Fox Rothschild Podcast

The Presumption of Innocence

Episode 66: Tariff Uncertainty and Compliance Risks for Businesses

Featuring Matt Adams of Fox Rothschild and Marina Gentile

Matt: Welcome back to "The Presumption of Innocence," a podcast brought to you by the White-Collar Criminal Defense and Regulatory Compliance Practice group at Fox Rothschild.

A day does not go by that we do not hear about tariffs in the news as the Trump administration uses them as a tool to carry out its foreign trade agenda. Like it or not, they have wide-ranging consequences to global commerce. But beyond that, at the intersection of global commerce and the criminal justice system, they present a major compliance risk for businesses that are engaged in international trade. The penalties that are associated with failing to properly follow customs and trade regulations related to these tariff schemes can be significant to businesses with global reach. Customs audits, fines, penalties, seizures of goods and criminal and civil enforcement action are all on the table when it comes to the legal, financial and reputational minefield that companies face when they fail to follow established trade regulations pertaining to tariffs.

My guest on the program today is Marina Gentile. Marina is a partner at the accounting and advisory firm Withum, leading the firm's Global Transfer Pricing Strategies Practice. She's also the Global Transfer Pricing Leader for HLB International, a global network of independent advisory and accounting firms that have banded together to provide seamless coverage for businesses around the globe regardless of where they operate.

Marina has been advising multinational clients in various countries around the world on all aspects of global transfer pricing for something like 30 years. Marina, old friend, it's a pleasure to finally have you on the program. Welcome to "The Presumption of Innocence."

Marina: It's great to be here, Matt. Thanks for having me.

Matt: So let's start with the basics, Marina. What is global transfer pricing? And then I have a series of follow-up related questions. But let's start at the bottom of the pyramid as we work to the top. Tell us what it is that you do.

Marina: Okay. Uh, about 30 years now, helping multinational companies as they're expanding into overseas markets, right? There's a lot of this underlying complexity and regulations out there that they're just not aware of, right? So companies are forming their business, expanding into other markets. And it gets very complicated, because now you have two tax authorities trying to grab, you know, a piece of that global pie, right? And, you know, the expectation and the regulations are really heavy. It's a highly litigated space. And it's honestly the biggest tax uncertainty for multinationals and has been for many, many years.

Now, tariffs is going to, you know, no pun intended, trump that.

Matt: So let's build that, build from that then, right?

So it's, it's the cost of doing business overseas that you're helping these businesses analyze.

Marina: Right.

Matt: Because you're focusing on not just like you would with a, a domestic business, that, that sort of one taxing authority or maybe a federal and a state taxing authority.

Marina: Right.

Matt: You're combining now the overseas portion of that, which brings additional complexity into the fold. And it's almost logical and intuitive then that this does in fact relate to these tariff regimes. But explain to the audience how that, as you called it, the piece of the global pie fits together once tariffs are layered on top of that.

Marina: Right.

Matt: Is it the pepperoni or is it the cheese?

Marina: I don't know which one it is right now. Maybe both at this point, right? So really how it interlinks is this: let's take a, a product transfer, okay. So you have a headquarter in China, company is manufacturing, they're selling a product into the U.S. market. That customs value that they're declaring is, you know, the dutiable value of transferring that good into a new market. It needs to align with the transfer pricing. Like, so this is now in a related party situation, it needs to be the same as the transfer pricing. And the reason for that is, you can't have it both ways as a company, right? Because the incentive is to minimize the dutiable customs price, so they pay a lower tariff, and then to maximize the transfer price to the distributor on the good, so they strip more profit out of the U.S. so they pay less taxes in the U.S., income tax. So the correlation between the two is pretty heavy. And effectively, it should be the same price, unless there's some kind of really quantifiable reason why it's not.

Matt: So then take us one step further, right? How does the imposition of a U.S. tariff regime technically work?

Marina: So, I mean, unless you're like sleeping through the news these days, right? We're hearing every three minutes there's some kind of change, some new sanction, new country, you know, et cetera. There's pauses, there's unpauses, there's retaliatory. The reality is, it's not about the rate. The tariff rate is going to go up. So, you know, there's no reason to like list all the drama around individual rates. Let's just say, it's getting complicated and more complicated. And these rates are getting higher, so now they're a factor for companies.

Well, the entity at stake and on the hook for this tariff increase is always the importer of record. That's my China headquarter example. Um, and by the way, this is whether it's a related party or a third-party supply chain, okay, it could be completely independent--

Matt: All they have to be is offshore.

Marina: Yeah, exactly. So, so, you sitting in the U.S., company sitting in the U.S., Now takes a bigger hit when the product is coming in offshore that has a high tariff associated with it. So China's right now at 30%, if I remember correctly, but it was at 145% and it might creep back up there. There's a lot of just kind of geopolitical stuff happening. So you don't know what it's going to be, so it creates an uncertainty for businesses, right? It literally just increases the price of the product dramatically for the importer of record.

That importer of record is typically the U.S. distributor buying from a foreign overseas, you know, manufacturer. So now what do they do? They are responsible for 100% of that increased tariff hit. So can they renegotiate their supply agreement on the fly? Probably not, right? They've got a legal contract, et cetera.

Can they, uh, pass along the cost of the good to the consumer? Sometimes yes, sometimes no.

I have clients that their main customers are, Walmart and Costco and Home Depot. They're not having any of this. They're just saying, no, we want the product, same price, same location, same time, no delays.

So it's never been more important to understand your bargaining power in that supply chain. And it's really different for everyone, Matt. That's the weird thing. I've talked to hundreds of clients and everyone is stressed right now, and I'm having these sort of strategic check-ins with them. And every situation is different because every supply chain is somehow different. So, it's crazy out there because it's dumping a lot of our distributors. You know, distributors don't have high margins to begin with typically, right? They buy a product, they sell a product. They're not a high-risk entity. They're not, uh, investing in intangibles, right? So the margin's already thin. Getting hit with a increased cost of the good via a tariff tax that they can't avoid, maybe they can't pass it along to the customer. We're going to see a lot of these businesses going into loss positions, and you know, really low profit positions. And then on the flip side, they've got the IRS coming after them for transfer pricing issues because they're not within that arm's length profitability range.

It's tricky. I think we're going to see a lot more controversy, double taxation situations happening.

Matt: So just to demonstrate how rapidly unfolding this tariff environment is. About four hours ago, as of the time that we're recording this episode, it was reported by financial media that President Trump said he would be sending letters to over 150 countries as he plans a barrage of tariffs to take place on August 1, 2025. Now, that could change. But that includes levies on pharmaceutical imports and semiconductors.

Marina: Yep.

Matt: It seems like nobody is immune. U.S. trade partners like Canada and, and some in South America have been threatened with tariffs ranging anywhere from 35% to 50%. You mentioned a tariff on Chinese goods that had exceeded 100% at one time and has receded, but could at any point fly back up. Can you give us some perspective on what segment of the U.S. economy relies on the type of foreign imports that would be subjected to these tariffs?

Because when I see the landscape as it exists, sitting here today, as rapidly unfolding as it is, I don't think there's a single industry that's immune. Is that true?

Marina: That's almost true... no, that is really true. They're just, it's the stage of where they're getting hit. Like for example, right now, services aren't being focused on, but we're going to get there too. So yeah, it, it really is every industry. Because think about it, a lot of products just don't exist in the U.S. They're just not manufactured here. We've evolved, you know, as a nation to sort of technology and to a service. And we've let those manufacturing, those things, those products, move out of the market.

I feel like there's a lot of discussion around people are taking our businesses or industries. It's, we've let them go to focus on other things because that's how global trade works, right? Like you, you go to what you do best. And, and somebody else takes what you don't wanna do anymore or, you know, doesn't make sense for you to do anymore.

So there are products that are just not manufactured in the U.S., period, full stop. So we need to get them from elsewhere. And it doesn't really make sense for us to start manufacturing them here again, like it just doesn't. Maybe they're low value products, low-markup products, but we still need them.

Matt: Well, one of the policy justifications is that this will in fact re-entrench some of these industries back into the United States. But I think the proof will be in the pudding at the end of this process whether that policy actually works.

Marina: Yeah. And, and, and listen, Matt, for some companies it's going to work. But reshoring, nearshoring, whatever we're calling it, you know, manufacturing back in the U.S., that's a long-term solution to an immediate problem. These tariffs, boom, everyone's getting hit like right now. Right today, okay?

So it takes a few years and a lot of money to start manufacturing something in the U.S. that for years has been manufactured offshore. And there's only, you know, the bigger companies that can do it. And even if they can do it, all those semiconductors got to come from China anyhow, right, or, or you know, or Vietnam or, right?

Like, I mean, it's, it's a little bit pie-in-the-sky to think that, people are just going to start manufacturing everything here. Sometimes it's just not at all possible. Other times it is, and I think that's great.

Matt: Well, before we get back into sort of the compliance angle on this, 'cause after all, this is the focus of our podcast. Just from a, as we're kind of laying the, the framework for our, our subsequent discussion, from that same macroeconomic perspective, are we going back to the dreaded supply chain disruptions that we saw during the COVID-era as a byproduct of, of these tariff regimes? Is that ultimately what's going to happen, is that while U.S. industry ramps up to "onshore" some of the production that this is going to eliminate? Are we going to see those disruptions like we saw during COVID?

Marina: I think we could see them. I think we're already starting to see them. I think it depends on, you know, the unique situation, like I said. The truth is companies are, they're a little bit frozen, right, in not knowing exactly what to do. So you get that category of people like, we are not going to do anything. We're not shipping product until we understand the exact tariff implication. And right now, August 1 is the, the, the dream date of, you know, what we're going to hear. I, I believe it's probably going to move after that. It takes a long time to come up with these individual trade agreements.

In the 90-day pause that we originally had, to July 9th, I wanna say two agreements were signed, you know, with two different countries, right? So these things just take time, right? We can't instantly renegotiate completely between sovereign countries.

I think there's a category of people that are trying to like, get their product in now, before a tariff goes up. And I think you have other knee-jerk reactions that I'm really concerned about. You know, we were talking about this. Your typical multinational, you know, income tax has been around for a long time. The tax department knows how to handle income tax. This tariff is, yes, there've been tariffs in the past, but now it's just overly dramatic. So we're in these situations where people don't know how to handle them. And I'm concerned that they're getting themselves into some trouble inadvertently.

Right, you know, I get fielded with calls like, well, I'm just going to drop my product price. Or I'm even going to sell it at a loss or at cost. And I have to kind of really give the message that, unfortunately that is the classic definition of tax manipulation. Like, they don't see it that way, right, they're just trying to: how do we tweak the business to account for this tariff. But a tariff is a tax. You can't make business decisions for tax-driven, tax-avoidance reasons, okay? So unless you have that economic substance, that justification for changing the pricing, not a good idea to just dump your pricing. As you can imagine, you know, customs and, and border protection are, they're looking for it.

Matt: So let's shift that focus back to these compliance risks that are associated with U.S. companies participating in global commerce against the backdrop of this new tariff landscape. I tend to believe that if this is in fact something that's here to stay and not just some giant ploy to bring people to the negotiating table, the --

Marina: Mm-hmm.

Matt: Proverbial art of the deal, no pun intended. I tend to believe that this may turn out to be one of the main and most significant areas of enforcement activity under this administration. Because the reason is simple: If it's such a focal point, they have to put teeth behind it. They have to aggressively dedicate resources to enforcement or it's a meaningless ploy.

Marina: Right.

Matt: So, let's shift our discussion here to what diligent companies with international reach need to do to stay ahead of the compliance curve. Because I would gather that's pretty much what you're doing 24/7 these days.

Marina: Yeah, it really is. So there's, you know, a few different aspects of it, and typical, the stakeholders are like the company themselves, the M&E. Then you've got the customs broker. They probably already have a customs broker. That firm is more of a compliance firm, right? So they make sure that everything is tick and tied and they're, you know, doing what they need to do with getting the duties paid through CBP. They are not typically strategists, you know, or, or at least you don't wanna go to your customs broker to develop all these different strategies. It gets a little bit tricky, you know?

Matt: It's an inherent conflict, isn't it?

Marina: It's a conflict, exactly. It's that they're mandatory reporters to CBP, right, so, you know, you wanna kind of take, have a little pause there now.

Matt: So, so you're, taking on the role, then, of the trusted adviser in sort of helping these, companies spitball around strategies that then can keep them on the proverbial up-and-up while modeling and doing things where there might be alternatives to choose from.

Marina: Exactly. Exactly. And of course, within the spirit of the law, Matt, I mean, that has, that goes without saying, but if you think about it, the customs broker is focused on the dutiable value, the customs price, full stop. This is my client, right? And I am focused on the health of their entire business, and I'm focused on how do we keep this business sustainable, and what needs to happen. And what are the things we can do right now to help this business stay afloat?

Matt: So what can you do? What can you do in this environment where we've got percentages that are... they are large percentages, some of these tariffs.

Marina: Absolutely. And p.s., there are large percentages. And you know what, one of the biggest things we're starting to do at Withum is getting our digital team involved to change the systems for these companies that maybe have been heavily focused on paper and humans and pencils to get through the invoicing process. And now they're like, whoa, one rounding error, you know, could make a big difference, right? So the systems, you know, we're helping get their systems in check if, you know they need that. We're looking at their entire business. We're looking at their entire supply chain.

And you know, normally when I'm doing transfer pricing, I might ask questions, you know, 10 questions related to a supply chain. Now I'm like at 37 or whatever, right? I mean--

Matt: And what are some of those questions? What do you wanna dig your teeth into in order to give-- I mean, the goal of this analysis, I think you stated earlier, is that this has to be an arm's length transaction.

Marina: Right.

Matt: They can't just undercut the price and make it a sham transaction. This has to be objectively arm's length. Is that, is that a fair assessment?

Marina: Exactly. So we keep following the supply chain one step further back, one step further back, as we go forward. And we're seeing things, unfortunately, Matt, like, okay, a client that thought it was purchasing a product from the U.S., lo and behold that company purchases the product from China and then sells to the U.S. as a made-in-the-USA, but they have no substantial transformation of the product. So that entity buying that product, thinking it's a U.S. product, is actually going to get hit with that 145% or 30% or whatever it is, because the country of origin is China. There's been no transformation to the product.

So people actually need to be careful and need to understand their suppliers, whether independent or related party. And then their suppliers' suppliers and their suppliers' suppliers. It's like this never-ending chain of, you know, making sure. Because we're seeing things like, okay, China now sells to Vietnam. So the U.S. is purchasing from Vietnam, which originally had a better tariff situation. Still does. But there was actually no transformation happening at all, or not enough. Like it's very specific. You have to transform the product. And that needs to be assessed and declared.

Matt: What do you mean by transform the product? Give me a concrete example for our audience about how, if that product is transformed, it may have an origin from the lower tariff nation, but if it's not transformed, it's just kind of passing through.

Marina: Yeah.

Matt: In an effort to evade the tariff. Give me a concrete example to drive that point home.

Marina: Yeah. So, uh, let's say it's a laptop coming from China. And you know, is China building the entire laptop or are they providing the components and the semiconductors but then the build is really happening in, in Vietnam? So there's an assessment and there's a transformation. It needs to be dug into. So I honestly can't even give you like, okay, if it's this and then that. Like, we really have to look at it and where things are coming from. And then what ends up happening is if it's ultimately sold to the U.S., rather than paying a like one tariff on one full finished product, we're looking at the components of this laptop. Okay, these six things came from China and these three were added by, by Vietnam. And maybe there are going to be two different tariff situations because of that. If it was deemed that Vietnam transformed the good, you know, actually added value to it, versus the whole product was done in China, shipped to Vietnam, shipped to the U.S. without anything happening.

Matt: So they can't just proverbially, uh, take it out of the package and put it in a new one, and then all of a sudden it's transformed from a Chinese semiconductor to a, a Vietnamese semiconductor.

Marina: Exactly. Exactly. And it's very complicated. We're looking at things like office chairs and saying, well, what piece touches plastic or aluminum or steel or whatever is highly tariffed. So the complexity for the company itself, for the customs broker and for CBP is, it's outta control, Matt, right? Like, I don't even know how anybody's keeping up with it. I, I feel like, you know, we hear about, okay, yes, tariff revenue has increased. I got to think it's on like, the most simple of products. Because the complicated products with different raw material components at different rates, we're not there yet. We can't evolve that quickly, right. This just started, you know, a couple months ago if you think about it. So...

Matt: It sounds like a brave new world, Marina, and I tend to think, and sort of drawing us back to the, the central hypothesis of this episode, is that this just will continue to be wrought with risk. And when I hear you talk about the types of strategy, I think that there is a component of this that is accounting and advisory, and then there's legal. And, and it is --

Marina: 100%, yep.

Matt: Really to, to drive this home, a lot of the discussion that you're talking about having where you're essentially doing an autopsy on the construction of a good in effort to track and trace where its constituent parts are, are coming from, is something that ought to be done under the protections of the attorney-client privilege.

Marina: 100%, 100%. That's, I was exactly going to go there. A lot of the work we're doing is under attorney-client privilege for that reason.

Matt, we need to ask ourselves things like, okay, so you have this global structure to your business. Does it still make sense now? Because your typical, Asia-Pac, European-headquartered company decides to expand into North America. They set up one related party distributor in the U.S. typically, sometimes Canada, but oftentimes it's the U.S., And then they onsell product to Canada and Mexico and other markets. So now it's like, does that make sense that you are shipping product into the U.S., paying a big tariff on it instantly, and then you're onselling to other markets? Right, so the question then becomes, okay, you could set up a bonded warehouse or a free trade zone -- not to get into those complicated discussions -- but it's not for everybody. Those are giant companies with really big costs associated with doing that.

So then it's, okay, well, do we set up legal entities then in Canada and Mexico, and do we have them creating their own supply chain to China or whoever the manufacturer is, right, to avoid the U.S. tariff because why should they be hit with that, right? So that sounds like a great idea, but guess what? Companies don't like to set up entities in Mexico because 34% tax rate, 10% mandatory employee profit sharing, you might be better off getting hit with a tariff than setting up your own supply chain.

Matt: Right.

Marina: It's a lot of complicated, very fact-specific discussions. People need advice, companies need advice that's like unique and specific to them.

Matt: How do you get that company that might be resistant to put in the legwork for this exercise to understand what happens if they just wing it?

Marina: So, we developed a proprietary modeling tool. We'll take their financials and run it through to show them sort of, you know, this is their position if they do nothing, and this is how we can help, And it's usually looking at -- so transfer pricing often is done on a, an aggregate basis. Like, okay, let's look at the U.S. distributor, and if it's within a range of operating profit, you know, operating margin that's acceptable based on like third-party benchmarks, right, then whatever transfer pricing they're doing ahead of that is deemed arm's length or market rate. So that's something we do sort of from a compliance standpoint.

This is the time to get granular and look at the entire business, just like we would do for a planning, for a new company, just establishing transfer pricing. What is actually happening? Because a lot of times, Matt, people will just do one intercompany transaction and it's a product. It looks like a product. But it's not a product, it's a product and a service and something else in between. But it didn't matter before because they weren't concerned about tariffs. They, they were zero or not, you know, a factor. Now that it's a factor, we again need to look at that product price and say, but is this really all product related or did you provide strategic leadership services or G&A services? Was there business development? Like, all these things that then would organically take down the product price because it's just not product related, right?

And again, it's so fact dependent. Some people that works for, some companies, some it doesn't, right? It's, you need to have the conversation. And really companies need to be prepared to have that sit down -- I think it's called like a desk visit or something -- with CBP and actually quantify the change in pricing. So that's the critical thing. You can't do a knee-jerk reaction. You can't do nothing. You need to quantify and prepare yourself for the discussion.

Matt: And if the government drops the proverbial hammer because you haven't done this type of preparation--

Marina: Yeah.

Matt: The consequences are potentially game changing, game over, do not pass go, go straight to jail.

Marina: I mean, you're more well-versed in the criminal aspects of it, Matt, for sure. But, um, yeah, no, there's a lot of hassle. There's a lot of, you know, we've got this dual incentive now we've got, you know, people wanna drop that customs value -- and so they're like, could get into trouble on that aspect of it -- but they wanna increase the transfer price, you know, product price. And anytime you do that, now you've, you've just got two -- you don't only have the IRS coming after you for transfer pricing, you know, issues, now you've got CBP coming after you for dumping your product price without any justification. And then when those get misaligned, there's a code, right? There's a tax code that aligns transfer pricing and customs pricing. So I think we're going to see a lot of controversy, litigation in the space. I really do.

Matt: We've been talking with Marina Gentile a Partner in the Global Transfer Pricing Strategies Practice Leader Withum about what's coming down the pike as the Trump administration's tariff regimes are scheduled to take effect on August 1.

Marina, I'm going to ask you a final question, which I ask a lot of guests, which is take out your crystal ball for a moment and gaze into the future. And in our waning moments together today, what happens next? August 1 comes and let's presume for the sake of our discussion today that that deadline sticks. We know that's been a moving target.

Marina: Mm-hmm.

Matt: Uh, we know that there is some, at least, negotiations that are going on, albeit perhaps in a limited way, with these nations for which extreme tariffs have been announced.

Marina: Yep.

Matt: Let's presume it continues at that pace, but August 1st comes and that that deadline does not move. Take out your crystal ball. These tariff regimes are implemented. Some businesses have taken the moment to plan and, and may be in better shape than others. They've used people like yourself to do their modeling.

Um, but what happens? What happens to international trade, to the global economy, to our U.S. economy, and in particular, the types of goods that we all buy every single day? What happens as that takes effect? And we have some people who are prepared. We have some people who are not. And all of a sudden that widget that used to enter the United States duty-free is now subjected to 100% tariff or a 50% tariff, and that widget is an instrumental component in some necessary device. Let's not even talk about luxury items, right, like--

Marina: Yeah.

Matt: We could do without them. Let's talk, let's talk about like a pacemaker or like a defibrillator or some other medical device. What's going to happen?

Marina: My crystal ball tells me that the ultimate consumer suffers, right? Like everything is going to go up, product pricing is going to go up. Some things, you know, maybe it won't matter because they can replace products with the U.S.-made product. I love Canadian maple syrup, but maybe I'm going to start buying Vermont maple syrup as an alternative. But guess what? Probably that Vermont maple syrup's going to go up too now because it understands the increased, you know, right--

Matt: Demand, yeah. Supply and demand.

Marina: Yeah. Supply and demand. Exactly. And that's, a fun story with maple syrup. I don't think anyone's going to live or die whether they have it. But you know, we have like energy at stake. Like we do a lot of trade with Canada and Mexico.

Because we just, we depend on a lot of things and they depend on a lot from us. Like Canada especially, depends on a lot of U.S. goods. And when we have these scenarios, it just gets, it gets ugly for everybody. But the consumer, I don't know any way about it. If it's a product that's needed, like a pacemaker that you said or whatever, unless there's some kind of heavy government intervention or exemption -- which we're not seeing now -- you know, I think it's going to be a problem. I think the cost of like, you know, things that we really need day to day are going to go up. And we have no choice around paying them. I don't see a choice.

Also, there's no exemptions, Matt, right? When he was in, this administration was here before, there were some exemptions that you could claim. There's no exemptions. So I have clients that, for example, 100% manufacture their goods in the U.S. U.S. company, U.S. headquarter, red, white and blue, five production facilities in the U.S. But they have a very specialized piece of equipment that they need to get from elsewhere overseas. They're now forced to pay a 30% tariff on this piece of equipment that they just can't get in the U.S. because nobody makes it in the U.S. Right?

You wanna have you know, more manufacturing in the U.S., you need to have exemptions for that profile, that, that setup, and not just completely across the board kind of punish everyone.

Matt: Well, from a enforcement perspective, I think we're about to see if this in fact takes shape the way that it's been outlined. I think we're about to see a tremendous uptick in these types of enforcement cases. And I don't think that this is the last that we're going to be talking about this subject, Marina. Come back on the program and, and when this starts to play out so that you're not just using your crystal ball, that you can talk a little bit more about what's happening in practice. I encourage you and, and invite you to come back.

But that's all the time we have for today on "The Presumption of Innocence." Marina, it's always a pleasure chatting with you. You're very, very knowledgeable on this subject. We'll see you next time. I'm your host Matt Adams. Take care.