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Developing your Section 301 trade mitigation strategy

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The United States and China have shifted gears from threats to action in an increasingly hostile global trade environment. On September 24, the trade war reached a new height, with the U.S. implementing additional tariffs on $200 billion in Chinese-origin goods.

These times call for quick movement by company leaders to seek out tariff mitigation planning that could significantly alleviate lost revenue from the increased duty rates. KPMG can help.

Please note that because this situation is fluid and evolves on a near daily basis, frequent updates are necessary to help ensure your company is equipped with the most current information.

Background: Section 301 tariffs

Under Section 301 of the Trade Act of 1974, which authorizes tariffs and other trade actions in response to a country's discriminatory trade practices, the Office of the United States Trade Representative ("USTR") has implemented tariffs of 25 percent against 818 products imported from China, impacting over $34 billion in imports, effective July 6, 2018. Referred to as "List 1," these tariffs focus on industrial machinery, vehicles, electronic equipment, medical devices, and various other product categories. A second round of tariffs on 279 products (List 2) was implemented on August 23, impacting $16 billion in imports.

Most recently—and perhaps most significantly—a third list of 5,745 products (List 3) with tariffs of 10 percent was implemented on September 24, 2018, which will rise to 25 percent on January 1, 2019, impacting a massive $200 billion in imports from China affecting nearly every industry, including consumer goods, textiles, chemicals, electronics, industrial machinery, and construction supplies and materials. A key purpose of the initial 10 percent followed by the increase to 25 percent is to allow U.S. companies a chance to make adjustments to their supply chains, or take other action, to mitigate the significant impact of the new tariffs. There are many opportunities to assess and implement short, medium and long term strategies in this interim time period. KPMG recommends reviewing the options and taking advantage of the lower tariff rate.

China has responded to the United States with proportional retaliatory tariffs, stating that each series of U.S. tariffs will be met with a commensurate response.

In September, the U.S. raised the possibility of a fourth round of tariffs impacting $267 billion in goods, which would entail a U.S. tariff on virtually all imported goods from China. The pace of newly announced U.S. tariffs and retaliatory responses from China has been rapid since the U.S. tariffs were first announced by President Trump in March 2018, followed by a series of public notices from the USTR and implementation of List 1 on July 6. Companies across all industries with any trade between the United States and China should consider tariff mitigation strategies to help manage the quickly shifting trade landscape.

Products affected include, but are not limited to:

Implemented §301 tariffs:

- List 1: Machinery and parts for: elevators, bulldozers, forklifts, off-shore drilling platforms, agricultural equipment, food manufacturing equipment, computer equipment, X-ray machines, MRIs and ultrasounds, electro-diagnostic patient monitoring machines, pacemakers, printers, bearings, textile processing equipment, metalworking equipment, rubber processing equipment, arms.
- List 2: Plastics and plastic products, agricultural machinery and apparatus, electronic equipment, semiconductors, diodes, optical fibers, telecom products, railway machinery and locomotives, motors and power generation equipment
- List 3: Consumer products (bags and luggage, sporting goods, bicycles and furniture), Food products (meat, seafood, nuts, fruits, vegetables, grains and prepared foods), tobacco products, personal care consumer goods, chemicals, petroleum, wood products and building materials, paper and paper products, textiles, metals (precious metals, steel, aluminum, copper, iron, nickel), printing machines, industrial machinery, HVAC, and consumer electronic equipment.

Proposed §301 tariffs:

- Potential $267 billion in goods across a variety of industries.

Background: Chinese retaliation

China has filed complaints with the World Trade Organization, challenging the U.S. tariffs as contrary to international law. China has also implemented tariffs against billions of dollars in imports from the U.S., impacting foods, metals, chemicals, vehicles and other products – with the possibility of billions of dollars in additional tariffs. In general, China is undertaking a policy of responding to proposed U.S. tariffs with potential retaliatory tariffs of comparable measure, with the potential to impact billions of dollars in U.S. exports.

Exclusion process

The USTR has announced a process for affected parties to potentially be excluded from the Section 301 tariffs under List 1 and List 2. Through an online process (regulations.gov), companies, interested parties and trade associations are able to submit product exclusion requests. This process is different from the exclusion requests for the Section 232 steel and aluminum tariffs, as a Section 301 exclusion will be applicable to all importers, rather than limited to the applicant. The deadline for submitting exclusion requests for List 2 is December 18. No exclusion process has been announced yet for List 3.

Factors USTR will consider in exclusion requests include:

- Whether the additional duties on the product would cause severe economic harm to the requester or other U.S. interests.
- Whether the product or a comparable product is available only in China, or whether it is available in the U.S. or a third country.
- Whether the product is strategically important or related to "Chinese industrial programs such as "Made in China 2025."

The application form also requires the following information:

- Description of the product's physical characteristics which distinguish it from other products within the covered 8-digit subheading.
- The 10-digit subheading of the HTSUS of the product.
- Annual import value and quantity of the Chinese-origin product for each of the past three years.
- Information about total gross sales.
- Requestors may also submit information on the ability of U.S. Customs and Border Protection to administer the exclusion.

Public responses to exclusion requests posted online are due within 14 days of being posted, indicating support or opposition. Public replies to responses must be posted within 7 days after the 14-day response period. Companies are able to submit applications with confidential information, although a public version must also be submitted. Approved exclusions would apply retroactively to July 6 (for List 1) and August 23 (for List 2), and will be effective for one year.

How KPMG can help you get ahead

KPMG deploys a tested cross-functional framework and methodology to guide our clients, short-term and long-term, through assessing, managing and mitigating the impact of the new tariffs on their Financial Value Chain. Leveraging this framework and supporting tools enables KPMG to assist its clients in defining its specific mitigation plan in a thoughtful, methodical, and holistic manner.

1) **Impact Analysis and Collecting Trade Data:** How big is the problem? Where is the pain coming from? What's coming next?

2) **Enterprise-level thinking:** KPMG is actively assisting companies with developing broad methodologies, including:

   — Consideration of manufacturing alterations to impact classification or country of origin.

   — Arranging manufacturing, distribution, and supplier sourcing to offset tariff impacts, balanced against competing costs such as pricing and tax implications.

   — Planning for secondary effects of any changes.

     – What is the amount of elasticity in your ability to price?

     – Will transfers of costs between your company, suppliers and customers reduce your market share?

3) **Identify Core Trade Methodologies:** KPMG can help identify core trade methodologies—duty planning and savings opportunities—to help mitigate the effects of the tariffs (e.g., Tariff Classification, Duty Drawback, First Sale for Export, and Foreign Trade Zones). KPMG is also working with clients to develop product exclusion requests.

4) **Plan Execution:** Once methodologies are identified, confidently execute them in a phased approach.

The Trade & Customs group at KPMG is standing by to assist your company in formulating a plan so that if the tariffs are implemented, an action plan is in place. We are happy to facilitate a meeting between your team and ours to discuss how to develop and execute on a mitigation plan.

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