Davis Polk

Senate tax bill retains provision targeting “unfair foreign taxes” with delayed effective date

June 18, 2025 | Client Update | 8-minute read

On June 16, 2025, the Senate Finance Committee released its version of the tax title of the House-passed One Big Beautiful Bill Act. The Senate text keeps the “revenge tax” provision that would increase U.S. withholding and other tax rates on residents of foreign countries that impose “unfair foreign taxes.” This update describes the key changes made to the provision in the Senate version, including changes that will delay the imposition of increased tax rates for many taxpayers.

Background

On May 22, 2025, the House of Representatives passed the One Big Beautiful Bill Act, which included proposed section 899 of the Internal Revenue Code (discussed here). Entitled “Enforcement of Remedies against Unfair Foreign Taxes,” section 899 would increase U.S. tax rates on certain non-U.S. persons, including both individuals and entities.

More specifically, the House version would target residents, and certain corporations majority owned by residents, of “discriminatory foreign countries,” by imposing increased tax rates on their U.S.-source interest, dividends and other “fixed, determinable, annual, or periodical income” (FDAP income), and on their 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). In addition, the House version would impose a more punitive version of the base erosion and anti-abuse tax (BEAT) – which is now being referred to as “Super BEAT” – on domestic corporations that are majority owned by residents of discriminatory foreign countries (other than certain publicly held corporations), and on U.S. branches of foreign corporations that are, or are majority owned by, residents of discriminatory foreign countries. The House version defined “discriminatory foreign countries” to include countries that imposed an undertaxed profits rule (or UTPR), a digital services tax (or DST), a diverted profits tax, or various other discriminatory or extraterritorial taxes within the discretion of the Treasury.

The Senate version retains section 899 and generally follows the same basic framework as the House version, but it differs from the House version in several important respects, including the scope of the provision, the extent of the increase in tax rates, and the effective date – the Senate version would delay implementation until 2027 for calendar taxpayers. As in the House version, however, certain key aspects of section 899 remain unclear. .

Key changes from the House version

Unfair foreign taxes

– The Senate version would impose increased tax rates on the U.S.-source interest, dividend and other FDAP income and ECI (and branch profits) of residents, and certain corporations majority owned by residents, of an “offending

Copyright 2025 Davis Polk & Wardwell LLP

foreign country" that imposes an "extraterritorial tax" (e.g., a UTPR). In contrast to the House version, the Senate version would *not* impose these increased tax rates on residents, or corporations majority owned by residents, of an "offending foreign country" that imposes a "discriminatory foreign tax" (e.g., a DST).

- Like the House version, the Senate version would apply the "Super BEAT" (discussed below) to domestic corporations majority owned by residents of offending foreign countries that impose *either* an extraterritorial tax (e.g., a UTPR) or a discriminatory tax (e.g., a DST).
- An "offending foreign country" is a country that imposes an "unfair foreign tax," which is either an extraterritorial tax (e.g., a UTPR) or a discriminatory tax (e.g., a DST). The Secretary will maintain a list of offending foreign countries and may designate additional countries as offending foreign countries.

Applicable persons

- Similar to the House version, the Senate version would apply to "applicable persons," defined as any individual (other than a citizen or resident of the United States) who is a tax resident of an offending foreign country, any foreign corporation (other than a United States owned foreign corporation) that is a resident of an offending foreign country, any foreign corporation (other than a publicly held corporation) if it is more than 50% owned (by vote or value) directly or indirectly by residents of an offending foreign country, and certain foreign trusts and other entities identified with respect to such an offending foreign country by the Secretary.

Observation: As drafted, the 50% ownership test would not apply to a publicly held foreign corporation, but it would apply to its non-publicly held domestic or foreign subsidiary. As a result, for purposes of determining whether the subsidiary is an applicable person (or subject to Super BEAT, discussed below) based on the ownership test, the draft appears to require looking through the foreign publicly held parent corporation to the shareholders of the foreign publicly held parent corporation, even if the publicly held parent corporation would itself have been exempt from the application of proposed section 899. For example, a publicly held Cayman parent company would not be an applicable corporation, but its Cayman subsidiary would be an applicable corporation if that Cayman parent were majority owned by applicable persons. Moreover, that Cayman parent's domestic subsidiary could be subject to the Super BEAT for the same reason. It is hard to see the justification for having the 50% ownership test apply in this manner, and it is hoped that this will be fixed in subsequent versions of the bill.

- The Senate version defines "publicly held corporation" to mean any corporation if at least 80 percent (by vote and value) of the corporation's stock is regularly traded on (i) a national securities exchange registered under section 6 of the Securities Exchange Act of 1934, or (ii) to the extent provided by the Secretary, any established securities market which satisfies regulatory requirements which are similar to the requirements that apply to an exchange described in (i).

Observation: It is not entirely clear how the "publicly held" test is to be applied, including (i) how to determine whether a corporation's stock that is listed on a specified stock exchange will be considered to be "regularly traded" on that stock exchange (in other contexts, "regularly traded" is usually defined by reference to listing and/or trading volume and frequency, although concentration of ownership is sometimes an exception to the general rule), and (ii) how to interpret the requirement that 80% of the corporation's stock be regularly traded. For example, this requirement could mean that a corporation with one or more significant shareholders who own, in the aggregate, more than 20% of the corporation's stock cannot satisfy the requirement that 80% of its stock be regularly traded and therefore cannot be a publicly held corporation.

Amount of increases in tax rates

- Under the Senate version, the increase in tax rates would generally be 5% in the first applicable year, 10% in the following year and 15% for any year thereafter, effectively capping the increase at 15% over the otherwise applicable tax rate (taking into account any rate applicable in lieu of the statutory rate, such as a treaty rate). By contrast, the House version provided for annual increases of 5% up to a cap of 20% over the applicable statutory rate (determined without regard to any rate applicable in lieu of the statutory rate, such as a treaty rate). By way of example, a withholding tax on interest or dividends that had been reduced to 0% under a treaty would eventually be increased to 50% under the House version (the 30% statutory rate, increased by the maximum 20%), whereas the same 0% rate would eventually be increased to 15% under the Senate version (the 0% treaty rate, increased by the maximum 15%).

Exceptions to increase in tax rates

Copyright 2025 Davis Polk & Wardwell LLP

- It was unclear how the increases in tax rates in the House version interacted with various statutory and treaty exemptions and reductions.
- The Senate version clarifies that if one of the enumerated exceptions discussed below applies, section 899 will not impose any incremental tax. In any other case where a withholding tax (or certain other taxes) is not imposed "by reason of an exemption or exception," or is imposed at a rate of zero (including under a tax treaty), an incremental 5-15% increase would be imposed on that otherwise applicable reduced or zero rate.
- The Senate version provides that certain amounts are not subject to increased tax rates under section 899. These amounts include (i) original issue discount otherwise excluded from tax under existing rules, (ii) portfolio interest, (iii) interest on deposits (if such interest is not ECI), (iv) certain interest-related dividends received from a regulated investment company and (v) other amounts specified by the Secretary.

Elimination of section 892 exemption

- Section 892 generally exempts from tax passive income generated by foreign governments (including their sovereign wealth funds) on their U.S. investments.
- The House version would eliminate this exemption for governments of countries with any discriminatory foreign tax, while the Senate version would eliminate the exemption only for governments of countries with an extraterritorial tax (e.g., a UTPR).

Super BEAT

- The Senate version generally retains Super BEAT as applied to certain U.S. corporations (and foreign branches of certain foreign corporations), with some changes. As noted above, for purposes of determining whether a corporation is an "applicable corporation" which is subject to Super BEAT, the relevant offending foreign countries include countries with either "extraterritorial taxes" (e.g., UTPRs) or "discriminatory taxes" (e.g., DSTs), or both.

	The House version	**The Senate version**
Threshold for applying "Super BEAT"	Eliminates the base erosion percentage threshold and gross receipts requirement for BEAT to apply	Eliminates the gross receipts requirement; retains the base erosion percentage requirement for BEAT to apply, but reduces the threshold to 0.5% (in separate amendments to the BEAT rules, the Senate Bill reduces the threshold to 2% for all taxpayers not subject to Super BEAT)
BEAT tax rate	12.5% (the current BEAT rate is 10%, which the House version would increase to 10.1% for all taxpayers not subject to Super BEAT)	Same as the generally applicable BEAT rate (which in the Senate version is proposed to be increased to 14%)
Calculation of BEAT	Expanded the amount of income that would be subject to BEAT, including by treating certain capitalized amounts as if such amounts had been deducted rather than capitalized, and disregarding certain tax credits in calculating the amount of BEAT	Same; notably, the Senate version adopts the House version's approach of disregarding certain tax credits in calculating the amount of BEAT

Applicable years

Both the House version and the Senate version have different rules for withholding taxes and other taxes. For applicable persons in countries that have already enacted unfair foreign taxes:

- The House version's increased rates of withholding tax would apply to payments made during the first calendar year beginning 90 days after enactment, and the other increased rates of tax would apply to each applicable person's first

Copyright 2025 Davis Polk & Wardwell LLP

taxable year beginning 90 days after enactment; and

- The Senate version's increased rates of withholding tax would apply to payments made during the first calendar year beginning after the one-year anniversary of enactment, and the other increased rates of tax would apply to each applicable person's first taxable year beginning after the one-year anniversary of enactment.

  Observation: For calendar year taxpayers, the Senate version would not apply before 2027.

Copyright 2025 Davis Polk & Wardwell LLP

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

William A. Curran
+1 212 450 3020
william.curran@davispolk.com

Lucy W. Farr
+1 212 450 4026
lucy.farr@davispolk.com

Judith Fiorini
+1 212 450 4294
judith.fiorini@davispolk.com

David S. Fisher
+1 212 450 3948
david.fisher@davispolk.com

Ethan R. Goldman
+1 212 450 4523
ethan.goldman@davispolk.com

Corey M. Goodman
+1 212 450 3521
corey.goodman@davispolk.com

Yixuan Long
+1 212 450 3410
yixuan.long@davispolk.com

Michael Mollerus
+1 212 450 4471
michael.mollerus@davispolk.com

Kara L. Mungovan
+1 212 450 3454
kara.mungovan@davispolk.com

David H. Schnabel
+1 212 450 4910
david.schnabel@davispolk.com

Patrick E. Sigmon
+1 212 450 4814
patrick.sigmon@davispolk.com

Aliza Slansky
+1 212 450 3054
aliza.slansky@davispolk.com

Mario J. Verdolini
+1 212 450 4969
mario.verdolini@davispolk.com

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's privacy notice for further details.

Copyright 2025 Davis Polk & Wardwell LLP