A NOTE FROM THE

EDITOR-IN-CHIEF

Targeting "Unfair Foreign Taxes" with Proposed Section 899

By Brian Jenn

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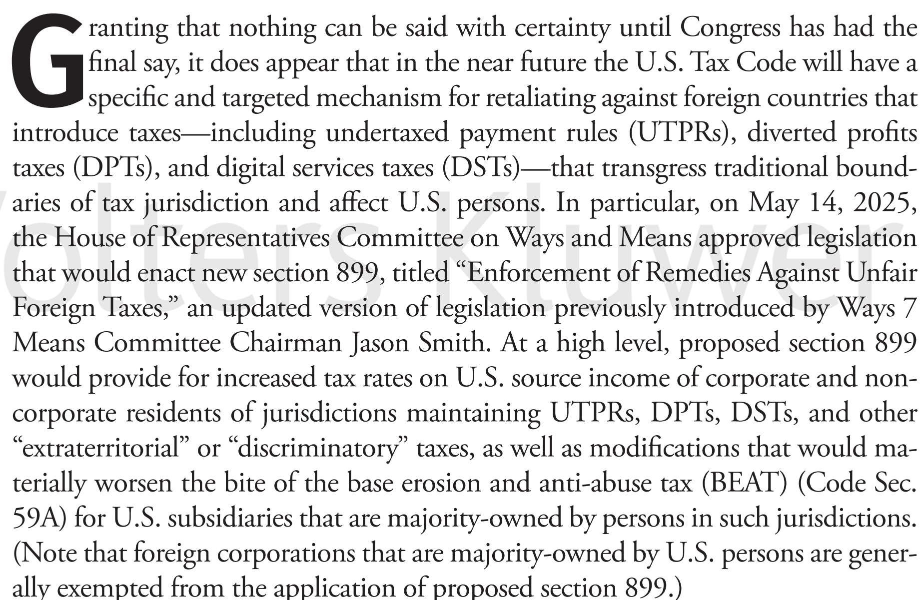

Granting that nothing can be said with certainty until Congress has had the final say, it does appear that in the near future the U.S. Tax Code will have a specific and targeted mechanism for retaliating against foreign countries that introduce taxes—including undertaxed payment rules (UTPRs), diverted profits taxes (DPTs), and digital services taxes (DSTs)—that transgress traditional boundaries of tax jurisdiction and affect U.S. persons. In particular, on May 14, 2025, the House of Representatives Committee on Ways and Means approved legislation that would enact new section 899, titled "Enforcement of Remedies Against Unfair Foreign Taxes," an updated version of legislation previously introduced by Ways 7 Means Committee Chairman Jason Smith. At a high level, proposed section 899 would provide for increased tax rates on U.S. source income of corporate and non-corporate residents of jurisdictions maintaining UTPRs, DPTs, DSTs, and other "extraterritorial" or "discriminatory" taxes, as well as modifications that would materially worsen the bite of the base erosion and anti-abuse tax (BEAT) (Code Sec. 59A) for U.S. subsidiaries that are majority-owned by persons in such jurisdictions. (Note that foreign corporations that are majority-owned by U.S. persons are generally exempted from the application of proposed section 899.)

In contrast to existing Code Sec. 891, which allows the President to double the rates of tax on all residents of a jurisdiction enacting a "discriminatory and extraterritorial" tax, proposed section 899 provides for a less drastic gradual increasing of rates by five percentage points a year (up to a 20 percentage point increase) and provides detailed criteria for identifying unfair foreign taxes. These features, combined with the more self-executing nature of section 899 (discussed below), make it more likely that section 899 will take effect. Also importantly, unlike Code Sec. 891, the application of section 899 should not be impeded by the application of existing tax treaties that were introduced following the 1934 enactment of Code Sec. 891.

Although details of the legislation may change as "The One, Big, Beautiful Bill" heads toward passage in the House and Senate, given the broad consensus among Congressional Republicans in favor of adopting new tools for retaliating against "extraterritorial" and "discriminatory" foreign taxes, it seems likely that the version of section 899 that is ultimately passed by Congress will hew closely to the approach adopted by the Ways & Means Committee. This note is intended to

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provide the reader an overview of key features of proposed section 899, including how and when it could come to impact the U.S. taxation of residents of foreign jurisdictions, as well as the application of the BEAT to their U.S. subsidiaries.

Increases in Tax Rates of Applicable Persons

At a high level, proposed section 899 would increase the rate of tax on certain items of U.S. source income of an "applicable person" by five percentage points a year over the four-year period following section 899 taking effect with respect to the foreign country of which the applicable person is a tax resident.[1] The increase in tax rates under section 899 is capped at 20 percentage points.[2] For foreign countries with which the United States has a tax treaty in effect providing for a reduced rate of tax, the increase in tax applies to the reduced treaty rate rather than the statutory rate (*e.g.*, the five percentage point increase would be applied to a 10% treaty-based withholding rate on royalties rather than the 30% statutory tax rate provided in Code Sec. 871(a)). According to the explanation of section 899 provided by the Joint Committee on Taxation, section 899 establishes the treaty-based rate as the baseline by applying the increase to (1) rates of taxes specified in the statute (*e.g.*, Code Sec. 871(a)(1)) or (2) "any rate of tax applicable in lieu of such statutory rate," with treaty-based rates being a case of a tax rate applied in lieu of the statutory rate.[3]

Proposed section 899 describes the "specified rates of tax" that are subject to increase, with separate rules for withholding taxes, non-withholding taxes, and the BEAT. In general, in the case of non-withholding taxes, the "specified rate of tax" that is subject to increase means (1) the 30% rate applicable to U.S. source FDAP (fixed, determinable, annual, or periodical) and capital gains of nonresident individuals under Code Sec. 871(a), (2) the graduated U.S. individual tax rates applicable to a nonresident individual's "effectively connected income" (ECI) under Code Sec. 871(b), (3) the 30% rate applicable to U.S. source non-ECI of foreign corporations under Code Sec. 881(a), (4) the 21% rate applicable to ECI of foreign corporations, (5) the 30% rate applicable under the branch profits tax of Code Sec. 884(a), and (6) the 4% tax on foreign private foundation income. In the case of withholding taxes, the 30% withholding rate on FDAP of nonresident individuals under Code Sec. 1441(a) and on foreign corporations under Code Sec. 1442(a), as well as the 15% Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) withholding rate under Code Sec. 1445, are subject to increase under proposed section 899.

It is not clear whether the increased tax rate would apply where a tax treaty completely exempts an item of income from tax (rather than specifying a zero tax rate), given that there is no "rate of tax" applicable under the treaty. Similarly, it would appear that where the Code completely exempts an item of income from tax, as in the case of the portfolio interest exception of Code Sec. 871(h), proposed section 899 should not apply.[4]

Modification of Application of the BEAT

In the case of any domestic corporation in which "applicable persons" (described below) own more than 50% of the corporation by vote or value, section 899 provides that the BEAT of Code Sec. 59A applies with some important modifications. As a threshold matter, the BEAT applies without regard to whether it has a base erosion percentage of 3% or higher or whether the taxpayer has average annual gross receipts of $500 million. For determining BEAT liability, section 899 provides that (1) the tax rate for determining BEAT liability under Code Sec. 59A(b)(1)(A) is increased from 10% to 12.5%, (2) no credits may reduce BEAT liability, (3) base erosion payments are determined without regard to whether U.S. withholding tax is imposed or the payments are eligible for the services cost method under Code Sec. 482, and (4) amounts (other than the purchase price of depreciable or amortizable property or inventory) that are capitalized are treated as deducted for purposes of determining base erosion payments. Collectively, these changes would make it much more likely that a U.S. subsidiary of a foreign-parented multinational enterprise (MNE) group incurs significant BEAT liability.

Identifying Applicable Persons, Discriminatory Foreign Countries, and Unfair Foreign Taxes

The term "applicable person" under proposed section 899 is generally intended to capture corporate and individual residents of "discriminatory foreign countries," apart from corporations that are majority-controlled by U.S. persons. Specifically, under proposed section 899(b), an applicable person means, *except as otherwise provided by the Secretary*, (1) any government of a discriminatory foreign country, (2) an individual tax resident of a discriminatory foreign country (other than a U.S. citizen or

resident), (3) a foreign corporation that is a tax resident of a discriminatory foreign country, other than a U.S.-owned foreign corporation within the meaning of Code Sec. 904(h)(6) (*i.e.*, a foreign corporation at least 50% directly or indirectly owned, by vote *or* value, by U.S. persons),[5] (4) a private foundation created or organized within a discriminatory foreign country, (5) any foreign corporation (other than a publicly held corporation) if more than 50% of its stock by vote or value is owned by other applicable persons, (6) any trust the majority of the beneficial interests of which are held by other applicable persons, and (7) foreign partnerships, branches, and other entities identified by the Secretary.

With regard to foreign corporations, the categories described above mean that a foreign corporation can be an applicable person if it is not directly or indirectly at least 50% owned by U.S. persons and either (1) it is a resident of a discriminatory foreign country or (2) it is a resident of a non-discriminatory foreign country but is majority-owned by residents of a discriminatory foreign country by vote *or* value. In practice, this means a foreign corporate joint venture generally should not be subject to section 899, provided that U.S. persons have at least 50% ownership by vote and value.

A discriminatory foreign country simply means a foreign country (or political subdivision thereof) that has one or more "unfair foreign taxes."[6] Proposed section 899 defines an unfair foreign tax by specifically identifying a UTPR, a DST, and a DPT, and then generally including other foreign taxes identified by the Secretary as an "extraterritorial tax," a "discriminatory tax," or "any other taxes enacted with a public or stated purpose indicating that the tax will be economically borne, directly or indirectly, by U.S. persons."[7] Proposed section 899 specifically excludes from the definition of "unfair foreign tax" any tax that neither applies to (1) any U.S. person nor (2) any foreign corporation if the foreign corporation is a controlled foreign corporation (CFC) and more than 50% of the total combined voting power of all classes of stock of the corporation, *or* the total value of the stock of the corporation, is owned by U.S. persons.

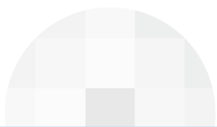
How and When Proposed Section 899 Could Come to Life

Although there are a variety of delegations of regulatory authority throughout proposed section 899, it appears that proposed section 899 is self-executing (*i.e.*, does not require the Secretary of the Treasury to act) with respect to UTPRs, DSTs, and DPTs,[8] which are *per se* unfair taxes, provided that they apply to a U.S. person or a CFC.[9] Treasury has authority in proposed section 899(b)(1) to limit the scope of applicable persons and in proposed section 899(b)(4) to limit the exceptions to the terms "extraterritorial tax" and "discriminatory tax." Additionally, there is a general delegation in proposed section 899(e), including to provide regulations or other guidance to (1) adjust the application of proposed section 899 to prevent avoidance, (2) list the discriminatory foreign countries in guidance that is updated on a quarterly basis, (3) provide notice to Congress with respect to changes to the list, and (4) prevent double counting. None of the contemplated regulations appears, however, to be a prerequisite to the application of proposed section 899 to UTPRs, DSTs, and DPTs, and Treasury does not seem to have broad authority to broadly prevent the application of section 899.

The effective date of proposed section 899 is specific to particular discriminatory foreign countries. In particular, proposed section 899(a)(4)(C) defines the "applicable date," with respect to any discriminatory foreign country, as the first day of the first calendar year beginning on or after the latest of (1) 90 days after the enactment of proposed section 899, (2) 180 days after the enactment of the relevant unfair foreign tax, or (3) the first date the unfair foreign tax of that country begins to apply. Accordingly, if the One, Big, Beautiful Bill is signed by the President before the end of September 2025, section 899 would take effect beginning in 2026 to "applicable persons" with respect to any country that continues to maintain a UTPR, DST, or DPT that applies to U.S. persons or CFCs that are at least 50% owned by U.S. persons.

ENDNOTES

1. Proposed sections 899(a)(1) and (3).
2. Proposed section 899(a)(4)(B).
3. Joint Committee on Taxation, JCX-21-25 (May 12, 2025), at 363.
4. A House Committee report indicates that section 899 would apply to income exempted by treaty but not to income subject to statutory exemptions like the portfolio interest exception.
5. This provision effectively excludes CFCs from application of proposed section 899.
6. Proposed section 899(d).
7. Proposed section 899(e)(1). Proposed sections 899(e)(2) and (3) generally define discriminatory and extraterritorial taxes, and proposed section 899(e)(4) provides certain exceptions. A detailed description of these rules is beyond the scope of this note, as they would only come into effect upon an exercise of rulemaking authority by the Secretary.
8. An exception is that under a safe harbor in proposed section 899(a)(5)(E), the application of section 899 with respect to withholding taxes is delayed until the inclusion of the relevant discriminatory foreign country in a list published by the Treasury Department.
9. Accordingly, it would seem necessary for countries to disapply UTPRs to all CFCs that are majority-owned by U.S. persons (including individual U.S. shareholders), and not just to CFCs that are members of MNE Groups for GloBE purposes.



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