdf

[5] http://www.shannondevelopment.ie/. The Free Zone is managed by Shannon Development, an Irish government agency. It was established in 1959, as the world's first Free Trade Zone.

[6] Akinci, G. and J. Crittle (2008), Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development, FIAS, World Bank Group, Washington.

[7] Akinci *et al*, p. 9

[8] Examples: Colon Free Zone, Panama, and Singapore

[9] Example: Karachi, Pakistan

[10] Example: Docklands, London

processing relief schemes. As a consequence, ports like Rotterdam have marketed themselves as "freer than a Freeport".[11]

Single factory EPZ schemes provide incentives similar to export processing zones but are not a zone at all, rather a single factory located anywhere in a country which receives the special duty-free privileges of zones. In the United States they are also called sub-zones.[12]

Foreign Trade Zones (FTZ) is the name of the specially designated zones in the United States. They are established in or adjacent to a port of entry in which all types of merchandise may be held without being subject to U.S. Customs duties and other taxes.

Special Economic Zones (SEZs): SEZs extend the relaxed tax and administration characteristics of FTZs to investment arrangements, labour laws, management practices, and wage rate policies in specific areas of the country. Originally this structure applied only to China but versions now exist in India and elsewhere. China has proposed applying special treatment within SEZs to promotion of real estate, tourism, infrastructure development and banking.

Bonded Warehouses: Specially designated storage warehouses that have the authorization of Customs authorities.

In addition to the zones above, there are a number of highly specialized zones promoting a specific industry such as information technology, tourism, or heavy industry. The location varies depending on the sector. Sites can be found adjacent to universities, ports or other relevant hubs of activities relevant to that sector.[13]

4. Rationale behind Establishment of Free Trade Zones

Generally, these zones are set up in underdeveloped parts of the host country; the rationale is that the zones will attract employers and thus reduce poverty and unemployment, and stimulate the area's economy. These zones are often used by multinational corporations to set up factories to produce goods (such as clothing or shoes). Corporations setting up in a zone may be given tax breaks as an incentive. It has been said that

> The objectives pursued by countries that use free zones have remained constant. The objectives include: development of disadvantaged regions, generating income and employment, attracting investment – especially foreign direct investment, and promoting technology transfer. The objectives …are usually pursued through free zones by providing a series of incentives to companies and firms operating in those zones.[14]

5. General Benefits of Free Trade Zones

There are primary benefits of locating a business in an FTZ. Some of these benefits are:

Duty Deferral – Import duties for imports shipped to an FTZ are deferred until the time those products leave the FTZ and enter countries' commerce.

Duty Exemption – Import duties are exempted for imports entering an FTZ and later exported without ever entering countries' commerce or destroyed within the FTZ.

Duty Reduction (Inverted Tariff) – Importers who import raw materials and conduct manufacturing operations in an FTZ may elect to pay duties for imported raw material based on the duty rate of the manufactured item (when the duty rate for the item is lower than the raw material duty rate) at the time the manufactured product leaves the zone and enters countries' commerce.[15]

6. Free Trade Zones in Nigeria

There are about 31 free trade zones in Nigeria with about 10 currently awaiting approval.[16] The Calabar Free Trade Zone was the pioneer free zone in Nigeria. It commenced operations in November 2001. A commentator has said that:

[11] Example: Hong Kong, China
[12] Example: Mauritius and Madagascar
[13] Examples: Labuan Offshore Financial Centre, Malaysia and Dubai Internet City, UAE
[14] Torres A. Raul 'Free Zones and the World Trade Organization Agreement on Subsidies and Countervailing Measures' (2007) Global Trade and Customs Journal, Vol. 2, Issue 5, 217.
[15] KPMG Trade and Customs Services: Comparative Review of Select Free Trade Zones around the World, 2009
[16] http://www.nepza.gov.ng/freezones.asp

> Since 1991 when the Federal Government established the Export Processing Zone Act, and established the Calabar site, the country has been seen to add a major policy package to make the economy more attractive to foreign investors. Export Processing Zone (EPZ) is an economic legation for FDI to operate free from the Nigeria tax laws, levies, duties and foreign exchange regulations.[17]

Since the establishment of the Calabar Free Trade Zone, the Free Zones Scheme has been used as a vehicle for industrial and commercial development of the country. Private sector participation and partnership with the Federal Government and other tiers of government has helped spread the scheme. This has culminated in the establishment of specialised Free Zones and other types of Zones. In Nigeria, there are two types of free trade zones – the specialised and the general-purpose trade/export zone. For the two FTZ types, two administrative bodies are empowered to effectively manage these zones. They are: (i) Nigerian Export Processing Zone Authority (NEPZA),[18] for the general-purpose zones and (ii) Oil & Gas Export Free Zone Authority (OGEFZA)[19], for oil & gas zone

Enabling Laws for Administration of Free Trade Zones in Nigeria
There are a number of laws and regulations for the administration of Free Trade Zones in Nigeria. The Acts are: (i) Nigerian Export Processing Zones Act (NEPZA),[20] for the general-purpose zones and (ii) Oil & Gas Export Free Zone Act (OGEFZA)[21], for oil & gas zone (iii) Companies and Income Tax (CITA)[22] (iv) Petroleum Profits Tax Act (PPTA)[23] (v) Value Added Tax Act[24] (vi) Federal Inland Revenue Service (Establishment) Act 2007. Some of the regulations are: (i) Investment Procedures, Regulations and Operational Guidelines for Free Zones In Nigeria, 2004[25] (ii) Oil & Gas Export Free Zone (OGEFZ) Regulations, 2003 (iii) Tinapa Free Zone And Resort Regulations, 2009[26]

Permissible Activities in Free Trade Zones in Nigeria
Below are the activities permitted by law to be carried out in the Free Trade Zones: (i) Oil and gas Logistics (ii) Electrical and Electronic Products (iii) Textile Products (iv) Garments (v) Wood Products and Handicraft (vi) Leather Products (vii) Petroleum Products (viii) Rubber and Plastic Products (ix) Cosmetics and other Chemical Products (x) Metal Products and Machinery (xi) Educational materials and Sports Equipment (xii) Printing Materials, Communication and Office Equipment (xiii) Medical Kits, Optical Instruments and Appliances (xiv) Biscuits, Confectioneries and other Food Processing (xv) Pharmaceutical Products (xvi) Ship building and Repairs

Nigeria Free Trade Zone Incentives[27]
Locating in any Free Zone in Nigeria automatically confers upon the investor certain advantages, benefits and incentives which have been strategically designed by the Federal Government of Nigeria to create a business-friendly environment for the investor and to be competitive.
These incentives, established by Act No. 63 of 1992 and which have been improved even more in subsequent legislation, are the following:

- Complete holiday from all federal, state and local government taxes, rates, and levies.
- Duty free importation of capital goods, machinery/components, spare parts, raw materials and consumable items in the zones.
- 100% foreign ownership of investments.
- 100% repatriation of capital, profits and dividends.
- Waiver of all imports and export licenses.
- Waiver on all expatriate quotas.

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[17] Dr. Jonathan Aremu, Attracting and Negotiating Foreign Direct Investment with Transnational Corporations in Nigeria (2005)
[18] Section 2, NEPZA Act, Cap. N107, LFN 2004
[19] Section 2, OGEFZA Act, Cap. O5, LFN 2004
[20] No. 63 of 1992, now Cap. N107, LFN 2004
[21] No. 8 of 1996, now Cap. O5, LFN 2004
[22] Cap C21; Amendment Act (No. 11 of 2007)
[23]PPTA, Cap. P13 2004 LFN defines the tax regime for exploration and production companies at 85% (67.75% till amortisation of pre-production expenses) and 50% for Production Sharing Contracts (PSCs). Incentives under MOUs for joint ventures (JVs) and PSCs (PPTA and Deep Offshore & Inland Basins PSC Act, Cap. D3 2004 LFN
[24] Cap V1; Amendment Act (No. 12 of 2007)
[25] Also known as NEPZA Regulations
[26] Made pursuant to section 27 NEPZA
[27] http://www.nepza.gov.ng/incentives.asp. Also see section 18 of both OGEFZ Act and NEPZA

- One-stop approvals for permits, operating license and incorporation papers.
- Permission to sell 100% of goods into the domestic market (However, when selling into the domestic market, applicable customs duty on imported raw material shall apply).
- For prohibited items in the custom territory, free zone goods are allowed for sale provided such goods meet the requirement of up to 35% domestic value addition.
- Waiver on all expatriate quotas for companies operating in the zones.
- Minimize delays in the movement of goods and services.
- Rent free land during the first 6 months of construction (for government owned zones).

The following benefits also accrue to investors in Nigeria's free trade zones

- Access to the Nigerian consumer market which is by far the largest consumer market in Africa with approximately 160 million people.
- Nigeria has an excellent location from which to export to the rest of Africa, the Middle East, Europe, and the Americas.
- Abundant supply of human and material resources.
- Nigeria enjoys several preferential trade arrangements such as Economic Community of West African States (ECOWAS), Africa Growth and Opportunities Act (AGOA)[28], World Trade Organisation (WTO), GSTP, OPEC, D-8 etc.

Tax Implications of Nigeria Free Trade Zones

a. No Value Added Tax (VAT) or Withholding Tax (WHT) is charged on purchases by Approved Enterprises in FTZs from companies in the customs territory.
b. For sales made by Approved Enterprises to companies in the customs territory, there is no WHT. However, the VAT is liable to be paid by the purchasing enterprise.
c. VAT and WHT is applicable on purchases/sales made from the customs territory by unapproved enterprises operating within the Zones.
d. No VAT or WHT is payable on imported goods conveyed through other ports outside the Zones but consigned to the Zones.
e. From 1 January 2015, approved enterprises in the Oil and Gas Free Zones are mandated to submit tax returns to the Free Zones Tax Administration Unit.[29]
f. Transfer pricing provisions[30] are applicable to transactions with head/branch offices (connected taxable persons) of approved enterprises in customs territory.
g. VAT and WHT are applicable to approved enterprises having contract of supplies or design with companies in the customs area.

Allowable Taxes in Nigeria Free Trade Zones

Under the FTZ legislation in Nigeria, the following types of taxes are generally exempted from being imposed on companies operating within the zone, such as

a. PAYE tax of employees of Free Trade Zones
b. Withholding tax of third party transactions in the free zones
c. VAT of third party transactions in the free zones
d. Industrial Training Fund (ITF) deductions of free zone employees

6. Contentious Issues and Vulnerabilities of Free Trade Zones in Nigeria

Worldwide, the characteristics, operators, regulators and requirements of free trade zones vary widely from country to country and there seems to be an absence of internationally accepted standard approaches within zones. As separate customs areas created to encourage trade and foreign direct investment, FTZs are subject to unique laws, regulations, and oversight to take account of their role in job creation and economic development policies. These features provide opportunities for legitimate business but also present weaknesses which expose it to misuse by criminal elements. The existence of vulnerabilities in the FTZ system makes it attractive for money launderers and tax evaders. Although zones vary in order to provide different benefits to countries and regions, they present similarities with regard to their vulnerabilities. And in general, the same challenges and vulnerabilities that beset international jurisdictions also apply to Nigeria and will be treated without borders.

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[28] Now a spent legislation since its renewal had not been triggered. Under the AGOA 2000, goods produced in the Zones enjoy preferential tariffs in the US until 2008

[29] Established by the Oil and Gas Free Zone Authority pursuant to section 34(c) of the OGFZA Regulations, 2003. Also see section 19 of both FTZ Acts

[30] Income Tax (Transfer Pricing) Regulations, 2012

Money Laundering and Financing of Crime

***Lack of standard financial laws and rules*:** Nigeria does not apply the same laws and regulations in the free trade zones as in the rest of the country. In particular the regulations that relate to financial crime preventive measures such as reporting large value currency transactions and, in some cases, Suspicious Transaction Reports (STRs) as they relate to financial institutions and businesses operating in the zones.[31]

***Relaxed Oversight and Lack of Transparency*:** The scope and degree of the Nigeria Customs Service (Customs) control over goods introduced, and the economic operations carried out in FTZs, is practically non-existent. Consistent with the purposes of establishing free trade zones, goods introduced in a FTZ are generally not subject to the usual Customs controls. There is therefore a risk of exploiting the FTZ system for commercial fraud. Goods introduced in a FTZ can undergo various economic operations, such as transhipment, assembly, manufacturing, processing, warehousing, re-packaging and re-labelling as well as storage for timely marketing, delivery and transhipment. The tracking of shipments, especially for repackaging is a key element in the control of FTZs. The same shipment may use FTZs as a base around the globe for no other purpose than to launder funds.[32]

Reliance on Cash for Transactions: The use of cash in Nigeria's FTZs continues to be important because it is easy to use in trade transactions. Cash does not require financial institutions and presents particular money laundering risks because of its portability, anonymity and lack of an audit trail. Moreover, even if banks outside of the FTZs are involved in the trade transactions, they are less able to manage this risk because of the other vulnerabilities of the zones (opaqueness and relaxed oversight).

Tax Evasion and Tax Avoidance

Exploitation of Exemption from Taxes, Rates, etc: Approved enterprises operating within the zones are exempted from all federal, state and local government taxes, levies and rates.[33] This provision is necessary for actualisation of the objectives for establishing the zones. However, in practice, a lot of companies exploit this provision and cloak illegal trading activities[34] under this section. These activities can range from non-disclosure of trading of unapproved items, inadequate disclosure of trade volume, trading with related entities in the customs territory without full or any disclosure.

***Large scale smuggling of prohibited goods**:* This vulnerability involves the illegal transportation, distribution and sale of large quantities of prohibited products such as hard drugs. This is usually carried out by criminal networks and the activities generally avoid all taxes. According to a Nigerian magazine[35]:

> Free Trade Zones, FTZs set up to promote trade in the country have now become pain in the neck of the government following allegation that they are promoting sharp practices, and sabotaging the economy. The Nigerian Customs Service, NCS, blew the alarm recently when it alleged that operators of the FTZs have been short-changing the government vis - a -vis the evasion of tax, aside from bringing in prohibited items into the country… the country may continue to suffer great losses due to the illegal activities going on within the FTZs. Aside exposing the country to dire security threats due to illegal arm importation, the economic consequence are even graver, analysts have warned.

***Illicit Manufacturing*:** This kind of tax evasion involves underreporting of actual production quantities with the difference between reported and actual production diverted through illegal channels, or in other cases, complete avoiding of reporting with all production diverted to the black market. It is quite difficult for Nigerian customs and other regulatory agencies to monitor actual production quantities of FTZ enterprises.[36]

[31] For example, the obligation on banks within the customs territory by the Central Bank of Nigeria to report transactions above a certain threshold. See section 28 FIRS Act
[32] Financial Action Task Force Report: Money Laundering Vulnerabilities of Free Trade Zones - March 2010. Also see Regulation 5 of the OGEFZ Regulations, 2003 and section 12 NEPZA Act
[33] See section 8 of both OGEFZA and NEPZA
[34] For example, trade in items not within the approved activities lists
[35] The Source: Vol. 34, No. 2, Oct 28, 2013
[36] See the restrictions emphasised by the Oil and Gas Free Zone Authority General Notice Under Section 34(c) of OGFZA Regulations, 2003; published in February 2015

Counterfeiting: Counterfeiting involves the production and distribution of products bearing a trademark without the approval of the trademark owner. These products are produced illegally and are distributed through the networks established by large-scale smuggling operations.[37]

7. Comparative Analysis of the Legal Framework of Select Free Trade Zones

To have a balanced picture of the Nigerian FTZ regime, one also needs to briefly observe the FTZ regimes of selected countries. The countries selected are United States, Mexico, Brazil and China.[38]

United States of America

In the United States, an FTZ is a secure area located in or near a port of entry that is considered outside the U.S. Customs and Border Protection (CBP) territory. Companies may also designate their own manufacturing or distribution centres as an FTZ anywhere in the United States and Puerto Rico. There are currently more than 260 such areas designated as FTZs, which offer services to more than 2,500 FTZ users nationally. The designation of an FTZ requires application to the U.S. Foreign Trade Zones Board and subsequent implementation of policies, procedures, and systems.

In addition to duty deferral, exemption, and reduction benefits, FTZs in the United States also offer the following incentives:

1. **Zone-to-Zone Transfers**: A vendor located at one FTZ may sell goods to a company in another FTZ and/or transfer those goods to the purchasing company's FTZ with no import duty paid on the goods.
2. **No Duty on Value Added**: When manufacturing operations are performed within an FTZ, no duties are assessed on domestic parts, materials, labour, and profit.
3. **Reduction on Broker and Processing Fees**: Because importers using FTZs are allowed to file weekly Customs entries, transaction costs relating to broker and merchandise processing fees are also reduced.
4. **Exemption of Inventory Taxes**: Inventory maintained within an FTZ is exempt from personal property taxes in states where this tax is applicable.
5. **Enhanced Processes**: Because the running of an FTZ requires strict inventory controls, processes around these controls often lead to increased security, CBP compliance, and supply chain improvements. One primary supply chain enhancement is the ability to import products under direct delivery procedures; imported items are not subject to CBP approval until after the product arrives in the FTZ, reducing the likelihood of cargo delays from CBP inspections at the port of arrival.

Mexico

Changes in Mexico's Customs regulations in recent years have greatly expanded FTZ-like programmes beyond conventional *Maquila*[39] operations previously available to importers. The Strategic Private Bonded Warehouse program (the REFIE) has existed since 2003 with benefits similar to those of the U.S. FTZs.. Under REFIE, goods and raw materials may enter approved sites (these can be private warehouses or warehouses run by state governments) with the deferral of import duties and other taxes. Once within the REFIE, goods may undergo manufacturing, assembly, or other value added services without the payment of duties and taxes. The key benefit under Mexico's new FTZ law is that, when a company is ready to withdraw finished merchandise from the FTZ, taxes are paid only if the merchandise will be released into local commerce. If the merchandise will be shipped to the United States or other foreign markets, the merchandise may leave Mexico without incurring customs duties or taxes.

Under a pure distribution REFIE environment (as opposed to one that would involve manufacturing or assembly operations), merchandise from abroad may be deconsolidated and inspected and, in some cases, the company may conduct repair, repackaging, labelling, and marking activities to prepare the goods for final sale. For products shipped out of the REFIE, Mexican duty is eliminated entirely. Merchandise returned to vendors, waste, and products destroyed within the FTZ may also enjoy duty elimination benefits in REFIE. This regime also affords attractive tax advantages. The main benefit consists of exemption of the VAT triggered by sales of goods subject to the REFIE regime. As it relates to income tax, REFIE locations are not deemed to be a permanent establishment for foreign parent companies and, therefore, reductions or exemptions for income taxes may be allowed for activities performed within the REFIE. Since 2007, Mexico's state government entities have been authorized to administer REFIEs. When dealing with a REFIE that is administered by a state government, the likelihood of obtaining additional tax incentives (e.g., payroll tax exemption or property tax exemptions)

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[37] China has been a major source of counterfeited products worldwide

[38] KPMG Trade and Customs Services: Comparative Review of Select Free Trade Zones around the World, 2009

[39] *Maquila* has been defined as a factory run by a U.S. company in Mexico to take advantage of cheap labor and lax regulation. See http://dictionary.reference.com/browse/maquila

increases, since the company may negotiate these types of incentives directly with the state when establishing the REFIE.

Brazil

There are two types of FTZs currently allowed to operate in Brazil: the *Manaus Free Trade Zone* and the *Export Processing Zone*. While both are considered to be FTZs, they were established by the government with distinct objectives. The Manaus FTZ offers benefits aimed at encouraging the manufacture of products within the zone for consumption in Brazil's domestic market. The Export Processing Zone provides benefits for companies performing manufacturing and assembly processes for products intended for exportation. Similar to the process in other countries, companies must obtain prior government approval before using either program. The Manaus FTZ is located in the capital of Amazonas, Brazil's northernmost state. Companies that are approved to operate within the zone must meet a minimum level of manufacturing. This minimum level of manufacturing varies by product and type of operation. Eligible companies enjoy the following benefits (in addition to corporate income tax benefits):

- Exemption from import duties (the II) for raw materials used for the manufacture of exported finished goods and an 88 percent reduction for finished goods entering domestic commerce
- Exemption from industrialized product's tax (the IPI) on imported raw materials and manufactured finished goods
- Reduction of VAT (the ICMS) and gross revenue (the PIS-COFINS) on imported raw materials and manufactured finished goods

Furthermore, regulations establishing Export Processing Zones were rectified by the Brazilian government in April 2009. Currently there are three Export Processing Zones with industrial projects approved by the National Council of ZPEs. These are located in the Northeast (Ceará and Piauí) and North (Acre) regions. Another 22 industrial complexes, in 18 states, are still in pre-operational phase.[40] Similar to the Manaus FTZ, companies must submit an application and be approved prior to operating in an Export Processing Zone.

Eligible companies enjoy exemption from II, IPI, PIS-COFINS, and navy processing fee (the AFRMM) for imported raw materials used in the manufacture of exported items and machinery and equipment installed in the zone and used to manufacture exported items (at least 80 percent of items manufactured by the equipment must be exported).

China

There are several special customs zones that allow importers, exporters, and manufacturers to take advantage of duty and other indirect tax savings in China. These zones include FTZs, Export Processing Zones (EPZ), and Bonded Port Areas (BPA). While all three of these regimes allow for certain duty and indirect tax savings, each program was established to meet certain objectives. FTZs allow for the most operations to be conducted inside the zone, including simple processing, manufacturing of goods intended for export, and trading between zones, territories, and non-FTZ companies. EPZs have been designated for manufacturing of goods intended for export; however, repairing, testing, and logistics services have also been allowed in all EPZs since 2009. Bonded Logistics Parks allow for simple processing, but do not allow the complex manufacturing conducted under processing trade. Two of these regimes - FTZs and EPZs -are described further below. To use bonded zones in China, the manufacturer should be a Chinese company, must be located in the zone, and must register the bonded actions with China's Customs authority. Once China Customs authority has approved the bonded activities, the company can begin to take advantage of the duty and cash flow benefits of the zone. There are 15 FTZs currently operating in China. In general, these FTZs are located on the eastern and southern coasts of China.2 Chinese companies that have both domestic and international sourcing can benefit from conducting manufacturing within one of these FTZs. The most substantial benefits of an FTZ are:

- Duty payment on raw materials only – When raw materials are imported into an FTZ, by a manufacturer that also sources domestic raw material, the duty owed to China's Customs authority for the finished product (if sold to China's domestic market) will be based on the imported raw materials rather than on the duty rate of the finished good. There will be no duty owed on the locally sourced material.
- Waiver of duty on raw materials for goods exported from China – China has a program, called Processing Trade, which allows for importers to claim duty free treatment for raw materials3 on the condition that they will be later exported. Importers do not actually need to be in an FTZ to conduct Processing Trade operations, but the management of bonded material would be more difficult if the operations are conducted outside of an FTZ.

[40] http://thebrazilbusiness.com/article/export-processing-zones-in-brazil

8. Conclusion and Recommendations

Worldwide, the concept of free trade zones has become central to the integrated global economy. FTZs stimulate economic growth and play a central role in business for many countries and leading manufacturers. The relevance of FTZs continues to grow as globalization defines economic progress. However the standards, oversight, and regulations governing FTZs have not kept pace with these developments. As a result, illicit actors have been able to take advantage of relaxed oversight and the lack of transparency in zones to launder the proceeds of crime, finance terrorism, and facilitate the proliferation of illegal weapons. The misuse of FTZs impacts all jurisdictions including those without FTZs of their own, because goods can originate from or be transhipped[41] through FTZs not subject to adequate export controls. Smugglers of weapons of mass destruction (WMD) abuse FTZs to tranship multi-purpose goods and to disguise the final destination of customs-sensitive items. FTZs can also be used to create legal entities and access the international financial system, providing opportunities to launder illicit proceeds. Many major zones are also located in strategic regional financial centres linking international trade hubs with access to global centres of finance. Following the review of the present legal framework of the FTZs under the Nigerian system and the negative implications on the tax and revenue base of the Nigeria, we, in our humble opinion, proffer the following suggestions which we believe could ensure a better structured and managed FTZ in the future, which include:

Ensure appropriate risk assessment and Customs control: Possible actions to prevent and detect commercial fraud cases exploiting free trade zone systems should be examined from two different viewpoints, namely

a. maintenance of appropriate level of Customs control over the admissibility of goods and the business operations carried out, and
b. Appropriate assessment of the risk associated with goods arriving from free zones.

Greater transparency of FTZ operations: Provisions such as Regulation 2(2) of the OGEFZ Regulations, 2003 are inimical to business transparency and should be amended to mean that even though approved enterprises are exempt from payment of income taxes for approved activities, they are still obliged to file income tax returns as provided under CITA.[42]

Ensure compliance with the requirements of transfer pricing: FTZ enterprises having connected taxable persons either in the customs zone or in other countries need to submit to the requirements of transfer pricing without being able to appropriate the FTZ objectives to shroud their operations in opacity, thereby raising the likelihood of tax fraud and evasion.

Procurement of data on the impact of FTZs: The Federal Government of Nigeria needs to procure and interpret meaningful empirical data on the impact of the FTZs. Currently, meaningful analysis is difficult due to the absence of accurate and current data on monetary value of FTZ incentives since inception, vis-à-vis the impact of FTZs on the local and national economy.

Ability to recommend additional incentives: The FTZ Authorities need to submit on a regular basis to the Federal Government results of impact assessment exercises of the FTZs using verifiable data of economic performance. This would help, for example, the NEPZ Authority to meet the requirement of recommendation to the Federal Government of additional incentive measures for the Zones.[43]

Ensure greater security and stability of FTZs: Instability in Niger Delta has been a major inhibitor to Nigeria FTZ's goal of being service hubs to entire Gulf of Guinea. However, Equatorial Guinea's Bioko FTZ has a likelihood of overshadowing Onne as a major oil and gas hub.[44]

[41] Illegal goods are moved from one form of transportation to the other
[42] See further section 52 of CITA on liability on all companies to file returns
[43] See section 4(g) NEPZA
[44] Afolabi Elebiju: Free Trade Zones & Nigeria Tax Regime, 2008 – Presentation made to Chartered Institute of Taxation in Nigeria (CITN)