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Tax Flash News

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US Reciprocal Tariff – To deliver balance of trade

Background

Significant and ongoing annual U.S. goods trade deficits have weakened the US manufacturing sector, reduced incentives for enhancing advanced domestic manufacturing, disrupted essential supply chains, and made the defense-industrial base reliant on foreign countries. To bolster the international economic standing of the US and its workforce, the reciprocal tariff policy has been introduced.

This policy urges other nations to adhere to the principle of fair trade: "Treat us as we treat you!“

Country specific tariff

The policy seeks to rebalance global trade by introducing an additional ad valorem tariff on all imports from trading partners, unless specified otherwise. This additional tariff will begin at baseline 10% starting April 5, 2025. Shortly after, from April 9, 2025, country-specific tariffs listed in Annex-I of the order will take effect at the specified rates.

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Reciprocal tariff is subject to modifications

President has the power to modify the executive order proclaiming the reciprocal tariff. The conditions requiring modification of executive order could be reduction in tariff on exports from US, improvement in balance of trade favoring US, better market access to US exports and resolution of long-standing issues like restrictive nature of data localization policy, restriction on import of remanufactured medical devices, etc. While India seems to be inclined to constructively collaborate in resolving underlying issues, some countries may retaliate, and hence, the modified tariff may improve the comparative advantage over other countries.

Tariff on exports from India

Exports from India will attract additional 10% baseline reciprocal tariff from April 5, 2025, and will change to 26% from April 9, 2025. However, as evident from PIB press release of April 3, 2025, Government of India will continue to constructively collaborate to resolve or mitigate the underlying conditions described by the US administration in its executive order. Outcome of such discussion may result in reduction in reciprocal tariff.

Exclusion from reciprocal tariff

In this announcement, US has currently excluded (a) products with prior levy under Section 232 like steel, aluminum, automotive goods, announced in the February/ March 2025, and (b) copper, pharmaceuticals, semiconductors, and lumber articles. However, further tariff announcement may follow for specific articles.

Computation of effective tariff

Reciprocal tariffs are determined by the tariff rate needed to equalize trade imbalances between the US and its trading partners. This method presumes that ongoing trade deficits result from both tariff and non-tariff barriers that hinder balanced trade. The rates for these tariffs can vary from 0% to 99%.

Export competitiveness

Countries with more than 30% reciprocal tariff like Cambodia (49%), Vietnam (46%), Bangladesh (37%), China (34%) and Indonesia (32%) may get adversely impacted. While India with a reciprocal tariff of 26%

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may be relatively better off, the position may improve as India addresses US trade sensitivities.

Expectation of accelerated FTA discussions

India's response to the ‘Liberation Day’ tariff announcement is likely to involve significant unilateral decisions and bilateral discussions. These decisions will be aimed at consultative resolution of issues at the product level and will require transitioning from general country-specific tariffs to mutually agreed product-level tariffs.

Business response

Business will be required to revisit their operating models for protecting market share and improving market access of the products, evaluation of alternate sourcing locations and exploring re-distribution of increased cost across the value chain. Revisiting the operating model may include exploring knocked down import and assembly model, localization of component sourcing or partial shifting of manufacturing to advantageous tariff jurisdiction like Europe, Canada and Mexico.

Our comments

Retaliatory tariff would result in mid-year change of import tariff of various products. In addition to this, India may reconsider its pace for rollout of non-tariff barriers like Quality Control Orders. A shift may be seen towards rupee denominated global trade. However, resolution of US concerns may require industry to engage with the Government in identifying key action items during the bilateral dialogues.

Exporters may experience possible re-distribution of increased tariff costs between importer, exporter and final consumer. Change in tariff may also impact product pricing and profit margins. It is very likely that US and beneficial tariff jurisdictions attract investment for manufacturing-led employment creation. Rebalancing of trade between India and US may also impact the rupee dollar exchange rate which will have a bearing on export competitiveness.

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KPMG in India addresses:

Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Hyderabad
Salarpuria Knowledge City, 6th Floor, Unit 3,
Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar, Noida – 201 305.
Tel: +91 0120 386 8000

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road,
Bengaluru – 560071 Tel: +91 80 6833 5000

Jaipur
Regus Radiant Centre Pvt Ltd., Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Pune
9th floor, Business Plaza,
Westin Hotel Campus,
36/3-B, Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411 001.
Tel: +91 20 6747 7000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road, Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
2nd Floor, Block T2 (B Wing),
Lodha Excellus, Apollo Mills Compound, N M
Joshi Marg, Mahalaxmi,
Mumbai- 400011 Tel: +91 22 3989 6000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club,
Vijayawada, Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000

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