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House tax bill proposes to increase U.S. taxes on non-U.S. individuals and entities

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On May 22, 2025, the House of Representatives approved the One Big Beautiful Bill Act, which includes a new provision that would increase U.S. tax rates (including withholding tax rates) on residents of foreign countries that impose “unfair foreign taxes.” This update describes the new provision and highlights important considerations for both U.S. and non-U.S. companies, banks, private funds and other taxpayers.

Overview

The House of Representatives approved the One Big Beautiful Bill Act on May 22, 2025. The tax changes in Title XI (the “House tax bill,” as revised by certain amendments) would add a new Section 899 to the Internal Revenue Code entitled “Enforcement of Remedies against Unfair Foreign Taxes.” Section 899, if enacted as currently drafted, would increase U.S. tax rates on certain non-U.S. persons, including both individuals and entities. We discuss other key provisions in the House tax bill in a client update that can be accessed here.

The new section 899 would create a new tax regime targeting residents of “discriminatory foreign countries” that impose “unfair foreign taxes” on U.S. persons. Unfair foreign taxes generally include taxes imposed under the so-called undertaxed profits rules under OECD Pillar Two, digital services taxes, diverted profits taxes, and other taxes “with a public or stated purpose indicating the tax will be economically borne, directly or indirectly, disproportionately by United States persons.” To date, more than 140 countries have agreed to Pillar Two, including the United Kingdom and many EU countries, although only a portion of those countries have enacted taxes that would constitute unfair foreign taxes.

The increased tax rates would apply to any individual (other than a citizen or resident of the United States) who is a tax resident of a discriminatory foreign country, any corporation that is a resident of, or more than 50% owned (by vote or value) by residents of, a discriminatory foreign country, and certain foreign partnerships, branches, trusts and other entities identified with respect to a discriminatory foreign country by the Secretary.

Key provisions

- **Increase in various tax rates.** The regime would be carried out by increasing various tax rates, including withholding tax rates on U.S.-source interest, dividends and other “fixed, determinable, annual, or periodical income” (FDAP income), and the tax rates on U.S. “effectively connected income” (ECI) (including branch profits tax rates but, in the case of individuals, limited to certain real property gains and losses), that apply to “applicable persons” with respect to any discriminatory country. The increase in tax rates would generally be 5% for each year, capped at 20% above the applicable statutory rate (determined without regard to any rate applicable in lieu of the statutory rate, such as a treaty rate).
- **Interaction with tax treaties.** Section 899 provides that it applies with respect to statutory rates of tax or “any rate of tax applicable in lieu of…[a] statutory rate.” Although it is not entirely clear, it seems that if a tax treaty provides for a reduced U.S. tax rate (including a rate reduced to zero) for the relevant residents of a discriminatory foreign country,

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such reduced rate (rather than the statutory rate) would serve as the base upon which the 5% annual increase would be imposed under section 899. For a further explanation, see the report from the Joint Committee on Taxation here (at page 363).

- **Modification of BEAT.** If enacted, section 899 would expand the application of the base erosion and anti-abuse tax (BEAT) as applied to U.S. corporations primarily owned by tax residents of discriminatory foreign countries (including U.S. subsidiaries of foreign corporations). The modifications would (i) assume that the BEAT regime is applicable to such a corporation without regard to the currently-applicable base erosion percentage threshold and gross receipts threshold, (ii) increase the BEAT rate from 10% to 12.5% and (iii) revise certain rules in calculating BEAT that would otherwise result in a lower amount of BEAT, including by treating certain capitalized amounts (other than the purchase price of depreciable or amortizable inventory) as if such amounts had been deducted rather than capitalized.
- **Elimination of section 892 exemption**. Section 899 would render section 892(a), which generally exempts from U.S. taxation certain U.S.-source income of foreign governments, inapplicable for governments or government entities of any discriminatory foreign country. Many of the countries that are likely discriminatory foreign countries have a sovereign wealth fund that may be impacted by this provision.
- **Applicable years**. Section 899 would apply to each taxable year beginning (i) after the latest of (A) 90 days after the enactment of section 899, (B) 180 days after the enactment of the unfair foreign tax that causes such country to be a discriminatory foreign country and (C) the first date that the unfair foreign tax begins to apply and (ii) before the last date that the unfair foreign tax is in effect.

Observations

If section 899 goes into effect as currently proposed, non-U.S. banks (both acting through U.S. branches and not acting through U.S. branches) will need to assess whether and how to participate in the U.S. loan and derivative markets, and investment fund sponsors will need to evaluate the potential impact to treaty fund structures.

- **Portfolio interest exemption.** Although section 899, as currently proposed, does not appear to impose withholding on U.S.-source interest with respect to persons that qualify for the statutory “portfolio interest exemption,” non-U.S. banks that rely on treaties rather than the portfolio interest exemption to be exempt from withholding on such interest may be subject to additional withholding taxes on such interest.
- **Treaty exemptions**. The potential impact of section 899 on treaty exemptions is unclear. As discussed above, the Joint Committee on Taxation indicates that section 899 would likely impose the 5% annual increase to any reduced rate under a treaty (capped at 20% above the statutory rate, determined without regard to any rate reduction provided by the treaty). However, it is not entirely clear how it interacts with other types of non-rate-based treaty exemptions. For example, many treaties limit the ability of a contracting state to tax business profits unless those profits are attributable to a “permanent establishment of fixed base” maintained by a resident of the other contracting state. Section 899, as currently proposed, does not appear to impact this type of non-rate-based treaty exemption. On the other hand, “business profits” provisions in income tax treaties often provide that, if business profits include income of a type addressed in another article of the treaty (e.g., interest), the source country may tax that income to the extent provided in that other article. Thus, application of section 899 to any particular income might differ, depending on the specific language of a relevant treaty.
- **Structuring considerations.** Foreign-parented groups and funds that rely on treaty exemptions would need to consider whether to structure U.S. investments that could give rise to tax under section 899 through (1) a non-U.S. entity that does not act through a non-U.S. branch, (2) a non-U.S. entity that acts through a U.S. branch or (3) a U.S. subsidiary. Depending on how the investment is structured and the type of income the investment generates, the tax may be imposed on specific gross amounts paid (in the case of FDAP withholding, which generally would apply to a non-U.S. entity not acting through a U.S. branch) or ECI (which would apply to a non-U.S. entity acting through a U.S. branch and may have a larger base, depending on the circumstances, but would take into account certain deductions). Additionally, if structured as an investment by a U.S. subsidiary, the group may be able to better control the timing of when payments subject to tax under section 899 are made to non-U.S. entities within the group, e.g., in the form of dividends.

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Both U.S. issuers and non-U.S. lenders or counterparties should consider the potential impact of section 899 on the allocation of taxes in their loan agreements, derivative contracts and certain note offerings that provide for a "gross-up" for withholding taxes.

- **Agreements and offerings already in effect.** To the extent a loan agreement or a derivative contract with a U.S. borrower or counterparty includes a provision requiring a gross-up for certain withholding taxes, it is possible that if section 899 goes into effect, certain termination, change-in-law or other similar provisions could be triggered to the extent non-U.S. banks not acting through a U.S. branch are involved. In the context of certain notes offerings by U.S. issuers (such as foreign currency note offerings), to the extent section 899 triggers an obligation to pay additional amounts to holders, that may be a tax redemption event under the relevant indenture.
- **Agreements and offerings currently being negotiated.** Parties to a loan agreement or a derivative contract that is currently being negotiated should consider clarifying the allocation of potential taxes under section 899 should it be enacted, taking into account when such agreement or contract is expected to become effective. U.S. issuers and underwriters of notes offerings that contain a gross-up for U.S. withholding taxes (such as certain foreign currency note offerings) should consider how to allocate the risk of withholding taxes that would become payable under section 899.

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