



S T R A T E G I E S

Tax & Accounting

Tariffs: How Exactly Do They Work?

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Tariffs are a source of revenue, and they operate as a tax on goods. The administration of tariffs, however, is much more involved than a tax, and its complexities underscore how tariffs are not a simple solution to trade or budget deficits.

Basic Principles

Importers remit [an import tax](#) resulting from a tariff to the U.S. Customs and Border Protection Office (Customs). Tariffs are not imposed on exporters.

Despite the imposition of tax on the importer, the party ultimately bearing the cost might not be the importer. The exporter could lower the selling price for its exports to offset the importer's added tax costs so that the ultimate consumer price remains unaffected. This is seldom the case.

Without a price concession from the exporter, the importer must either absorb the tariff cost or pass it on to the consumer. The importer most often will choose the latter, increasing the price of a good or raw material, or may select alternative materials or goods that may be more expensive, inferior in quality or both.

In either case, the real economic cost of an import tax falls to the consumer. One study concluded that tariffs cost each American an average of \$213 over the first nine months of 2018. Extrapolated over the full year, this totals approximately \$86 billion of increased costs for American consumers.

Tariff Administration

There are four ways of applying a tariff to an item. Only one of these four ways is value-based; other methods reference an item's quantity or weight. Furthermore, there are approximately 13,500 possible rates that can apply, depending on the nature of the item and the country that it is coming from.

Commodity groups add another complicating factor. For industrial tariffs alone, there are approximately 5,000 different commodity groups with 11,000 subgroups and nearly 20,000 smaller sub-subgroups.

It is the responsibility of the importer to ensure that the imported item is properly classified, which includes

documentation to show that the proper classification processes were followed. Penalties for improper classification can be imposed on the importer.

Importers are also responsible for requesting tariff exemptions on the items they import. To be granted an exemption the importer must demonstrate that there is either insufficient quality or quantity of the item available via a U.S. source, or that there is a national security need for the imported item.

Workarounds

Some companies have pursued creative workarounds to tariffs. One tariff levies a 25% import tax on U.S. importers of light trucks. The normal U.S. import tax is 2.5% on most vehicles. Some companies would build vans (classified as light trucks) overseas, disassemble them, ship the pieces to the U.S. and then reassemble them in the U.S. Others would build light trucks with rear-facing seats so that the trucks could be classified as a passenger vehicle instead of a truck.

These workarounds are not always successful or practical. Ultimately, many of the companies that had tried to get around the import tax on their trucks discontinued their efforts.

If they're so complicated, why use tariffs?

Added together, the additional costs to consumers and the administrative complexity make import taxes burdensome. But they remain a negotiating tool for international trade agreements because of their potential to [offset the additional costs of import taxes](#) by greater U.S. productivity. For that reason it is unlikely tariffs will be going away any time soon. 🚩



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