DO'S AND DON'TS WHEN DIVERSIFYING MANUFACTURING OPERATIONS

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To date, the United States has imposed tariffs on US$250 billion worth of Chinese-made products while China has imposed retaliatory tariffs on US$110 billion worth of U.S.-produced goods.

Manufacturers in China and the United States are facing hard choices, whether to absorb the additional tariff costs or to pass those costs onto their customers (and, eventually, the consumers). A large number of companies have chosen to diversify and relocate all or part of their manufacturing operations to countries outside of China and the United States. Of course, not all moves away from China are the result of the additional U.S. tariffs; the rapidly increasing cost of doing business in China has been a major push factor. The additional U.S. tariffs have just accelerated boardroom decisions to diversify manufacturing operations.

Many tech companies are already moving all or part of their operations out of China to countries such as Taiwan, Malaysia, Japan, and Vietnam. Vietnam appears to be the most popular destination for many companies.

Although China has threatened to punish any company that leaves China to manufacture in another country, businesses are more concerned about financial security and stability. This is why companies such as Nintendo, Foxconn, and even Google are considering or are in the process of moving parts of their manufacturing to neighboring countries.

WHAT TO LOOK OUT FOR WHEN THINKING ABOUT DIVERSIFICATION

There are many factors companies should consider when making the decision to move, including the current regulatory environment and its expected future direction, the ease of doing business and regulatory transparency, the risk of being hit with tariffs by the United States or other countries, infrastructure (e.g., roads, ports, electricity, telecommunications), labor cost, skilled labor availability, and cost of real estate. In particular, companies should assess their options for long-term development rather than for short-term gains.

Companies that want to remain in China also have options. Some may consider re-engineering their product, putting it into a classification attracting a lower tariff rate. They may also explore indirect tax planning opportunities, which may benefit them or their customers.

The current customs and trade environment in Asia is very dynamic and fluid. It is critical that companies in the process of restructuring their supply chain perform a proper greenfield study to better understand their options and assist in making a more informed decision.

As part of this process is to consider whether one makes this move via a joint venture acquisition or uses the services of a contract manufacturer for a period to test the new environment.

The following is a suggested list of factors to consider:

- Find out about the investment incentives offered and the conditions to avail of such incentives. Are there limitations that may impede an early exit of investment, if need be? What are the costs?
- Review the Harmonized System tariff classification of the products and make sure that they are correct. The tariff classification determines more than just the duty rate of a product, it also may determine any prohibitions, restrictions, and licensing requirements for that product.
- Consider the supply chain flow for the raw materials used in manufacturing a product. Can the raw materials be imported into the country efficiently and effectively? Are there any restrictions on any of the raw materials?
- Verify the origin of products supplied by third parties. Does the “Made in…” label accurately reflect where the product was manufactured?
- Identify and assess opportunities to revise the methodology of valuing products. Does the price of the product include cost elements that may not be subject to import duty?
- Check the export control laws. Do the products fall under the export control laws and require an export license? Do the products contain U.S. components and/or technology that may be controlled under U.S. export controls?
- Check the licensing requirements or restrictions imposed on the products. Does a product or raw material require a license or permit prior to importation or exportation?
- Consider the cross-border payment flows. Are there any restrictions or requirements when making overseas payments for or receiving payments on goods? How can profits be repatriated overseas?
- What are the corporate tax rates, and are there any other domestic indirect taxes that would apply to your products or company?
- Is the target country a signatory to free trade agreements, and how can your company avail of those?
- How transparent are the laws, procedures, and practices in the target country?
- What are the customs requirements in respect to registration as an importer/exporter?
- From a customs perspective, are there areas in the country that have restrictions on the types of operations that can be done there?
- What are the labor costs, and are their sufficient skilled persons to support your operations?

- Will you be able to maintain a high-quality product?
- How are products manufactured in your selected country viewed by your market?

Oftentimes, where products are subject to high import tariffs, there would be an uptick in "creativity" in respect to the product and/or the supply chain. Certain "creative impulses" may violate the law (*please see* the alert Origin Fraud – When "Made in Vietnam" is not made in Vietnam).

The customs authorities are well aware of the temptation for companies to try to circumvent high tariffs. This means that the authorities will be paying greater attention to goods coming from countries considered likely accomplices to some type of circumvention action.

Companies should ensure full compliance with all the laws related to import, export, and transshipment of goods. When in doubt, seek advice from a trade or customs professional, including about the veracity of information regarding the origin of the product.

"CREATIVITY" GONE WRONG

To circumvent the additional U.S. tariffs imposed on Chinese products, some companies thought they could simply relabel Chinese-made products and transship them through other countries to mask their country of origin. The manufacturer, a sales agent, or a customs broker may suggest that relabeling and/or transshipping goods via another country is quite safe, as no one has ever been caught. This is simply wrong.

Transshipping or importing and repackaging or relabeling a product in another country does not change the country of origin of the product. Such a supply chain flow, if it does not involve substantial processing or manufacturing in the other country, does not alter the origin status of the product. If the product was made in China, then it would still be subject to the additional U.S. tariffs, regardless of whether it had been relabeled or repackaged elsewhere. The reverse also holds for U.S. goods exported to China. In fact, intentionally misdeclaring such a product as not-of-Chinese or not-of-U.S. origin in order to evade the additional tariffs can be a serious offense and may result in substantive financial and other types of penalties, including, if the crime is considered serious enough, imprisonment.

Importers who knowingly import products with false country-of-origin labels into the United States can be subjected to substantive fines and penalties under 19 U.S.C. 1592, as well as criminal prosecution under 18 U.S.C. 542 (false declaration/statement) and 18 U.S.C. 545 (smuggling).

Individuals or companies can also bring qui tam lawsuits against individuals or companies that defraud the federal government under the False Claims Act (31 U.S.C. 3729). The potential damages can be quite substantive and can hurt a company's reputation.