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Client Alert

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United States: A Closer Look at How Proposed Section 899 Would Increase Tax Rates for Certain Non-US Persons and Governments

Tax News and Developments May 2025

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In Brief

On May 22, 2025, the House passed the One Big Beautiful Bill Act of 2025 as modified by the manager's amendment from the Rules Committee. No modifications were made to the retaliatory tax provision in proposed section 899, which has garnered interest from US inbound companies.

Section 899

The House bill includes an updated version of proposed section 899, a provision aimed at retaliating against the Under Taxed Profits Rule (**UTPR**) under the OECD's Pillar Two project, as well as unilateral measures, such as Digital Services Taxes (**DSTs**). Chairman Smith previously proposed section 899 both earlier this year and in 2023. For our analysis of the version of section 899 proposed earlier this year, see our client alert, "House bill would target 'extraterritorial' or 'discriminatory' taxes, including UTPRs, DSTs, and other measures." The present version includes several modifications that we understand were necessary for the provision to withstand Byrd rule scrutiny in the Senate. For more on the reconciliation process, see our reconciliation refresher. The provision was also expanded to address additional considerations, and to include elements of Representative Estes' "Unfair Tax Prevention Act," which uses a strengthened BEAT to respond to UTPRs and other “unfair foreign taxes.”

Treasury Reports

One major structural change in section 899 as included in the House bill is that the original language directing Treasury to issue periodic reports listing jurisdictions with offending measures has been removed with respect to UTPRs, DSTs, and the diverted profits tax (**DPT**). Such taxes are now deemed to be an “unfair foreign tax.” We understand that the prior structure made it difficult to determine the economic effects of the provision (because the scope of the provision's application would be at the discretion of the Secretary), thus raising potential Byrd rule issues. The provision has thus been restructured, at least in part, to have a more definitive scope.

The text still requires the Secretary to issue quarterly reports listing "discriminatory foreign countries." This requirement is embedded in the grant of regulatory authority, which provides that the Secretary "shall issue regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section," including to prevent the avoidance of the purposes of section 899. As will be discussed below, while section 899 would apply automatically with respect to most residents of foreign countries that have enacted a UTPR, DST, or DPT, section 899 can apply to additional jurisdictions based on these periodic reports from Treasury.

Definition of "Unfair," "Extraterritorial," and "Discriminatory" Taxes

Modified section 899 is still aimed at "extraterritorial" and "discriminatory" taxes, but frames both categories as "unfair foreign taxes." This new defined term specifically includes UTPRs, DSTs, and DPTs. Further, the provision states that "unfair foreign taxes" also include:

> [T]o the extent provided by the Secretary, an extraterritorial tax, discriminatory tax, or any other tax enacted with a public or stated purpose indicating the tax will be economically borne, directly or indirectly, disproportionately by United States persons.

Thus, section 899 should apply automatically, without need for Treasury action, to residents of countries that have enacted UTPRs, DSTs, and DPTs ("**per se unfair foreign taxes**"). Importantly, the bill does not define the terms UTPR, DST, or DPT. In contrast, section 899 applies with respect to jurisdictions that have enacted tax measures (other than per se unfair foreign taxes) only if Treasury determines that the tax measure constitutes an extraterritorial or discriminatory tax, or that the tax measure is enacted with the overt intent for the tax to be economically borne disproportionately by US persons.

Specifically excluded from the definition of “unfair foreign tax” is any tax that does not apply to a US person (including a trade or business of a US person) or any foreign corporation (including a trade or business of such foreign corporation) if the foreign corporation is a CFC and more than 50% of the vote or value of such corporation is owned (within the meaning of section 958(a)) by US persons. The prior version of section 899 would have applied regardless of whether a particular foreign tax was extraterritorial or discriminatory as applied to US persons.

The House bill retains the prior definition of an "**extraterritorial tax**":

> Any tax imposed by a foreign country on a corporation (including any trade or business of such corporation) which is determined by reference to any income or profits received by any person (including any trade or business of any person) by reason of such person being connected to such corporation through any chain of ownership, determined without regard to the ownership interests of any individual, and other than by reason of such corporation having a direct or indirect ownership interest in such person.

It is not clear which taxes are intended to be caught by the definition of “extraterritorial tax” that would not also satisfy the definition of a "discriminatory tax" (discussed immediately below) beyond a UTPR, which as discussed above, is now automatically deemed to be an “unfair foreign tax.” Because the bill does not define a UTPR, it may be that this definition is a backstop in the event other taxes that are not called UTPRs operate in the same manner.

The definition of a "**discriminatory tax**" remains mostly the same. The new version defines a discriminatory tax as a tax imposed by a foreign country that satisfies any one or more of the following criteria:

1. The tax applies "more than incidentally" to items of income that would not be considered to be from sources, or effectively connected to a trade or business, within the foreign country imposing the tax, if the foreign country applied the applicable US rules on source and nexus;
2. The tax is imposed on a base other than net income and is not computed by permitting recovery of costs and expenses;
3. The tax is exclusively or predominantly applicable, in practice or by its terms, to nonresident individuals and foreign corporations or partnerships because of the application of revenue thresholds, exemptions or exclusions for taxpayers subject to such foreign country's corporate income tax, or restrictions of scope that ensure that substantially all residents (other than foreign corporations and partnerships) supplying comparable goods or services are excluded from application of such tax;
4. The tax is not treated as an income tax under the laws of the foreign country or is otherwise treated by the foreign country as outside the scope of double tax treaties.

The first category of discriminatory taxes described above appears to capture a foreign country’s imposition of an indirect s tock transfer tax. For example, assume that a US parent company ("**USP**") directly wholly owns stock of a CFC organized under the laws of country X (“**CFC X**”). CFC X in turn directly wholly owns the stock of a CFC organized under the laws of country Y (“**CFC Y**”). CFC X sells some or all of its stock in CFC Y. Pursuant to the tax treaty between country X and country Y, capital gains derived by CFC X are exempt from country Y’s capital gains tax on nonresidents. However, pursuant to country Y’s indirect stock transfer tax, country Y imposes its capital gains tax on USP. The tax treaty between the United States and country Y permits each contracting state to tax capital gains in accordance with its domestic law. Because country Y’s capital gains tax applies to items of income (i.e., capital gains from the sale of stock) that would not be considered to be from sources within country Y or effec tively connected with a trade or business within country Y, the capital gains tax likely constitutes a “discriminatory tax.” Thus, payments to a resident of Country Y could be subject to the penalty provisions of section 899.

The definitions of “extraterritorial tax” and discriminatory tax” include several new exceptions, which apply except as otherwise provided by Treasury including:

- an income tax generally imposed on the income of citizens or residents, even if the computation of income includes payments that would be foreign source income under US sourcing rules;

- an income tax that would be an "unfair foreign tax" solely because it is imposed on the income of nonresidents attributable to a trade or business in the foreign country;
- an income tax which would be an "unfair foreign tax" solely because it is imposed on citizens or residents of the foreign country by reference to the income of a corporate subsidiary of such person (apparently to allow for the imposition of tax under the Income Inclusion Rule (IIR) of the GloBE/Pillar Two Model Rules); and
- a tax which would not be an extraterritorial or discriminatory tax except by reason of consolidation or loss sharing rules that generally apply only with respect to income of tax residents of the foreign country.

The bill retains the other prior exceptions for consumption taxes, ad valorem or per-transaction taxes, and taxes on real or personal property (presumably regardless of whether the tax is only assessed by a direct sale of stock of a corporation holding such real estate or, alternatively, is assessed on indirect sales of such stock). The bill expands this last exception to include state, gift and similar taxes. The bill also modifies the exception for withholding taxes on amounts described in sections 871(a)(1) and 881(a) (i.e., FDAP income). Such exception for withholding taxes does not apply to “any withholding taxes, or other gross basis tax, imposed with respect to services performed by persons other than individuals.” Thus, a foreign country’s withholding tax that is imposed on the cross-border payment of services based on the residence of the payor (rather than by reference to the place-of-performance of such services) is presumably a “discriminatory tax” because, applying US sourcing principles, such services income would not be sourced to such foreign country. Finally, the bill provides a general exception for "any other tax identified by the Secretary."

Imposition of Increased Rates of Tax

The House bill retains the same retaliatory mechanism as in prior versions of section 899, with some modifications. It provides for increased rates of tax with respect to income taxes, withholding taxes, and dispositions and distributions related to United States real property interests. In each case, the rate increases by the "applicable number of percentage points," which starts at 5 percentage points and increases by 5 percentage points "for each annual anniversary" of the "applicable date."

Notably, the House bill does not include the language from the prior version of section 899 which explicitly overrode potentially applicable treaties. Specifically, the prior version provided that the increased rate would not take into account reductions under treaties for withholding taxes under sections 1441(a) and 1442(a). This could have run afoul of the Byrd rule because the Senate Foreign Relations Committee has primary jurisdiction over tax provisions affecting US income tax treaties. The budget resolution that initiated the reconciliation process does not include a reconciliation instruction for the Senate Foreign Relations Committee. Under the Byrd rule, provisions that are outside the jurisdiction of the committee considering the provision are not germane and are at risk of being struck from the bill. Taking this risk into account may explain why the House chose to remove any reference to an *explicit* treaty override in the bill.

A new provision limits the increased rate, stating that the increase "shall not result in such rate exceeding the amount of the statutory rate (determined without regard to any rate applicable in lieu of such statutory rate) increased by 20 percentage points." Although the "any rate applicable in lieu of such statutory rate" language does not explicitly provide for a treaty override, it would appear to implicitly do so. For example, assume that a US tax treaty provision provides for a reduced 5% tax with respect to dividends. It would appear that the maximum rate of US withholding tax under section 899(a)(4)(B) is 50% regardless of the treaty, starting with a 10% rate in the first applicable year and increasing by 5% each year thereafter.

Inclusion of Rep. Estes' "Super BEAT" Proposal

The House also made a surprising addition to section 899 that incorporates aspects of Rep. Estes' "Unfair Tax Prevention Act," which was introduced earlier this year and in 2023. Rep. Estes' original proposal used modifications to the BEAT to respond to the imposition of UTPRs. The House bill merges this so-called "super BEAT" proposal into section 899 by applying its provisions to corporations owned or controlled by foreign companies resident in jurisdictions that have enacted "unfair foreign taxes."

Specifically, the House bill includes Rep. Estes proposal to eliminate the $500M gross receipts test and the 3% base erosion percentage threshold requirement for a corporation to be subject to the provision. It would also apply a 12.5% BEAT rate, instead of the 10% BEAT rate. Further, the provision would adopt the approach under the Estes bill to turn off certain provisions within the BEAT that lessen its impact, including provisions that exclude: (i) any base erosion tax benefit attributable to a base erosion payment if withholding tax applies to the payment, (ii) base erosion payments for amounts that qualify under the services cost method, and (iii) payments made at cost. The House bill does not include the portion of the original Estes bill that deemed 50% of the entity's cost of goods sold (COGS) to be a base erosion tax benefit with respect to a base erosion payment.

A new component of this section 899 BEAT provision establishes that the amount described in section 59A(b)(1)(B)(ii) (i.e., the favored credits in the BEAT calculation) will be zero. In addition, the provision includes a new feature that establishes that if any amount (other than the purchase price of depreciable or amortizable property or inventory) would have been a base erosion payment but for the fact that the taxpayer capitalizes the amount, then such amount is treated as if it is deducted rather than capitalized (for purposes of determining base erosion payments and base erosion tax benefits).

This new section 899 BEAT provision applies to any corporation described in section 899(b)(1)(E), applied by substituting "corporation" for "foreign corporation." Section 899(b)(1)(E), as modified, describes the following:

> [A] ny ~~foreign~~ corporation (other than a publicly held corporation) if more than 50 percent of—
>
> (i) the total combined voting power of all classes of stock of such corporation entitled to vote, or
>
> (ii) the total value of the stock of such corporation, ***is owned (within the meaning of section 958(a)) by persons described in this paragraph***.

We note that this emphasized language refers to the paragraph describing the various categories of "applicable persons." This means that the "super BEAT" provision is aimed at corporations controlled, generally, by persons from "foreign discriminatory countries." This should be distinguished from the withholding tax provisions, which focus on payments to any "applicable person."

Consider the following example: USCo is wholly owned by SwissCo. SwissCo also wholly owns UKCo. USCo makes deductible royalty payments to UKCo that would constitute base erosion payments for purposes of the BEAT. Assume that Switzerland does not have any "unfair foreign tax" and is therefore not a "discriminatory foreign country." Further assume that SwissCo is not a United States-owned foreign corporation (as defined in section 904(h)(6)). Assume that the United Kingdom is a discriminatory foreign country. The super BEAT provisions of section 899 ought not to apply because not more than 50% of the vote or value of USCo is owned (within the meaning of section 958(a)) by an "applicable person" (i.e., SwissCo is not an applicable person because it is not a foreign corporation tax resident in a discriminatory foreign country). However, such royalty payments likely would still be subject to increased withholding taxes because UKCo is an "applicable person" (i.e., UKCo is a resident of a discriminatory foreign country). Alternatively, if Swiss Co owns UKCo which owns USCo, then the royalty payment from USCo to UKCo would likely be subject to the super BEAT provisions because USCo would be more than 50% owned (within the meaning of section 958(a)) by UKCo, a foreign corporation that is a tax resident of a discriminatory foreign country (i.e., the UK). In addition, the increased withholding taxes would likely apply because the payment is made to a foreign corporation that is a tax resident of a discriminatory foreign country. Similarly, if UKCo were the ultimate parent and SwissCo was an intermediate holding company for USCo, then the royalty payments to SwissCo would likely also be subject to both the super BEAT provisions as well as increased withholding taxes, even though Switzerland is assumed not to be a discriminatory foreign country.

"Applicable Person" Definition

Section 899 applies to any "applicable person." This term is defined to include:

- Any government (within the meaning of section 892) of any "discriminatory foreign country" (defined as any foreign country which has one or more unfair foreign taxes);[1]
- Any individual (other than a citizen or resident of the United States) who is a tax resident of a discriminatory foreign country);
- Any foreign corporation (other than a "**United States-owned foreign corporation**," as defined in section 904(h)(6)) which is a tax resident of a discriminatory foreign country;
- Any private foundation (within the meaning of section 4948) created or organized in a discriminatory foreign country;

[1] The definition of "applicable person" in the prior version of section 899 did not explicitly include a foreign government within the meaning of section 892.

- Any foreign corporation (other than a publicly held corporation) if more than 50% of (i) the total combined voting power of all classes of stock, or (ii) the total value of the stock of such corporation, is owned (within the meaning of section 958(a)) by applicable persons;
- Any trust the majority of the beneficial interests of which are held (directly or indirectly) by applicable persons; and
- Foreign partnerships, branches, and any other entity identified with respect to a discriminatory foreign country by the Secretary.

The House bill clarifies that, if a person ceases to be an "applicable person" for a period of less than one year, the person continues to be treated as an applicable person during that period.

We note that the reference to section 904(h)(6) appears to exclude certain United States-owned foreign corporations from the application of section 899. The prior version of section 899 referenced a “specified 10-percent owned foreign corporation,” as defined in section 245A(b), which requires ownership by a domestic corporation that is a “United States shareholder” (as defined in section 951(b)). In contrast, section 904(h)(6) defines a "United States-owned foreign corporation" as any foreign corporation if 50% or more of (i) the total combined voting power of all classes of stock of such corporation entitled to vote, or (ii) the total value of the stock of such corporation, is held directly or indirectly (pursuant to section 958(a)(2) and (3) and section 318(a)(4)) by United States persons.

Applicable Date

This new version of section 899 includes more complex provisions for establishing the applicable date. Section 899(a) establishes two sets of applicable date rules – one for purposes of determining the "applicable number of percentage points," and the other for purposes of determining when those increased rates begin to apply. More specifically, the provisions establishing increased rates of tax for income taxes and imposing the modified BEAT apply to each taxable year beginning after the later of (1) 90 days after the date of enactment of section 899, (2) 180 days after the date of enactment of the unfair foreign tax that causes such country to be treated as a discriminatory foreign country, or (3) the first date that an unfair foreign tax of such country begins to apply, and before the last date on which the discriminatory foreign country imposes an unfair foreign tax.

In contrast, the provisions applying increased rates of withholding apply to each calendar year beginning during the period that the person is an applicable person. The bill establishes two safe harbors with respect to withholding that can modify this applicable date. First, the withholding provisions shall not apply if the discriminatory foreign country with respect to the applicable person is not listed by the Secretary as a discriminatory foreign country. Further, withholding does not apply to foreign corporations and trusts that are applicable persons due to the fact that they are owned by applicable persons if the discriminatory foreign country has been listed by the Secretary for less than 90 days. The bill also establishes a temporary safe harbor for withholding agents. Under this safe harbor, no penalties or interest shall be imposed for failures to deduct or withhold any amounts if the withholding agent demonstrates to the satisfaction of the Secretary that the agent made best efforts to comply with the increased rates for withholding in a timely manner. This safe harbor applies only to failures to withhold before January 1, 2027.

As noted above, the bill also establishes separate applicable date rules for purposes of determining the applicable number of percentage points. For this purpose, "applicable date" means, with respect to a discriminatory country, the first day of the first calendar year beginning on or after the latest of:

- 90 days after the date of enactment of section 899
- 180 days after the date of enactment of the unfair foreign tax that causes such country to be treated as a discriminatory foreign country, or
- The first date that an unfair foreign tax of such country begins to apply.

When applied to the provisions for increased rates on income taxes, the applicable number of percentage points is the applicable number of percentage points in effect for the discriminatory foreign country during the taxpayer's taxable year. If more than one applicable number of percentage points is in effect for the discriminatory foreign country during the taxpayer's taxable year (*e.g.*, for a taxpayer with a taxable year different than the calendar year), a weighted average must be applied. This is based on the number of days during the taxable year that each applicable number of percentage points applied. When applied to withholding taxes, the applicable number of percentage points is determined with respect to the date of the payment or disposition.

To illustrate how the applicable date provisions would apply, we will consider a series of examples.

Example 1: Withholding on payments to foreign corporation resident in country with existing DST.

Facts: X Corporation is a resident in Country A, which enacted a DST. Country A has been imposing and collecting its DST for five years. X Corporation's taxable year begins on July 1. X Corporation receives US source royalty payments. We will assume, for purposes of this example, that section 899 is enacted by July 4, 2025.

Analysis: Corporation X should be an applicable person, because it is a foreign corporation that is tax resident in a discriminatory foreign country, Country A. Pursuant to the applicable date provisions discussed above, the withholding provisions will apply to each calendar year beginning during the period that such person is an applicable person. Corporation X will become an applicable person upon enactment of section 899. Thus, the provisions applying increased rates of withholding should begin to apply in calendar year 2026, as it is the first calendar year beginning during Corporation X's first taxable year that it is an applicable person. Further, the applicable number of percentage points is determined upon the date of the royalty payments paid to Corporation X.

Example 2: Income tax imposed on foreign corporation (resident in a country with a DST) with a US trade or business.

Facts: Same as Example 1, except that X Corporation has business activities in the United States that rise to the level of a US trade or business.

Analysis: Corporation X should be an applicable person, because it is a foreign corporation that is tax resident in a discriminatory foreign country, Country A. Pursuant to the applicable date provisions discussed above, the increased rates of tax for the income effectively connected with Corporation X's US trade or business will apply to Corporation X's taxable year beginning after the later of (1) 90 days after the enactment of section 899 (here, October 2, 2025); (2) 180 days after the date of enactment of the Country A DST; or (3) the first date that the Country A DST began to apply. Because Country A has been imposing its DST for 5 years, the second and third dates have passed. Thus, the increased rates will apply to Corporation X's taxable year beginning after October 2, 2025 (*i.e.,* increased rates would not apply until July 1, 2026).

Example 3: Withholding tax imposed on foreign corporation resident in country that repeals its DST.

Facts: Same as Example 1, except that Country A repeals its DST on December 31, 2025. Country A has no other unfair foreign taxes.

Analysis: Corporation X should be an applicable person from enactment of section 899 on July 4, 2025, until repeal of the Country A DST on December 31, 2025. Country A should no longer be considered a discriminatory foreign country after it repeals its DST, because it does not impose any other unfair foreign taxes. Pursuant to the applicable date provisions discussed above, the withholding provisions will apply to each calendar year beginning during the period that such person is an applicable person. Corporation X became an applicable person upon enactment of section 899 and is no longer an applicable person as of December 31, 2025. If the provisions applying increased rates of withholding were to begin to apply, it would be in calendar year 2026, as it is the first calendar year beginning during Corporation X's first taxable year that it is an applicable person. This provision does not explicitly state when the increased rates of withholding would no longer be applied if the foreign country were to no longer be a discriminatory foreign country. However, the applicable number of percentage points is determined on the date of payments. Further, section 899 provides that the applicable number of percentage points for a foreign country that is not a discriminatory foreign country is zero. Thus, Corporation X should not be subject to increased rates of withholding after the repeal of the Country A DST. We note that the safe harbors for withholding may also provide relief from withholding in this situation, depending on whether or when Country A is listed by the Secretary in his quarterly report.

Next Steps

The House bill including section 899 will need to be considered by the Senate. It is possible that the Senate will offer additional changes to section 899 or clarifications with respect to certain of the issues addressed above. We will continue to closely monitor the legislation.

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