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CLIENT ALERT

Federal Tax Rates For Many Non-U.S. Individuals And Entities Set To Increase With Proposed House Bill

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Executive Summary

On May 22, 2025, the U.S. House of Representatives approved the “One Big Beautiful Bill Act” (the “Bill”),[1] which proposes, among other measures, to add a new Section 899 to the Internal Revenue Code (the “Code”).[2] This provision, if enacted, is likely to increase U.S. federal tax rates on individuals and entities located in countries deemed to be “discriminatory foreign countries” having “unfair foreign taxes,” including countries with undertaxed profits rules (under OECD Pillar Two), digital service taxes, and diverted profit taxes, as well as certain other tax rules. In this client alert, we highlight the key considerations of Section 899, outline their practical consequences, and flag other factors that clients should consider while preparing for the potential enactment of Section 899.

1 One Big Beautiful Bill Act, H.R.1, 119th Cong. (as passed by the House of Representatives, May 22, 2025) (hereinafter “Bill”).

2 Bill § 112028(a) (proposing to amend the Code to add Section 899, “Enforcement of Remedies Against Unfair Foreign Taxes”).

1. Section 899 Generally

Proposed Section 899 is intended to provide a legislative response to what the Trump administration views as "unfair" foreign tax regimes, enforced against U.S. individuals and entities operating in such foreign jurisdictions.[3]

For certain "applicable persons," the provision proposes to increase a broad number of U.S. federal tax rates generally by 5% per year, with such increase capped at 20% over the statutory rate. These include, among others, (i) withholding tax rates on U.S.-source interest, dividends, and other "fixed, determinable, annual, or periodical" ("FDAP") income; (ii) tax rates on "effectively connected income" ("ECI"), including branch profits tax rates, but, for individuals, generally limited to gains and losses on dispositions of U.S. real property interests; (iii) private foundation excise tax on gross investment income; and (iv) certain tax rates otherwise reduced or set to 0% as part of a tax treaty with certain foreign jurisdictions.

Applicable Person

Section 899 applies to "applicable persons," defined as follows:

- Any government (within the meaning of Section 892) of any discriminatory foreign country;
- Any individual, other than a U.S. citizen or resident, who is a tax resident of a discriminatory foreign country;
- Any foreign corporation, other than a U.S.-owned foreign corporation as defined in Section 904(h)(6), which is a tax resident of a discriminatory foreign country. Section 904(h)(6) requires more than 50% ownership by U.S. persons by vote or value, and contains constructive ownership rules to determine such U.S. ownership;
- Any private foundation (within the meaning of Section 4948) created or organized in a discriminatory foreign country;
- Any foreign corporation, other than a publicly held corporation, if more than 50% of the vote or value of its stock is owned, directly or indirectly under certain attribution rules, by applicable persons (a "Majority-Foreign-Owned Non-Public Corporation");
- Any trust in which the majority of beneficial interests 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.

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[3] *Ways and Means Republicans Introduce Legislation to Reinforce Trump Administration's Rejection of Biden Global Tax Surrender*, UNITED STATES HOUSE COMMITTEE ON WAYS & MEANS (January 22, 2025), https://waysandmeans.house.gov/2025/01/22/ways-and-means-republicans-introduce-legislation-to-reinforce-trump-administrations-rejection-of-biden-global-tax-surrender/ .

Discriminatory Foreign Country

A "discriminatory foreign country" is any foreign country which has one or more "unfair foreign taxes." Countries likely to be considered "discriminatory foreign countries" include, but are not limited to, Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Hungary, India, Ireland, Israel, Italy, Luxembourg, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, South Korea, Spain, Sweden, Thailand, Turkey, the United Kingdom, and Uruguay.

Unfair Foreign Tax

Unfair foreign taxes include:

- Undertaxed profits rules ("UTPRs");
- Digital services taxes ("DSTs");
- Diverted profits taxes ("DPTs"); and
- Extraterritorial taxes, discriminatory taxes, or any other tax enacted with a public or stated purpose indicating the tax will be economically borne, directly or indirectly, disproportionately by U.S. persons. Extraterritorial taxes and discriminatory taxes are defined in further detail in the Bill.

Increases in Federal Tax Rates

For all "applicable persons" under Section 899, the provision increases existing tax rates provided in certain provisions, including the following:

- 30% withholding tax rate imposed on FDAP and certain other types of capital gains or U.S.-source income made to an applicable person, under Section 1441(a) or 1442(a);[4]
- 15% withholding tax rate (or other applicable rates) applicable to dispositions of U.S. real property interests ("USRPIs") by an applicable person, under Section 1445(a) and (e);
- Individual income tax rates imposed on a nonresident alien individual's ECI (but only to the extent of gains from the disposition of USRPIs);
- 21% tax rate imposed on a foreign corporation's ECI;
- 30% branch profits tax on foreign corporations;

4 Existing regulations expressly carve out certain amounts from being considered as FDAP income—for instance, original issue discounts, interest on bearer bonds, and insurance and reinsurance premiums subject to federal excise tax are each excluded. Treasury Regulations § 1.1441-2(a)(1–8). Accordingly, the increased tax rates should generally not apply to such amounts.

- Applicable withholding rates on ECI allocable by a partnership to foreign partners, under Section 1446(a); and

- 4% tax rate imposed on U.S.-source gross investment income of foreign private foundations, not including unrelated business taxable income.

Each of such tax rates will be increased by an "applicable number of percentage points" in effect with respect to the relevant discriminatory foreign country during the taxpayer's tax year. The "applicable number" is generally 5 percentage points during the first one-year period beginning on the applicable date, increasing by an additional 5 percentage points for every subsequent one-year period, up to a maximum of an additional 20 percentage points. For instance, for an applicable person with regard to a discriminatory foreign country, the U.S. tax rate on FDAP income, e.g., dividends, will increase from 30% to 35% in 2026, to 40% in 2027, to 45% in 2028, and cap out at 50% in 2029 and onwards, with the rate increases starting on January 1, 2026.

Furthermore, in cases where another tax rate applies in lieu of the statutory rate—"such as pursuant to a treaty obligation of the United States"[5]—that rate of tax would be subject to the increase. As drafted, the "20 percentage point" cap on increases will be with respect to the statutory rate, rather than a rate in lieu of such statutory rate, such as a treaty rate. In other words, if there is a 0% treaty rate on FDAP income instead of a 30% rate, the relevant tax rate on applicable persons will increase up to a cap of 50% (20 percentage points over 30%), rather than 20% (20 percentage points over 0%).

Expansion of BEAT

As drafted, Section 899 would broaden the application of the base erosion and anti-abuse tax (BEAT). Currently, only corporations that meet the US$500 million current average annual gross receipt test and the 3% base erosion percentage test are subject to BEAT.[6] Enacting Section 899 would increase the BEAT rate from 10% to 12.5%. BEAT would also be presumed to apply to all Majority-Foreign-Owned Non-Public Corporations,[7] regardless of if they meet the thresholds set by the aforementioned tests. Furthermore, for such corporations, certain exceptions to base erosion payments will be eliminated.[8] Any amounts, other than the purchase price of depreciable or amortizable property, that would have been a base erosion payment but for the fact that the amount was capitalized, would be treated as if they had been deducted rather than capitalized (and thus included in the calculation for BEAT).

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5 Joint Committee on Taxation*, Description of the Tax Provisions of the Chairman's Amendment in the Nature of a Substitute to the Budget Reconciliation Legislative Recommendations Related to Tax* (May 12, 2025) at 368.

6 *See* § 59A(e)(1)(B), (C).

7 *See* "*–Applicable Persons*," *supra*. This also includes U.S. subsidiaries of certain foreign-parented groups.

8 These include exceptions for amounts taxed under §§ 871 and 881, amounts withheld under §§ 1441 and 1442, and amounts paid or accrued for services eligible for the services cost method under § 482.

2. Key Considerations

Private Equity and Private Credit Funds

While Section 899 would be a significant departure from current U.S. tax law and policy, its impact on many private equity and private credit investors is less significant than it may appear. Private equity funds generate the majority of their returns through the sale of portfolio companies, and other than in the case of U.S. real property holding companies, non-U.S. investors will continue to be free from U.S. taxes on such a sale. Similarly, private credit funds typically rely on the "portfolio interest exemption," discussed below, which exempts non-U.S. investors from withholding taxes on portfolio interest, typically a significant portion of the returns for private credit funds. Dividends are one area where Section 899 will have an impact. Many private equity portfolio companies engage in leveraged distributions, which are taxable as dividends to the extent of the portfolio company's current or accumulated earnings and profits. Dividends paid to non-U.S. investors that are impacted by Section 899 would have an increased withholding tax rate. If Section 899 is enacted, private equity funds should be mindful of the increased tax burden on their affected non-U.S. investors before engaging in leveraged distributions.

Portfolio Interest Exemption and Certain Other Exemptions Appear Not to Be Impacted

Because Section 899 refers to increases in "rates" of taxes, it appears that certain exemptions from taxes may still apply that would prevent the application of Section 899, such as the "portfolio interest exemption" preventing U.S. withholding tax on certain U.S.-source interest income under Sections 871(h) and 881(c) of the Code.[9] Other exemptions that appear to continue to apply include exemptions for bank deposit interest under Sections 871(i) and 881(d) of the Code, exemptions for interest-related dividends under Sections 871(k)(1) and 881(e)(1) of the Code, and exemptions for qualified foreign pension funds under Section 897(l).

Reinsurance and insurance premium payments paid to foreign insurers or reinsurers should also continue to be subject to federal excise tax but not U.S. withholding tax, so should not be subject to Section 899.

Treaty language similarly may provide an exemption from certain taxes. For example, the business profits articles in some treaties exempt such income from U.S. tax if not attributable to a U.S. permanent establishment or U.S. fixed base. However, it is yet unclear to what extent such treaty exemptions will also prevent application of Section 899.

Foreign Government Entities Impacted

Under the proposed Section 899 as drafted, Section 892 of the Code—which exempts foreign governments from U.S. federal income tax on certain U.S. source income—will not apply to governments of "discriminatory foreign

9 *See* H.R. REP. NO. 119-106, pt. 2, at 462 (2025) n.1533 ("Because the provision only increases the specified rates of tax, it does not apply to income that is explicitly excluded from the application of the specified tax [such as portfolio interest] . . . . Contrast certain categories of income that are subject to a reduced or zero rate of tax in lieu of the statutory rate, such as amounts that are exempted or subject to a reduced or zero rate of tax under a treaty obligation.").

countries." As a result, government entities of such countries, including sovereign wealth funds, will no longer be exempt from U.S. taxes under Section 892, a significant departure from current law.

Foreign-Owned Groups With U.S. Businesses or U.S. Investments May Be Impacted

Foreign controlled entities that are "applicable persons," i.e., deemed located in "discriminatory foreign countries" or controlled by "applicable persons" that are so located, may have an increased tax rate on U.S. investments or businesses under Section 899. This includes such foreign entities that rely on treaties to reduce or eliminate U.S. taxation. Should Section 899 be enacted, foreign-parented groups and entities, including those that rely on preferential treaty rates, should re-examine available options in structuring their U.S. investments. Income generated by U.S. investments may, depending on the structure, be characterized as (i) FDAP income subject to the new rate, e.g., dividends, or (ii) ECI subject to the new rate, e.g., if there is a U.S. business in a U.S. branch of a non-U.S. entity. Multiple considerations may determine the optimal form of ownership of U.S. investments or businesses under Section 899. For example, conducting U.S. business activities through a U.S. branch generating ECI may be preferable despite the new rate if the taxpayer has certain deductions available to reduce such a tax base or if a treaty still provides some further relief. Dividends from a U.S. subsidiary would be taxed on a gross basis and be subject to the new Section 899 rate, but the taxpayer may have more control over the timing of the application of the higher rate, and a treaty may also provide some relief for a period of time.[10] Changes in the character of the relevant income may change the overall tax liability as a result of the proposed Section 899.

Cross-Border Lending and Derivative Agreements Impacted

Credit agreements typically require lenders to be indemnified by a U.S. borrower for U.S. withholding taxes imposed on payments on the loan after a change in law. Non-U.S. banks entering into loan agreements generally are not eligible for the portfolio interest exemption. Thus, if enacted, Section 899 may impose U.S. withholding tax on interest under those agreements to the extent the bank is not acting through a U.S. branch. Such an event may be considered a "change in law" provision to the extent that non-U.S. banks are involved, which could further trigger termination provisions or require contracts to be renegotiated. Certain derivative contracts, e.g., repos, also often contain gross-up provisions for U.S. withholding taxes that may be impacted by the enactment of Section 899. Any such contracts and agreements to be entered into should consider the allocation of risk of additional taxes under Section 899 in the event that it is enacted. Lenders and underwriters should review their gross-up provisions for U.S. withholding taxes to properly reflect an up-to-date allocation of risks associated with the additional tax rates. Borrowers with non-U.S. bank lenders should also review their agreements to determine the impact on them if Section 899 is enacted.

3. Next Steps

[10] Leverage may be available to reduce the rate of taxation of the U.S. subsidiary. However, the portfolio interest exemption does not apply to interest on a shareholder loan if the shareholder owns 10% or more of the voting stock of a corporation, and a treaty may not prevent the application of Section 899 to such interest.

The Bill, inclusive of the proposal to enact Section 899, passed the U.S. House of Representatives on May 22, 2025. As of June 4, 2025, the Bill is currently being considered by the Senate Finance Committee—where certain provisions could be changed from their current state—and will further be presented before the full Senate.

If enacted as drafted, Section 899 would take effect, with respect to a foreign country, on the first day of the first calendar year beginning on or after the latest of (i) 90 days after the date of enactment of Section 899, (ii) 180 days after the date of enactment of the unfair foreign tax that causes such foreign country to be treated as a discriminatory foreign country, or (iii) the first date that an unfair foreign tax of such country begins to apply. The first date that Section 899 could apply is January 1, 2026. Safe harbors for the failure to properly withhold will apply to payments made to applicable persons of discriminatory foreign countries that have been listed by the Secretary for fewer than 90 days, and for withholding agents that fail to withhold before January 1, 2027, to the extent that such agents can demonstrate that they have made best efforts to comply.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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