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## Trade and Tax Considerations in a Transforming Supply Chain Environment

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As the world emerges from an unprecedented pandemic and widespread disruptions in supply chains, C suite priorities are centered around creating new, resilient, and lasting supply chains. In the meantime, trade policy has emerged as a determining factor for sourcing and production location decision making. In

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This article may be cited as George Zaharatos, Doug Poms, Kimberly Tan Majure, Elizabeth Shingler, Sarah Nelms, and Brianna Sullivan, *Reprioritizing Domestic Production: How Is Your Company Preparing?*, 63 Tax Mgmt. Memo. No. 14, 171 (July 4, 2022).

the United States, the president has issued two Executive Orders (EOs) specifically leveraging U.S. government purchasing power and adjusting procurement regulations to incentivize and prioritize domestic production of critical products and technologies such as pharmaceutical ingredients, semiconductors, certain minerals, and advanced batteries. EO 14005<sup>1</sup> (Made in America EO) mandated a reassessment of the Made in America provisions and waivers offered to suppliers of products and services to the U.S. government, and EO 14017<sup>2</sup> (Supply Chain Review EO) ordered a 100-day review of certain critical supply chains.

What does this mean? Will companies stop importing? Will the U.S. goal of significantly increasing domestic production finally materialize? Signals show that several industries are leaning into the government regulations and investments, placing tariffs at the forefront of where executives are making their supply chain bets.

Furthermore, trade policy won't be the only driver of these decisions. The U.S. and foreign income tax implications of companies' manufacturing operations — as they currently stand and as they evolve over the next few years — will also play a large part in determining the “all in” cost of manufacturing in one location versus another.

In this article, we begin with a discussion of the relevant trade policy developments, then continue with the income tax considerations, both of which may help multinational corporations decide how to structure their supply chains.

### SCOPE OF THE MADE IN AMERICA AND SUPPLY CHAIN REVIEW EXECUTIVE ORDERS

While the EOs address differing issues, the goals are clearly aligned: to improve and prioritize development of U.S. manufacturing capabilities. For companies involved in government procurement, compliance with Buy America and Buy American requirements will be more closely scrutinized by the newly created Made in America Office. However, the solu-

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<sup>1</sup> Executive Order 14005 of January 25, 2021, Ensuring the Future Is Made in All of America by All of America's Workers, 86 Fed. Reg. 7475 (Jan. 28, 2021).

<sup>2</sup> Executive Order 14017 of February 24, 2021 America's Supply Chains, 86 Fed. Reg. 11,849 (Mar. 1, 2021).

tions proposed under the 100-day supply chain review may make domestic sourcing options more available.

## Made in America Executive Order

President Biden’s Made in America EO announced that the government would prioritize and maximize “the use of goods, products, and materials produced in, and services offered in, the United States”<sup>3</sup> when making procurement decisions and awarding federal financial assistance. The Made in America EO specifically prioritizes the Buy America and Buy American procurement programs that either require or provide a preference for goods, products, or materials produced in the United States. Further, the EO mandated the creation of a Made in America Office that would be responsible for implementing federal procurement policy, including approving any waivers granting exceptions to program requirements. In certain cases, the granting agency would be required to assess whether a significant portion of the cost advantage related to a foreign product arises from the use of dumped or subsidized imports. To implement the Made in America EO, the Administration issued a final rule in March 2022 which, among other steps, increases domestic content requirements under the Buy American Act (BAA).<sup>4</sup> Specifically, effective in October 2022, the BAA’s domestic content requirement will increase from 55% to 60%, with subsequent increases to 65% in calendar year 2024, and to 75% in calendar year 2029.

In short, the Made in America EO will drive a fundamental change to long-standing sourcing practices, pushing companies to continually increase their domestic content to keep up with increasing government requirements.

## Infrastructure Investment and Jobs Act

The Infrastructure Investment and Jobs Act (IIJA)<sup>5</sup> authorizes federal funds for highways, highway safety programs, transit programs, and other purposes. In line with the Administration’s intentions to rebuild infrastructure and maximize the use of goods, products, and materials produced in the United States, the IIJA includes several revisions to existing Buy America and Buy American procurement programs. Most notably, with regard to Buy America provisions, the IIJA requires the head of each federal agency to ensure, within 180 days following enactment, that funds are made available for a project benefitting from federal financial assistance only if all of the iron, steel, manufactured products, and construction materials used in the project are produced in the United States.

<sup>3</sup> 86 Fed. Reg. 7475.

<sup>4</sup> Federal Acquisition Regulation: Amendments to the FAR Buy American Act Requirements, 87 Fed. Reg. 12,780 (Mar. 7, 2022) (to be codified at 48 C.F.R. §13, §25, and §52).

<sup>5</sup> Pub. L. No. 117-58.

For purposes of the IIJA, the term “produced in the United States” is defined as outlined below; any existing Buy America procurement program that does not currently meet the standards outlined in the IIJA will be required to do so.

Product Type	“Produced in the United States” Definition
Iron or steel products	All manufacturing processes, from the initial melting stage through the application of coatings, must occur in the United States.
Manufactured products	The manufactured product was: <ul style="list-style-type: none"> <li>● manufactured in the United States; and</li> <li>● the cost of the components of the manufactured product that are mined, produced, or manufactured in the United States is greater than 55% of the total cost of all components of the manufactured product.</li> </ul>
Construction materials	All manufacturing processes for the construction material occurred in the United States.

Regarding the BAA, the IIJA implements a new limitation on the long-standing commercially available off-the-shelf (COTS) exception. Specifically, the IIJA ends exemptions from BAA requirements — previously based on the COTS exception — for iron and steel articles, materials, and supplies. The IIJA also directs the Federal Acquisition Regulatory Council to revise the Federal Acquisition Regulations to increase the domestic content requirement under the BAA to 75%, consistent with the rule changes discussed above.

These changes represent the codification of actions promised to close loopholes within the various long-standing “Made in America” regulations to which companies have been accustomed.

## Supply Chain Executive Order

The Supply Chain EO ordered six federal agencies to conduct a 100-day review of certain critical supply chains to address vulnerabilities highlighted by the Covid-19 pandemic. Citing pandemics, biological threats, cyber-attacks, climate shocks, terrorist attacks, geopolitical and economic competition, and other conditions which may reduce critical manufacturing capacity, the Supply Chain EO focuses on the risks of four critical products:

Critical Products	
Semiconductor manufacturing and advance packaging	Critical minerals
High-Capacity Batteries	Pharmaceuticals and active pharmaceutical ingredients

The U.S. Departments of Commerce, Energy, Defense, and Health and Human Services completed reports in June 2021 and assessed the resiliency, security, and diversity of the supply chains that play pivotal roles in the U.S.’s economic and national security. The reports included assessments and strategies to strengthen supply chains, addressing a host of issues related to supply chain security such as manufacturing capabilities, supply chain capacity, primary risk drivers, and the role of U.S. allies.

Following submission of these reports, the Assistant to the President for National Security Affairs (APNSA) and the Assistant to the President for Economic Policy (APEP) consolidated and submitted the reports to the president, making any additional recommendations to address the identified risks. The Administration’s consolidated 100-day report also noted the establishment of the Supply Chain Disruption Task Force (SCDTF) which was a rapid response effort led by the Secretaries of Commerce, Transportation, and Agriculture to address the short-term, immediate impacts of the pandemic.

At the one-year mark since first issuing the Supply Chain EO, the Administration released its capstone report summarizing the key findings of the six agency reports, providing a status update on the implementation of recommended short-term changes, and proposing a set of solutions designed to bolster the economic resiliency and longevity of the United States.

Six-Point Recommendation Plan	
1.	Rebuilding domestic production and innovation capabilities.
2.	Supporting market development that invests in workers, values sustainability, and drives quality.
3.	Leveraging the government’s role as a purchaser/investor in critical goods.
4.	Strengthening international trade rules/trade enforcement mechanisms.
5.	Working with allies to decrease vulnerabilities in the global supply chain.
6.	Monitoring near term supply chain disruptions as the economy reopens from the Covid-19 pandemic.

While many of the strategic action points underpinning the broader recommendations have yet to be implemented, they indicate that the government will be more heavily involved in fostering innovation both through funding and opportunity creation. For example, the capstone report recommends dedicated funding for semiconductor manufacturing and research and development (R&D) of at least \$50 billion in investments. Similarly, the report recommends leveraging the Defense Production Act (DPA) to expand production in critical industries and leverage federal procurement to strengthen U.S. supply chains.

Other proposed investments by industry included the following:

Critical Industries	Proposed Funding Mechanisms
Semiconductor manufacturing and advance packaging	<ul style="list-style-type: none"> <li>● \$50 billion in funding for the Creating Helpful Incentives to Produce Semiconductors (CHIPS) for America Act to include production incentives.</li> <li>● Federal incentives to build or expand semiconductor facilities.</li> <li>● Congressional funding for R&amp;D potentially through the National Institute of Standards and Technology (NIST) or the Defense Advanced Research Projects Agency (DARPA).</li> <li>● Department of Commerce financial support for upstream (e.g., equipment, materials, and gases) and downstream industries.</li> <li>● U.S. Export-Import Bank (EXIM) provide loans or loan guarantees for facilities.</li> <li>● Small Business Administration (SBA) loans/programs for small domestic suppliers</li> <li>● Department of Defense to invest in critical testing facilities.</li> </ul>
High-capacity batteries	<ul style="list-style-type: none"> <li>● Appropriate funds to GSA to convert the federal fleet of vehicles to electric vehicles (EV) and zero emission vehicles (ZEV).</li> <li>● Federal grant funding to the Environmental Protection Agency (EPA) or Department of Energy (DOE) to change the nation’s school buses to EV and ZEV.</li> <li>● Funding for the Federal Transit Administration’s Low and No Emissions grant program to procure zero emission transit vehicles and supporting infrastructure.</li> <li>● Implement Congressional “point of sale” rebates for EV purchasers with increased rebates for vehicles with higher domestic content and conform to higher labor standards. Offer tax credit for medium and heavy duty EVs.</li> <li>● Build out of EV charging infrastructure.</li> <li>● DOE investment in extraction and refinement and R&amp;D.</li> <li>● Invest in domestic refinement of materials.</li> </ul>
Critical minerals and materials	<ul style="list-style-type: none"> <li>● Use the DPA to incentivize production and R&amp;D across the supply chain, including new magnet capabilities and advanced electric motor designs.</li> <li>● EXIM loans or guarantees to support the export of U.S. mining equipment and engineering services.</li> </ul>



Pharmaceuticals and active pharmaceutical ingredients

- Investments in rare earth element processing capacity in the United States.
- Strengthen critical mineral stockpiling.
- Implementing advanced sustainability standards for minerals used in electronics.
- Invest in specialized equipment and updates to manufacturing processes.
- Offer procurement guarantees.
- Provide funding through the DPA.
- Support for virtual drug stockpiles with surge manufacturing capacity.

Although the number of critical supply chains is limited, the modifications to “Made in America” requirements to support domestic industry mean that industries outside of those targeted in the Supply Chain EO review may be impacted. One of the most impactful changes on the horizon for companies that contract with the federal government are the upcoming domestic content requirement changes as announced in the Buy American Final Rule.

As these changes are implemented, federal contractors will face increased pressure to source from domestic suppliers. The government also clearly is still trying to understand the full impact the modifications to the “Made in America” requirements may have on critical industries and where domestic production may need to be ramped up. The Departments of Transportation and Energy recently collected public comments on the availability of EV chargers manufactured in the United States, and whether they comply with applicable Buy American requirements. Ramping up domestic component and hardware production is a necessary precursor to support the development of a domestic EV infrastructure and multitude of other industries.

## TODAY’S BUSINESS ENVIRONMENT: WHAT COMPANIES ARE FACING

The business environment in which these reviews were conducted provides clarity on the proposed government intervention. In the last several years, the challenges facing multinational companies have increased exponentially in both number and complexity. As a result, companies have fought to preserve market share and maintain profitability while grappling with increased raw material and shipping costs. The most successful companies have been those that adapted quickly to the supply chain uncertainty created by the Covid-19 pandemic, often adopting a more vertical supply chain and moving away from the long-preferred “just-in-time” approach to inventory management, to a “just-in-case” strategy. The pandemic also highlighted a need for companies to increase supply chain visibility and decrease reliance on vendors to manage upstream production. This was a hard lesson learned during the pandemic when certain

large manufacturers initially scaled down and then, when consumer demand surged (such as with cars), were unable to quickly ramp up production — thus leading to domestic shortages and high prices. In the future, the ability to quickly model the all in production costs, including landed costs as tariffs fluctuate, will be paramount in responding to pricing pressures. Companies that continue to be successful will understand the influence that the Administration’s policy on trade and tariffs will have on shifting supply chains and act accordingly to improve supply chain agility.

For U.S. importers, the combination of supply chain disruptions and the significantly increased costs arising from the substantially higher tariffs on products from China created a perfect storm. The United States Trade Representative (USTR) implemented steep tariffs in 2018 following an investigation that found China was engaging in unfair trade practices, including intellectual property theft. Punitive tariffs ranging from 7.5% up to 25% were imposed on most imports from China and are in addition to the normal tariff rates. For some industries — including many companies in the semiconductor, communications, electronics, and building equipment — the tariffs didn’t just add 25% more to the cost of goods sold, it also highlighted the need for tariff management strategies given that these industries have enjoyed historically low to no tariffs. In a matter of months following the imposition of the China tariffs, the importing environment changed dramatically — making trade strategy a boardroom issue.

Companies had barely adjusted to this new high-tariff environment when the pandemic began, and many were ill-equipped to face another round of unprecedented challenges. Moving goods had never been so difficult as suppliers struggled to keep up with surging demand in the face of understaffed and shuttered factories. Logistics providers were at maximum capacity and could not move goods with the normal efficiency international supply chains required. This meant that the “just-in-time” supply chain model that many retailers employed broke down and could not meet customer needs. The large scale supply chain breakdown brought on by the Covid-19 pandemic highlighted the need for supply chain visibility and diversification — particularly for critical goods.

Even industries that already had high tariffs and had the staff and strategies in place to mitigate the China tariffs faced a new set of challenges as U.S. Customs and Border Protection (CBP) turned its focus to forced labor concerns. The recent heightened enforcement targeting forced labor in supply chains, particularly for the apparel and footwear industries, added a new wrinkle in compliance management. Social compliance, specifically human rights, has emerged as a significant policy issue with trade ramifications for both importers and exporters. This issue has recently come to the forefront for multinational companies as CBP issued and enforced a wide range of Withhold Release Orders (WROs) which effectively prevent the import of goods into the United States if forced labor is suspected in their production. CBP has specifically targeted imports from specific countries, including

China and Malaysia, in response to allegations of forced labor being used those countries. The majority of these WROs have been imposed with respect to Chinese imports. In December 2021, there were 54 active WROs in place with no sign of slowing. Further, CBP made clear the expectation to have full visibility into companies' supply chains — a difficult ask for global companies that rely on a web of suppliers and manufacturers. On the export side, the Bureau of Industry and Security (BIS) added more companies to the Entity List which requires exporters to obtain licenses before certain products are shipped to certain end users. With the Russia-Ukraine crisis, it is likely that more export sanctions, restrictions, and enforcement are on the horizon, adding an additional compliance element that multinational companies must manage.

## PREPARING FOR WHAT COMES NEXT

Read simply as policy recommendations, the roadmap for achieving enhanced domestic manufacturing appears clear and defines achievable outcomes that will not only bolster U.S. capabilities but help prevent future supply chain meltdowns. However, the real world success of these recommendations will be closely tied to the ability to adapt them to specific challenges as the economy evolves through the pandemic. While the path forward may not be clear until the implementation of recommendations from the various reports and finalization of proposed rules, some of the challenges are clear.

The hurdles to maintaining supply chains for critical products are broadly similar, diverging only in the details of potential solutions. For example, approximately 80% of the world's active pharmaceutical ingredients are reportedly sourced from a small group of countries, notably including China and India. Although in most cases active pharmaceutical ingredients have a longer shelf life than finished drugs, the cost of moving supply chains while simultaneously moving away from step-by-step manufacturing to a continuous manufacturing model will require the right funding at the right times or we may end up with unequally distributed domestic supply chains that don't close the gap.

While the private sector may drive much of the pharmaceutical change through government funding, addressing gaps in the semi-conductor industry may require a closer public-private partnership. Industry groups are advocating for government interventions to support the development of the semi-conductor supply chain by aligning policies with strategic market interventions. This includes government incentive programs around precompetitive research, building manufacturing capacity, and developing alternatives where critical areas could be threatened either as a result of export control considerations or disruptions by third-country producers.

In sum, what these industries need will vary. Meeting those needs will require individualized solutions.

How will the industries access the funding? How is progress defined, and which benchmarks will need to be achieved? If the recommendations are not supported by funding that is easily accessible and tied to requirements that make sense to the private sector, realizing gains will be challenging to measure. Yet, even while it's still unclear how funding will be made available and how government policies will drive change, there are a few steps businesses can take now.

## Identify How Business May Change

With increased pressure to produce domestically, industry may ultimately reassess their supply chains. One of the more obvious ways is for importers to adapt their import profile to include more raw materials versus finished goods. Over the last few years, companies have faced a high-tariff environment that added substantial costs. Tariffs as a policy tool are likely here to stay, particularly as policymakers begin to focus on improving domestic supply chains. Further, the six high-level trade recommendations resulting from the report each raise trade considerations that will have lasting effects.

Recommendation	Trade Implication
Rebuilding production and innovation capabilities.	<ul style="list-style-type: none"> <li>● Potential increase in component imports creating complexity around Harmonized Tariff Schedule classification and tariff rate management.</li> <li>● Increased opportunity from tax and duty savings incentives, especially where the U.S. is export-base.</li> </ul>
Supporting market development that invests in workers, values sustainability, and drives quality.	<ul style="list-style-type: none"> <li>● Increased pressure to source responsibly combined with increased import detentions to prevent forced labor.</li> <li>● New requirements for trade teams to oversee, similar to the United States-Mexico-Canada Agreement (USMCA) Labor Value Content (LVC) requirement. This rule requires, for the first time, that trade teams monitor labor wages involved in production.</li> </ul>
Leveraging the government's role as a purchaser of and investor in critical goods.	<ul style="list-style-type: none"> <li>● Modeling impact to business as Buy America and Buy American Act (BAA) requirements increase.</li> <li>● Stringent waiver requirements combined with increased compliance auditing.</li> </ul>
Strengthening international trade rules, including trade enforcement mechanisms.	<ul style="list-style-type: none"> <li>● Potential additional tariffs or quotas that will add costs into the existing supply chains.</li> <li>● Increased CBP audits and investigations.</li> </ul>

Working with allies and partners to decrease vulnerabilities in the global supply chain.

- Monitoring Free Trade Agreement (FTA) opportunities and trade promotion measures such as regional bloc trading strategies for discrete components and subcomponents (e.g., development and manufacture of a pump in ASEAN, production of motor in EU and assembly in the United States, Mexico, Canada (USMCA) bloc).

- Being able to access global trade data quickly and easily.

Monitoring near-term supply chain disruptions as the economy reopens from the Covid-19 pandemic.

- Developing and implementing a supply chain risk management strategy for the business's value drivers (e.g., developing a multi-sourcing strategy for the highest value or critically important parts).

## Managing Trade Costs

As companies pivot to on-or-near-shoring production, inevitably trade profiles will shift, ultimately impacting duty spend and associated savings opportunities. As companies begin to consider what domestic production may look like for them, assessing both tax and trade implications will be crucial. From a trade strategy perspective, there are various avenues that can mitigate increased tariff burdens that may occur when parts are imported instead of finished goods.

### Foreign Trade Zones (FTZs)

For onshoring companies that are relocating capital goods from overseas to the United States, establishing an FTZ may be a significant tariff reduction avenue. An FTZ allows importers to bring goods into the United States and enter them in an FTZ, but defer duty until they are withdrawn from the FTZ. Duty deferral can significantly enhance cash flow while also reducing certain fees and expenses. For companies relocating capital goods, setting up an FTZ can help defer the significant duty implications arising from moving expensive manufacturing equipment.

Further, FTZs offer an “inverted tariff” benefit. For traders importing critical components, there may be an opportunity to elect a more favorable duty rate if the tariff rate on the finished goods is lower than that of the parts they are importing. Finally, for global companies that envision distributing parts or subassemblies from the United States, an FTZ offers several benefits. First, goods may be exported from an FTZ without tariffs being assessed at all. Additionally, U.S. FTZs allow companies to leverage their U.S. logistics infrastructure as well potentially retaining FTA benefits for importers in other countries (i.e., FTZ may protect against transshipment rules). As such, the ongoing benefits of an FTZ can substantially reduce the costs associated with relocating production to the United States.

Duty drawback is a tariff recovery program that is becoming increasingly important to importers. Duty drawback is a refund of duties, fees, and/or taxes paid on goods that are imported into the United States and

subsequently exported or destroyed. It allows the drawback claimant to recover up to 99% of the duties paid on goods if certain requirements are met. While there are several types of drawback, each with their own requirements, manufacturing direct identification and substitution may offer significant benefits for companies onshoring manufacturing. Similar to finished goods production in an FTZ, manufacturing direct identification and substitution would support domestic production of components and export to foreign markets. Substitution drawback in particular can be advantageous when imported or domestically produced products are substitutable at the same eight-digit Harmonized Tariff Schedule classification as manufactured articles that are then exported or destroyed. While duty drawback is heavily data driven, its savings are substantial.

### Free Trade Agreement Qualification

FTAs offer potential savings on both inbound and outbound products. FTAs can reduce or eliminate tariffs on qualifying products. On the inbound side, onshoring additional production to the United States will likely have a positive impact on FTA claims within the USMCA trading bloc. This will likely bring additional work for trade compliance teams who will need to plan accordingly. That said, with the implementation of correct processes and reviews, the work involved in qualifying goods can maximize duty benefits.

On the outbound side, traders electing to use the United States as a production hub for markets beyond the USMCA region should carefully consider manufacturing and sourcing decisions so their foreign buyers can benefit from potential FTAs. For example, this may require developing parallel manufacturing and production processes based on the destination market. Doing so necessitates additional skill building for the U.S. export trade compliance and logistics team. For example, this team will have to be trained and well versed in the local FTA requirements (e.g., record-keeping, certificates of origin, and responding to local customs requests for information). However, with the emergence of the Regional Comprehensive Economic Partnership (RCEP) and other FTAs, buyers may make qualification a requirement for future purchases.

There are a host of tariff mitigation and reduction opportunities that can help companies offset potential expenses arising from reshoring production. Understanding which one most benefits a company depends on the current and future trade profile, as well as both short- and long-term goals. However, companies not aggressively implementing savings programs are leaving money on the table and putting themselves at an economic disadvantage.

## Strategic Advantages and Challenges of Domestic Production

### Trade Implications

If domestic production ramps up in response to efforts to protect U.S. critical industries and meet the re-



quirements of Made in America regulations, traders will be faced with a new set of advantages and challenges that must be managed. For example, as domestic production increases more traders may potentially qualify for existing programs. In particular, Buy America, the Buy American Act and Trade Agreements Acts may become more broadly applicable for certain groups. While the savings and competitive advantages these programs offer is significant, they require highly nuanced, fact-specific analyses. Trade compliance teams may need to acquire this expertise and work closely with their internal partners (e.g., sourcing, engineering, finance, sales, etc.) to help their companies remain competitive for the most lucrative work.

### **Income Tax Implications**

As noted above, companies should also consider the potential income tax-related costs and benefits to “inbounding” manufacturing operations from a foreign jurisdiction to the United States. Although the trade benefits alone could be significant, companies should understand the net effect of such a move, once income tax implications are taken into account. The specific tax consequences of an inbound transaction will depend on the exact nature of the transaction, including the legal entities involved, and the tax profile of the assets, i.e., whether they are assets that have appreciated significantly and thus harbor unrealized gain at the time of the transaction. When considered in tandem with trade considerations, the tax implications are expected to be highly technical, complex, and multifaceted. With that in mind, companies could approach this part of the inbound analysis by considering the material income tax implications from three perspectives: (1) the U.S. tax cost of inbounding; (2) the foreign tax cost of moving operations from a foreign jurisdiction to the United States; and (3) the comparative ongoing tax cost of operating in the United States versus the current tax cost of operating abroad. We will next dig deeper into each of these aspects.

#### ***U.S. Tax Cost of Inbounding Manufacturing***

If a U.S. company owns manufacturing assets outside the United States, e.g., as a principal in a maquiladora structure in Mexico, it may still need to physically locate manufacturing in the United States to qualify for certain trade benefits described above. Two threshold questions are: how and by whom the current manufacturing activities are conducted, and whether the related assets are being held in a foreign jurisdiction. If activities and related assets are located in a foreign branch and “relocated” into a U.S. branch, the U.S. company generally has no gain or loss recognition from the “inbounded” activities and related assets (putting aside potential currency gain or loss issues).

However, things get more complicated if the activities and assets are held through a foreign corporation, particularly one that is controlled by the U.S. company (often referred to as a controlled foreign corpo-

ration or CFC). An inbound distribution of the assets from a CFC to a U.S. shareholder is generally treated as a dividend in kind; this results in potential gain recognition to the CFC from a deemed sale of the assets under U.S. corporate tax rules.<sup>6</sup> The same consequences arise from an actual sale of the manufacturing operations by the CFC. There is no recognition for any built-in losses as a result of an in-kind distribution. Significantly, although income earned by the CFC may be currently included in the income of qualifying direct or indirect U.S. shareholders under §951 (as “subpart F” income) at the prevailing federal income tax rate, gain from the sale of a CFC’s business assets is generally excepted from the relatively harsh subpart F rules. Still, the gain falls within the “global intangible low taxed income” (GILTI) rules. Application of the GILTI rules potentially leads to current inclusion of the CFC’s gain at the U.S. shareholder level, albeit at reduced U.S. federal income tax rates pursuant to a special GILTI deduction provided in the Tax Cuts and Jobs Act of 2017 (TCJA).<sup>7</sup> Foreign tax credits may be available to offset the U.S. federal income tax liability, although only on a limited basis given the application of the GILTI-specific foreign tax credit limitation rules.

Finally, if the assets and activities are inbounded via a liquidation of the CFC (i.e., an inbound liquidation under §367(b)), the U.S. parent company is treated as receiving a deemed dividend to the extent of the liquidation of the foreign corporation’s previously untaxed earnings and profits; such dividend may be eligible for a deemed dividend deduction under §245A. In addition, the assets that are held by the U.S. shareholder after the deemed liquidation would take a carryover tax basis, which means if selling the assets in the future, the U.S. shareholder will take the historical asset gain (or loss) into account in determining tax consequences. Simply stated, U.S. tax planning on the treatment of assets when moving to domestic production can have a significant impact on the overall supply chain transformation project.

#### ***Foreign Tax Cost of Inbounding Manufacturing***

The specific foreign tax consequences of an inbound transaction will depend on the rules of the relevant jurisdiction. As a general matter, however, either a dividend/distribution or a sale of the manufacturing assets and activities to a U.S. shareholder could trigger gain (or possibly loss) for the transferor in its local jurisdiction. This may be the case even if the assets and activities are held in a foreign branch of a U.S. home office, under foreign branch repatriation rules. A dividend or foreign branch repatriation may also trigger foreign withholding taxes (which, for qualifying distributees, could in turn be reduced pursuant to an applicable income tax treaty). Gains on the disposition of assets could be subject to either capital

<sup>6</sup> See §311(b). All section references herein are to the Internal Revenue Code of 1986, as amended (the Code), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

<sup>7</sup> Pub. L. No. 115-97.

gain or ordinary income tax rates under foreign law, depending on the nature of the assets and/or their holding period. If foreign income or withholding taxes are triggered upon a dividend or deemed sale of the assets, a foreign tax credit may be available in the United States to offset the U.S. tax paid on the same amount. Additional “exit taxes” may also apply on the inbound transaction, e.g., where it involves a transfer of assets, functions, and/or personnel from an EU jurisdiction. Please note, in addition to typical income and withholding tax disclosures, depending on the nature and magnitude of the transfer, the transaction may be subject to disclosures, e.g., under the EU’s “DAC 6” (Council Directive EU/2018/822) regime or similar requirements in other jurisdictions.

### ***Go-Forward Tax Implications***

On a prospective basis, whether an inbound transaction will be beneficial or detrimental from the overall tax perspective depends largely on the comparison between (i) the aggregate foreign and U.S. income tax burden on the current manufacturing activities (e.g., foreign income tax applicable to sales income or, if the foreign entity is being used as a contract manufacturer, to manufacturing services income; plus residual U.S. federal, state and local income tax after application of the foreign tax credit rules), and (ii) the applicable U.S. corporate income tax rate (currently 21% at the federal level, plus any applicable state and local income tax). The U.S. income tax rate may be affected by additional U.S. federal income tax benefits, e.g., bonus depreciation for capital assets that have been purchased or otherwise received a basis step-up in the hands of the U.S. manufacturer and, depending on specific location within the United States, state or local tax or investment incentives, which are comparable to any analogous benefits incorporated in the federal income tax calculation. For certain foreign-source intangible income, the United States also offers a foreign-derived intangible income (FDII) deduction, which reduces the applicable income tax rate to approximately 13.125%. (That rate is scheduled to increase, to 16.4% in 2026.) Notably, FDII benefits are reduced by 10% of the U.S. company’s investment of tangible assets in the United States. Although the FDII benefits (unlike the various trade regimes discussed above) are not conditioned upon satisfying U.S. content requirements with respect to exported goods, no FDII benefit would have been available if income from foreign sales had been derived through a foreign branch or a foreign subsidiary (i.e., sales must be through a U.S. company).

As noted above, if the foreign manufacturing operations are currently owned by a CFC, its income is generally GILTI. While the GILTI rate is currently

around 10.5% (and scheduled to increase to 13.125% in 2026), there is a need to watch for potential U.S. corporate tax rate increases. Legislation is currently being debated in Congress (i.e., as part of the Build Back Better Act). If enacted, the proposal would raise the income tax rate for GILTI to a 15% effective tax rate, with more significant tax implications for domestic sales. Similar to the computation of FDII benefits, GILTI is reduced by 10% of the U.S. company’s investment of tangible assets in the United States. Although the legislation under consideration would generally leave the FDII rules intact, it would raise the applicable tax rate on FDII from 13.125% to about 15.8%.

Interestingly, the deduction for 10% of the investment in tangible business assets for both GILTI and FDII purposes actually incentivizes companies keeping manufacturing in a CFC. This is because the deduction reduces FDII benefits (leaving the income taxable at the default, 21% federal corporate income tax rate) where tangible assets are located in the United States and reduces the amount subject to GILTI (leaving the income taxable at the default, 0% rate under §245A) if the tangible assets are located in a foreign corporation. Nonetheless, locating manufacturing in the United States creates a natural U.S. distribution hub through which FDII benefits may be accessed. Note, intercompany sales abroad may also qualify for FDII benefits, subject to the company’s ability to document and demonstrate that the ultimate customers are non-U.S. persons. Also note such intercompany sales must be conducted at arm’s length under U.S. transfer pricing rules — which may result in different intercompany sales pricing than under the transfer pricing rules of the current manufacturing jurisdiction.

## **CONCLUSION: PLAN NOW FOR SUCCESS IN THE TRANSFORMING SUPPLY CHAIN ENVIRONMENT**

Global supply chains will likely remain under stress in the near term. While the pressures persist, business executives and political leaders will continue to focus on supply chain transformation. To address the risks identified in their supply chains, many companies will have to seriously consider and plan for how they can increase domestic production in the immediate future in the context of changing government regulations. Remodeling the global supply chains that have been developed over the last few decades will be a timely and complex endeavor. While there is no silver bullet that makes a supply chain shift easy, companies can develop a blueprint to succeed in supply chain transformation and begin planning now.



Any company's blueprint must consider traditional supply chain value drivers of production capacity, quality, and reliability, but to manage costs and maximize earnings before taxes, depreciation and amortization (EBITDA), tariff costs, tax incentives and costs, and regulatory risks need to be part of their framework. Implementing these new supply chains will require orchestration across various functions,

and a complex analysis of operations, trade, tax, regulatory, and legal matters. Once these are understood, leaders can diversify to parallel or alternative supply chains that are either in or near the U.S. market. The sooner that companies face this new reality, the better positioned they will be to drive growth beyond the pressures shaped by the current supply chain environment.