



WCO Secretariat Note

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Expanding the Concept of Authorized Economic Operator (AEO) to Free Zone Stakeholders

(2nd Edition)

I. Introduction

Free Zones have become a global phenomenon and an integral part of the global supply and value chains within just the 50 years. The rapid expansion of free zones (FZs) has been mainly driven by political decisions closely affiliated with national economic development strategies. However, it has been pointed out in various publications that FZs attract not only legitimate business but also illicit activities that take advantage of regulatory exemptions in FZs and the lack of oversight therein.

With the aim of responding to growing Customs and private-sector needs, and a desire to ensure the adequate application of Customs procedures and surveillance in Free Zones, the WCO developed Practical Guidance on Free Zones (hereafter “FZ Guidance”) based on the WCO Research Paper No.47¹’s findings, which was endorsed by the December 2020 Policy Commission after in-depth discussions in the Enforcement Committee and Permanent Technical Committee.

Given the fact that organized crime and even terrorist organizations are involved in illicit activities inside some FZs, relaxed Customs procedures and controls in FZs should not be the key advantage of FZs at the expense of the safety and security of trade and people. Customs’ failure to conduct risk-based background checks on FZ applicant tenant companies, their key employees, compliance records and goods could become a significant enabling factor for illicit trade related to FZs. Nevertheless, further facilitation benefits within FZs could be potentially provided to tenant companies meeting the globally established Authorized Economic Operator (AEO) criteria provided by the WCO SAFE Framework of Standards (SAFE Framework), with the necessary adjustments to reflect FZ characteristics and national AEO programmes.

¹ WCO Research Paper No. 47: “Extraterritoriality” of Free Zones: The Necessity for Enhanced Customs Involvement” 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.

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.

The aim of this document is to provide information to help Customs administrations in their efforts to apply the AEO concept to FZ stakeholders, in particular to FZ Authorities and FZ companies based on Practical Guidance on FZs, taking into consideration their roles, characteristics and business types.

II. Risk pertained to FZs

It has been pointed out in existing papers² that FZs attract not only legitimate business, but also illicit activities whereby criminals take advantage of regulatory exemptions in FZs and the lack of oversight therein. And those papers 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.

The analysis of WCO Customs Enforcement Network (CEN) data and the result of WCO online survey in 2018 reveal that variety of offenses is also notable: e.g., tax evasion; illicit trade in counterfeit products, drugs, weapons, cultural goods; and money laundering.

Chart 1: CEN data - Seizures inside FZs - (total 626 seizures*)

*After excluding one unusually-large reporting country

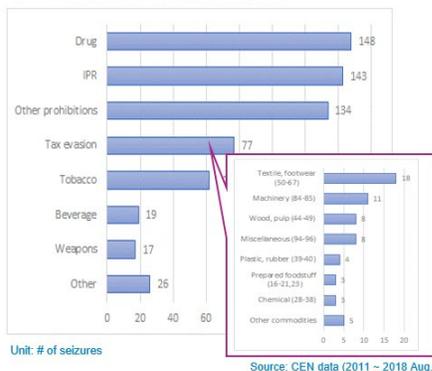


Chart 2: CEN data -Seizures of goods coming from another country's FZs - (total 85 cases)

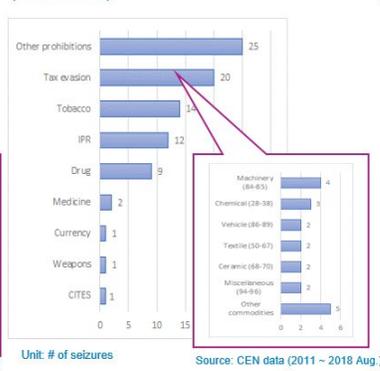
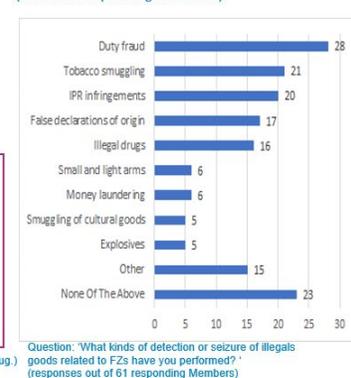


Chart 3: WCO Online Survey on FZs (2018)

(unit: # of responding Members)



Given that not only Customs but also existing papers have underlined the important role played by Customs in FZs' development, as well as in surveillance of cargo movements, and the needs of due diligence and compliance record checks of FZ related companies, Customs administrations should be heavily involved in validating FZ operating companies and tenant companies in order to contribute to the latter's safety and security, as well as competitiveness.

² 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) The literature is referenced in WCO Research Paper No. 47.



III. Expanding the AEO and Strengthening Partnerships in FZs

The AEO concept is a means of securing and facilitating global trade, while providing incentives which benefit both Customs and traders that have decided to work in partnership.

FZ Guidance suggests expanding the AEO concept to FZ stakeholders and strengthening partnership with them as one of the key elements in ensuring the effective and efficient management of FZs.

Guidance for Customs approval of FZ operators and companies operating in FZs (Practical Guidance on 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.

This note focuses on how to apply AEO to FZ supply chain, in particular to FZ operating companies and tenant companies by understanding their roles and specific business models, in order to establish an AEO cooperation framework between FZs and Customs for their mutual benefit.

IV. Expanding AEO concept to FZ operating bodies and FZ tenant companies

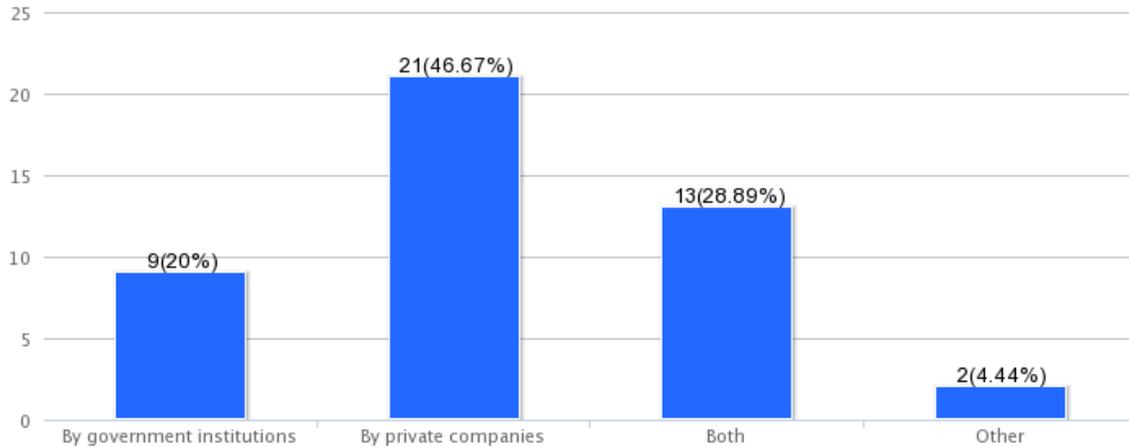
Free zone is a geographically designated area where goods may be imported, stored, handled, manufactured, or reconfigured and re-exported. Free zones are generally organized around major seaports, international airports, and national frontiers.

The rapid expansion of FZs has been mainly driven by political decisions closely affiliated with national economic development strategies. However, the World Bank has reported the growing number of privately owned, developed, and operated FZs worldwide over the past 15 years³, while some are public owned FZs. The WCO online survey on FZs in 2018 shows that nearly 50% of FZs are operated by private companies.

³ World Bank 2010 "Special economic zone : performance, lessons learned, and implication for zone development"

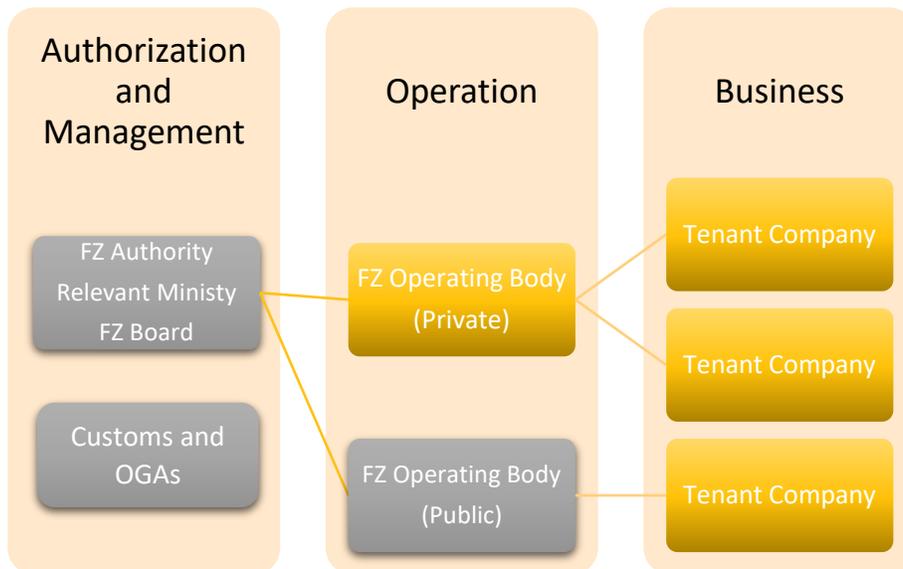
Chart 4: FZ operations (source: WCO FZ online survey in 2018)

Are FZs Operated by Private companies or Governments?



Typically, FZs are usually authorized and managed by a FZ Authority, relevant Ministry, or FZ management board where its operations are dedicated to a FZs operating body which could be the private sector, public sector or some combined mechanisms.

Chart 5: FZ Management and Operations



The WCO's Compendium of Authorized Economic Operator Programmes indicates that Customs administrations have been making effort to cover the whole supply chain operators including: importers/exporters, manufactures, warehouse, port operators, terminal operators, airport operators, carriers, freight forwarders, Customs brokers, express carriers, postal operators, etc. A few Customs administrations also indicated that their AEO programmes also cover FZ companies, and FZ parks.



Furthermore, the WCO online survey on FZs (2018) shows that Customs administrations which apply the AEO concept in FZs amount to less than half of the respondents.

With the facts that many attractive benefits including relaxed Customs procedures and controls are given to FZ tenant companies, and that the unlimited duration of cargo storage is one of main characteristic of FZs as stipulated in Standard 14 of Specific Annex D2 of the RKC, Customs administrations are facing various challenges in managing increasing volumes of cargoes and adapting to new types of business - including the growing use of FZs. As a consequence, Customs are facing a pressing need to establish partnership with FZ stakeholders to achieve effective and efficient border procedures in a rapidly changing environment.

Since the AEO is a Customs-Business partnership programme and aiming at ensuring the safety and security of whole supply chain, it is essential to consider expanding the concept of AEO partnership to the entire FZ supply chain in particular by including the following FZs players which are relatively new to Customs as AEO partners:

- FZ operating bodies (private); and,
- All FZ tenant companies operating inside FZs

i. FZ operating body

In the FZ Guidance, “FZ operating body” is explained as a corporation, partnership, or person that operates a FZ under agreement and authorization by FZ Authorities.

It is considered that the main tasks of FZ operating body could be similar to those of warehouse operator, terminal operators and port/airport operators in terms of the need to control the entrance, exit and storage of cargo in those areas (please see Chart 5 in below). Thus, expanding the concept of AEO to FZ operating body would not be a challenge if Customs utilize the experiences, expertise and high technology applying on those traditional operators in particular regarding eligible benefits and security criteria.

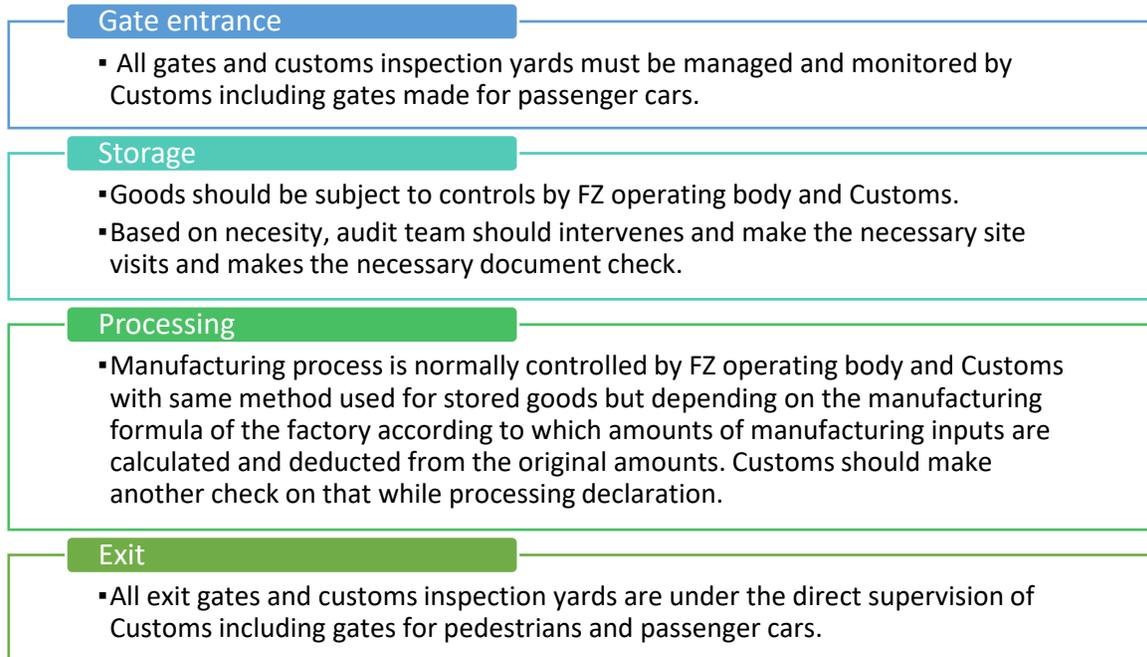
However, possible influence of some notable characteristics of FZs such as bigger size of areas, variety of operations, number of cargoes and companies therein and longer or unlimited storage duration should be carefully measured when applying the AEO to FZ operating bodies. Current challenges of lack of Customs involvement in FZs and company approval process and less Customs controls during the storage time compared to other areas such as Customs warehouses should be duly considered as well.

Furthermore, some FZ operating bodies conduct screening of businesses and persons wishing to operate in a FZ and their admissible activities and operations, with or without relevant agencies including Customs, before giving the applicant approval to operate in the FZ.

In this regard, it is critical to apply AEO Programme to FZ operating bodies in order not only for Customs to establish robust relationship with them but also to ensure the compliance of all tenant companies operating therein by meeting the AEO criteria as well. Some Customs request establishing a connection between FZ's IT system to Customs IT

system as a prerequisite criteria to be an AEO and it seems to be very effective to ensure the compliance of FZs as a whole.

Chart 6: FZ Daily Operations



ii. FZ tenant company

“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 is given a license by the FZ Authorities by close consultation with relevant authorities including Customs administrations.

FZ tenant companies can be export-oriented manufacturing companies which utilize the characteristic of FZs such as duty free and long or unlimited duration of the storage. It has been observed that distributors and even e-commerce platforms are utilizing FZs for the purpose of grading, repacking and labelling purpose without manufacturing operations.

Since many Customs administrations already apply AEO for importers, exporters which can be manufacturing companies, and distributors as well, the expanding the AEO concept to FZ tenant companies is not new initiative.

Rather, as stated in WCO Research Paper No. 47 and the FATF report (2010), lack of due diligence and compliance record checks during the initial phase of admitting companies into FZs are identified as one of elements enabling illegal activities in FZs, Customs should consider expanding the AEO by utilizing current experience and expertise of applying AEO



to tenant companies based on necessary cooperation with FZ Authorities and FZ operating bodies.

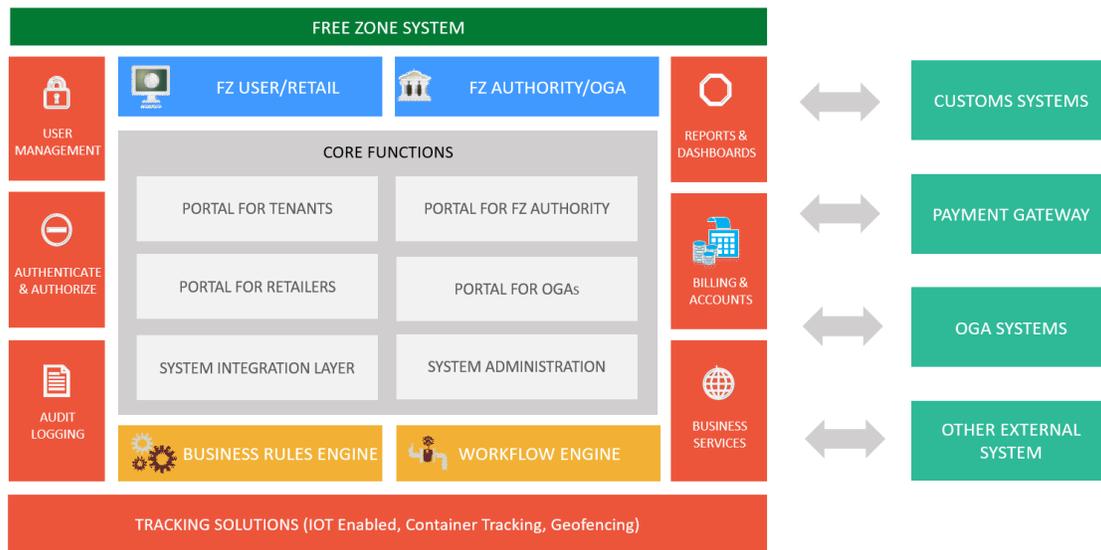
Customs should conduct risk-based background checks to prohibit legal or national persons convicted of illegal activities from operating within FZs, and take appropriate action to revoke permits if they observe any non-compliance, illegal activities or loss of goods.

V. Data exchange mechanisms with AEO partners

As seen in Chart 6, FZ operating body and tenant companies can be recognized as a source of data necessary for Customs procedures and controls in FZs. Such data sharing with Customs, in turn, could realize tangible AEO benefits, such as simplification and facilitation of Customs procedures, and minimum cargo security inspections to support their ongoing business development.

Thus, Customs should explore opportunities for engaging with them to establish AEO partnerships and to explore possible data exchange mechanisms.

Chart 7: Image of FZ system (Source: PTC presentation by CrimsonLogic/ GeTS, 28 September 2019)



VI. Establishing conditions and criteria for FZ AEOs

In order to ensure the integrity of the AEO programme, the general conditions and criteria regarding compliance and security should be met by the AEO partners.

It is recommended that Customs consider the specific features of FZs such as bigger size of areas, number of cargoes and companies therein, longer or unlimited storage duration

and lack of Customs involvement and controls in FZs, along with possible data exchange mechanisms.

The SAFE FoS provides 13 broad categories of criteria in its Annex IV⁴. This Secretariat Note identified some additional criteria for FZs to the above SAFE criteria based on criteria used for applying AEO for warehouses and the suggestions from FZ Guidance as seen in below. “AEO Implementation and Validation Guidance”⁵ can be also helpful to established criteria for validating FZ operators as AEOs.

Customs-identified security standards and best practices identified by SAFE with additional security standards for expanding the AEO to FZs stakeholders

A. Demonstrated Compliance with Customs Requirements

- Taking any appropriate actions to revoke approval if non-compliance, illegal activities or losses of goods are observed.

B. Satisfactory System for Management of Commercial Records

- Having a transparent IT system for managing commercial records, including transport documents including B/L, inventory books, financial records and other records related cargo movements, inventories and company operations inside FZs as accurately as possible.

C. Financial Viability

D. Consultation, Co-operation and Communication

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

E. Education, Training and Awareness

- Establishment of mechanisms for education and training of personnel regarding security policies in FZs, recognition of deviations from those policies and understanding what actions must be taken in response to security lapses.
- Such education include ensuring the understanding of any prohibitions including, 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.

⁴ The details of Customs-identified best security standards and best practices can be found on page.3 to 14 of Annex IV to the SAFE Framework, at <http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/safe-framework-of-standards.PDF?la=en>

⁵ A new link to the AEO Implementation and Validation Guidance will be provided after its publication (in June 2021)



- Establishment of notification 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.

F. Information Exchange, Access and Confidentiality

- Connection of FZ operating body's IT system and/or company's IT system storing the data on cargo movements, inventories and company operations inside FZs Customs IT system.
- Submission of the periodical reports, including the balance of cargoes, raw materials and a list of inventories, etc. to the Customs.

G. Cargo Security

- Adequate self-management mechanism of cargoes stored in FZs
- Periodical audits by FZ operating bodies and/or with Customs to be reported to Customs
- Acceptance of Customs ex-officio onsite check when Customs consider necessary

H. Conveyance Security

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I. Premises Security

- Following Customs basic construction standards and other standards to be implemented in FZs for Customs control. This covers Customs checkpoints, enclosed fencing surrounding the FZ, Customs inspection areas, video surveillance systems, installation of non-intrusive inspection (NII) equipment, the information network to be interfaced with Customs, etc.

J. Personnel Security

K. Trading Partner Security

L. Crisis Management and Incident Recovery

M. Measurement, Analyses and Improvement

VII. Benefits for FZ AEOs

The success of an AEO programme is based on several elements, including facilitation benefits being provided to AEOs. The benefits should be tangible, meaningful, transparent and measurable.

Annex IV to the SAFE Framework provides a non-exhaustive list of benefits in two broad categories: general benefits and operator-specific benefits⁶. Currently operator-specific benefits are listed for importers, exporters, warehouse operators, Customs brokers, port operators, carriers, and logistics operators.

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 the safety and security of trade and people.

However, further facilitation benefits within FZs could be provided to FZ stakeholders meeting the globally established AEO criteria. For this purpose, each Customs administration should cooperate with FZ stakeholders, in particular FZ Authorities, FZ operating bodies as well as FZ tenant companies, to understand their roles in FZs and the different business models that they operate.

This Note identifies some possible operator-specific benefits for FZ operating bodies and FZ tenant companies (see below). These benefits could, together with the general benefits in SAFE, provide guidance to Customs administrations in developing their own list of benefits in close consultation with relevant FZ stakeholders.

It should be also noted that these players could benefit from additional trade facilitation through Mutual Recognition Agreement (MRA) with partner countries when exporting their cargoes from FZs.

Operator-Specific Benefits for FZ operating bodies

- A. Faster approval of new free zone within a specified number of days after submission of complete documents or only by notification;
- B. Faster approval of new tenant companies within a specified number of days after submission of complete documents or only by notification;
- C. Waiver of past record verification usual for granting a FZ authorization;
- D. Waiver of solvency certificate requirement;
- E. Waiver/reduction of financial security and other related requirements for warehousing license;
- F. Extended validity of FZ authorization (corresponding to the AEO validity period);
- G. Automatic renewal of FZ authorization.

Operator-Specific Benefits for FZ tenant companies

- A. Availability of an e-payment option for collection of duties and taxes
- B. Electronic application for authorization process and electronic validation procedures

⁶ A non-exhaustive list of AEO benefits can be consulted in p.14 to p.21 of Annex IV to the SAFE via <http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/safe-framework-of-standards.PDF?la=en>



- C. Deferred payment of duties, taxes, fees, and charges or periodic payment of duties/taxes
- D. Financial guarantee waivers, reductions or rebates;
- E. Faster disbursement of drawback amount;
- F. Faster processing of refunds and adjudications;
- G. Acceptance of self-certified copies of Free Trade Agreement (FTA) / Preferential Trade Agreement (PTA) origin-related or other certificates required for clearance;
- H. Paperless declarations with no supporting documents;
- I. Export permit can be obtained without carrying the cargo into Customs area;
- J. Direct Port Entry for factory stuffed containers meant for export;
- K. Notification of intention to release prior to goods' arrival i.e. pre-arrival clearance;
- L. Pre-qualification for simplified procedures, including possibilities for a single-step process (simultaneous release and clearance) or a two-step process (release followed by clearance) for release/clearance purposes, according to the importer's preference;
- M. Involvement in the development of new policies and programmes related to FZs.

VIII. AEO Validation for FZs

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, FZ operating bodies as well as FZ tenant companies.

It should be underlined that validating only a FZ operating body is not sufficient to prove the compliance level of a FZ as a whole. As clearly pointed out by FATF report, illegal operations conducted in tenant company's premises have been repeatedly reported and Customs need to conduct due diligence and compliance record checks of tenant companies based on Customs intelligence network.

Furthermore, Customs can utilize the Customs to Customs intelligence exchange network through Mutual Recognition Agreement (MRA) with partner countries when conducting validation of tenant companies who are operating globally.

IX. Conclusion

Customs should explore opportunities for engaging FZ stakeholders such as FZ operating bodies and FZ tenant companies to establish AEO partnerships and to explore possible data exchange mechanisms as stipulated in the WCO Practical Guidance on FZs.

In order to ensure the safety and security of whole supply chain, it is duly essential to consider expanding the concept of AEO partnership to the entire FZ supply chain.

Validating only a FZ operating body is not sufficient to prove the compliance level of a FZ as a whole.

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, FZ operating bodies as well as FZ tenant companies.

It should be noted that the AEO status requires continuous and effective cooperation among FZ supply chain parties – specifically, this involves taking into account their role in international supply chains and their specific business models.

Customs administrations should be receptive to the concerns of AEOs and determine, in consultation with them, a formalized method of communication, which ensures that issues are properly received, addressed and resolved for the benefit of both parties. Identifying benefits, utilizing technology and assigning dedicated account managers who are specialized in FZ industry and can help FZ stakeholders coordinate and resolve Customs related issues could be valuable in establishing mutual trust, based on an understanding of business model and of mutual responsibilities.

Annex I : List of WCO Instruments and Tools related to AEO on Free Zones

Annex II : Member's experiences on expanding the scope of AEO to Free Zone stakeholders

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Annex I : List of WCO Instruments and Tools related to AEO on Free Zones

The WCO Practical Guidance on Free Zones

http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/activities-and-programmes/free-zone/wco-fz-guidance_en.pdf?la=en

The WCO SAFE Framework of Standards to Secure and Facilitate Global Trade (SAFE)

http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/frameworks-of-standards/safe_package.aspx

AEO Implementation and Validation Guidance

<http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/aeo-implementation-guidance.pdf?la=en>

WCO Online AEO Compendium

<https://aeo.wcoomd.org/>



Annex II : Member’s experiences on expanding the scope of AEO to Free Zone stakeholders

The following figures and statistics are based on input from Members in June-August 2021, responding to the questionnaire circulated from the Secretariat, to which 28 Members replied.

Table 1: Responded Members to the questionnaire: sorted by WCO regions to which the Member belongs

Region	Responded Members						Total
	AMS	MENA	WCA	ESA	Europe	A/P	
	8	1	0	3	7	9	28

Full list of Members that responded:

AMS: Brazil, Costa Rica, Dominican Republic, Guatemala, Jamaica, Paraguay United States, and Uruguay

MENA : Qatar

WCA : -

ESA : Angola, Malawi, and South Africa

Europe : EU, Israel, Lithuania, Moldova, North Macedonia, Serbia, and Switzerland

A/P: China, Iran, Korea, Malaysia, New Zealand, Pakistan, Thailand, Sri Lanka, and Vietnam

Out of the total 28 responses, more than half, 17 Members, replied that one or more types of free zone stakeholders are included in the scope of their current national AEO programmes. In contrast, 11 Members replied that no such stakeholders are included at the moment.

Figure 2-1 : Number of Members whose AEO programme has already covered one or more types of free zone stakeholders

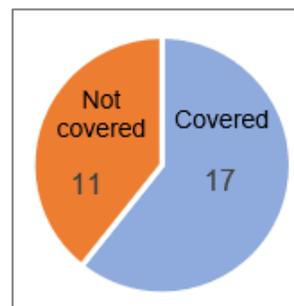
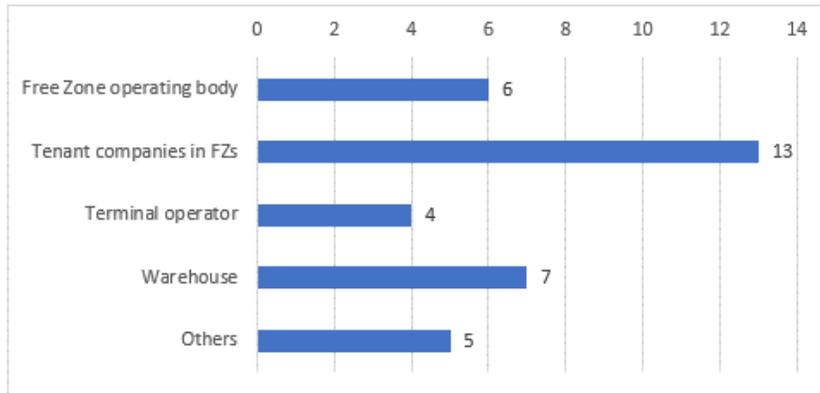




Figure 2-2 shows the type of free zone stakeholders covered by the scope of the respective AEO programmes. Tenant companies in FZs seem to be the most popular stakeholder, and other type of stakeholders, such as Warehouses and FZ Operating bodies are also covered considerably.

Figure 2-2 : Free zone stakeholders covered by current national AEO programmes (Breakdown of responses of 17 Members identified as “Covered” in Figure 2-1 above)



- Free Zone operating body : Dominican Republic, the European Union (EU), Guatemala, South Africa, and Uruguay
- Tenant companies in FZs : China, Costa Rica, EU, Guatemala, Iran, Korea, Malaysia, Moldova, Serbia, South Africa, Paraguay, Thailand, and Uruguay
- Terminal operator : China, Dominican Republic, EU, and Guatemala
- Warehouse : Brazil, China, Dominican Republic, EU, Guatemala, Malaysia, and Thailand
- Others : Brazil (importer/exporters and Customs warehouses), EU (consolidator, container operator, stevedore, shipping line service), Guatemala (any actors in the supply chain), North Macedonia (Customs broker), and United States (see below)

Current experiences by Members:

EU : Experiences show that expanding the AEO concept to FZ stakeholders is one of the key elements allowing to ensure the effective and efficient management of FZs, aiming to:

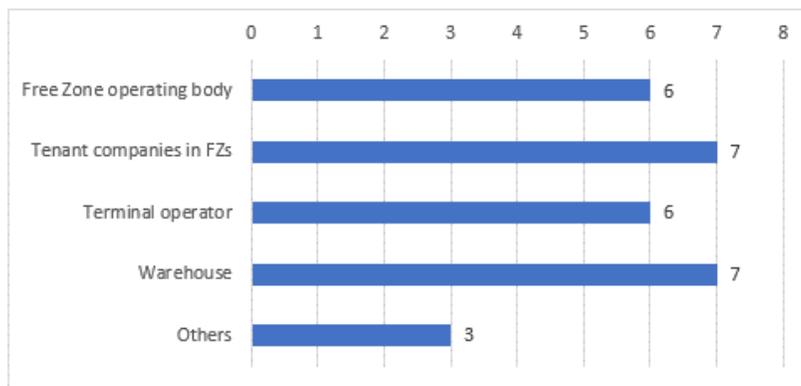
- Strengthen the partnership between Customs and FZ stakeholders
- Establish the effectiveness of the customs controls in FZ by:
 - Confirming that the records keeping complies with the required standards
 - Ensuring that the records can be audited and that the Customs transactions can be traced
 - Evaluating if the operator’s internal control system ensures compliance by confirming that accounts, transactions and all data comply with legislation and other requirements
 - Evaluating safety and security aspects
 - Assessing the operator’ s solvency

Thailand : Many of Tenant companies and Warehouses in FZs have applied for AEO status under the Importer/Exporter and Customs Broker categories.

United States : Beyond CTPAT Importer operated zones, FTZ components are generally only able to influence international security for cargo already having physically arrived into the United States. Conversely, where a CTPAT certified Importer operates a FTZ facility and is receiving cargo by Sea or Air, the full range of CTPAT program benefits is available to that partner. Within the land border environment, CBP has granted limited access (case-by-case) to expedited FAST lane processing for CTPAT Importer operated FTZ's, primarily for the purposes of exigent circumstances in response to pandemic conditions during 2020.

Figure 3 provides future possible AEO expansion to FZ stakeholders. All types of stakeholders seem to be of interest by Members for future possible AEO expansion.

Figure 3 : Future possible AEO expansion to free zone stakeholders



Future Consideration by Members:

Dominican Republic :. The AEO status would be expanded to new free zone parks of the textile industry and other areas that are well established in the country.

Paraguay : Currently, the work is being done on expanding the list of benefits for companies that use suspensive regimes such as users of free zones and maquiladora companies installed within them. For this, a draft modification of the Customs Code has been submitted.

South Africa : SARS AEO programme already includes the free trade zone and warehouse will be included as soon as the amended legislation becomes effective.