

Proposed Section 899 - The Retaliatory Tax Regime

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The [One Big Beautiful Bill Act](#) (the “Bill”), which was passed by the House of Representatives on May 22, 2025, contains a provision that, if enacted in its current form, would have a dramatic impact on the U.S. tax treatment of investments by foreign persons in the United States. Section 112028 of the Bill would add to the Internal Revenue Code (the “Code”) a new Section 899, entitled “Enforcement of Remedies Against Unfair Foreign Taxes.” If enacted, Section 899 would increase the rate of certain taxes on individuals and companies resident in countries that impose “unfair foreign taxes” on U.S. persons.

Unfair Foreign Taxes

“Unfair foreign taxes” generally include digital services taxes (“DSTs”), taxes imposed under OECD Pillar Two “undertaxed profits rules” (“UTPR”), “diverted profits taxes” and, to the extent provided by the Secretary of the Treasury, “extraterritorial taxes,” “discriminatory taxes” or any other taxes enacted with a public or stated purpose that the tax is economically borne, directly or indirectly, disproportionately by U.S. persons.

Countries with unfair foreign taxes would be considered to be “discriminatory foreign countries.” Individuals and entities that are residents of discriminatory foreign countries and certain entities owned by such persons would be subject to Section 899.

DSTs

A number of foreign countries have enacted DSTs, which are imposed on gross receipts from advertising, streaming services and other digital services offered by large companies with limited physical footprints in those countries – e.g., Google, Meta and Netflix. Countries with DSTs include (i) the United Kingdom, which imposes a two-percent tax on the revenue derived from online marketplaces, search engines and social media platforms, which derive value from United Kingdom users; (ii) Austria, which imposes a five-percent tax on revenues from digital advertisement services sourced in Austria; and (iii) Colombia, which enacted legislation to tax a foreign service provider if it provides digital services to domestic users.

OECD Global Agreement and Pillar Two - UTPR

Pillar Two of the OECD introduced a global minimum tax for multinational enterprises (that are part of multinational groups with annual revenue of at least 750 million Euros), with provisions regarding taxable income, deductions and a “top-up tax.” The Pillar Two UTPR limits the ability of a multinational enterprise to take deductions to the extent it is not subject to a global minimum 15% tax rate.

The UTPR has been adopted by most European Union member states, as well as by the United Kingdom, Australia, South Korea and Japan.

Persons Potentially Subject to Section 899 Tax Increases

Section 899 would potentially increase the taxes of “applicable persons,” which would include:

- the government of any discriminatory foreign country;
- any individual (other than a citizen or resident of the United States) who is tax resident of a discriminatory foreign country;
- any foreign corporation (other than a “United States-owned foreign corporation”) which is a tax resident of a discriminatory foreign country;
- any private foundation created or organized in a discriminatory foreign country;
- any 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 by other applicable persons;
- any trust the majority of the beneficial interests of which are held (directly or indirectly) by other applicable persons; and
- foreign partnerships, branches, and any other entity identified with respect to a discriminatory foreign country by the Secretary of the Treasury.

Types of Taxes Potentially Increased Under Section 899

In the case of applicable persons, Section 899 would potentially increase the rates of several different types of taxes, including:

- Income taxes payable on sales of U.S. real property interests;
- Income taxes payable by foreign corporations on income effectively connected with a trade or business in the United States;
- Branch profits taxes; and
- Withholding taxes on payments of U.S.-source interest, dividends, rent, royalties and other types of fixed or determinable annual or periodical gains, profits, and income (“FDAP income”) to foreign persons.

Where an income tax treaty to which the United States is a party would otherwise reduce the rate of withholding taxes, the increase would be to the reduced rate of tax. Notably, it appears that Section 899 would not affect the application of the portfolio interest exception to withholding taxes on interest. Thus, lenders would not be subject to increased taxes under Section 899 on interest that is currently not taxable because of the portfolio interest exception.

Amount of Tax Increase

If Section 899 were to be triggered by a discriminatory foreign country, the rate of tax applied to applicable persons with respect to that country would increase by five percent for the first year, then by an additional five percent each year until the total increase reached 20 percent over the statutory

rate. Some foreign taxpayers benefit from reduced U.S. tax rates under income tax treaties, and the total increase could exceed 20 percent for them. Since the standard U.S. withholding tax rate on payments of U.S.-source FDAP income (including U.S.-source interest, dividends, rent, and royalties) to foreign persons is 30 percent, Section 899 could eventually increase the withholding tax rate on such income to 50 percent, even if a lower treaty rate were otherwise available.

Disallowance of Section 892 Exemption

Section 899 would disallow the Section 892 tax exemption in the case of governmental entities (including sovereign wealth funds) that are applicable persons. Section 892 generally exempts foreign governments and their controlled entities from U.S. tax on passive income provided the income is not derived from commercial activities. Governmental entities that are applicable persons would thus be subject to U.S. tax at the same escalating rates as other applicable persons.

Effect on Base Erosion and Anti-Abuse Tax (“BEAT”)

The 2017 Tax Cuts and Jobs Act added to the Code the “base erosion and anti-abuse tax” (the “BEAT”), which imposes an additional tax on certain corporate taxpayers that have had, for the preceding three tax years, average annual gross receipts of at least \$500,000,000. Section 899, if enacted, would eliminate the \$500,000,000 gross receipts threshold for foreign corporations majority owned by applicable persons, expand the circumstances under which the BEAT would be payable, increase the rate of the BEAT from 10% to 12.5%, and make other modifications to the BEAT.

Applicable Date

In the case of taxes other than withholding taxes, the Section 899 tax increase would begin to apply as of the “applicable date” for a discriminatory foreign country, which would be 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 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.

In the case of withholding taxes, Section 899 would apply to each calendar year beginning during the period that a taxpayer is an applicable person (i.e., beginning on the first January 1 after the taxpayer becomes an applicable person).

If Section 899 is enacted in its current form on or before October 3, 2025, then the retaliatory taxes described above could be triggered starting January 1, 2026.

Impact on Loans to U.S. Persons

Although interest payable by a U.S. borrower to a foreign lender is often exempt from U.S. tax or subject to a reduced U.S. withholding tax rate pursuant to an applicable U.S. tax treaty, Section 899 would impose a U.S. tax on the interest payable to the foreign lender assuming it is an applicable person.

Existing loan agreements should be examined to determine whether the Section 899 taxes would be subject to gross-up or indemnification obligations by the U.S. borrowers. Because loan agreements typically provide that the borrower bears the cost of any withholding taxes enacted after the closing

of the financing, the borrower may be required to gross-up and indemnify with respect to withholding taxes imposed pursuant to Section 899.

Loan agreements typically provide that if a borrower is required to gross-up or indemnify with respect to post-closing withholding taxes, the borrower can mitigate its obligations by (i) requiring the lender to assign its interest to a lender that is not subject to withholding or (ii) requesting that the lender designate a different lending office, provided that the designation is not disadvantageous to the lender.

If a borrower cannot avoid a gross-up and an indemnification obligation with respect to Section 899 taxes, it may be required to prepay the loan.

With respect to new loan agreements, (i) U.S. borrowers should seek to exclude from their gross-up and indemnity obligations all taxes resulting from Section 899, and (ii) lenders should seek to be held harmless with respect to all such taxes.

Practical Effect of Section 899

The Senate will likely amend the Bill, and Section 899 will undoubtedly be scrutinized far more carefully in the Senate than in the House. If enacted in its current form, Section 899 would have a drastic but uncertain impact upon cross-border transactions. It could significantly discourage foreign investment in the U.S. It could also incentivize foreign countries to repeal tax legislation that is deemed to unfairly target U.S.-based multinationals. There is one certainty, however: if enacted in its current form, Section 899 will undoubtedly trigger an enormous increase in U.S. tax compliance costs.