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Alert | Tax

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Section 899: Proposed Legislation Would Increase US Tax Rates on Many Foreign Individuals, Companies, and Governments

Under the proposed *Defending American Jobs and Investment Act*, introduced in the House of Representatives and approved by the House Ways and Means Committee on May 14, 2025, as part of the Trump administration's tax package known as "The One, Big, Beautiful Bill," a new Section 899 would be added to the Internal Revenue Code. This proposed provision—titled "Enforcement of Remedies Against Unfair Foreign Taxes"—represents a significant new international tax enforcement measure.

According to the administration, the proposed Section 899 is intended to serve as a strong legislative response to the growing use of foreign tax regimes that, in its view, unfairly target and burden U.S. businesses and individuals operating abroad. The provision would authorize countermeasures against persons and companies located in jurisdictions that impose what the legislation defines as an "unfair foreign tax."

The bill is expected to be considered by the full House next week as part of the reconciliation measure. Presuming it passes the House, this portion of the reconciliation measure will then be considered by the Senate Finance Committee, where provisions of the House measure could be changed, and then the full Senate.

Go-To Guide

- Proposed Section 899 would significantly increase U.S. federal income tax rates—by 5% to 20%—on certain types of income earned by non-U.S. individuals and entities that are tax residents of, or are established or effectively managed in, "discriminatory foreign countries." These jurisdictions are defined as those that impose an "unfair foreign tax" under the proposed legislation.
- These elevated rates would apply to passive U.S. source income (such as dividends, interest, royalties, and rents), as well as income effectively connected with a U.S. trade or business (ECI).
- The legislation defines "unfair foreign taxes" broadly, encompassing digital services taxes and other measures that have been widely adopted by foreign jurisdictions. As a result, a large number of non-U.S. individuals and entities could fall within the scope of the increased tax rates.
- These higher rates would apply across a broad spectrum of existing tax provisions and would affect nonresident individuals, foreign corporations, and even sovereign entities.
- If enacted, Section 899 would introduce substantial economic and compliance challenges, particularly for foreign governments, multinational enterprises, and investors with connections to jurisdictions that impose taxes perceived to disproportionately impact U.S. interests—such as digital services taxes or global minimum tax regimes.
- Taxpayers potentially impacted by this proposal should carefully assess how their U.S. tax exposure could change under the new rules and evaluate possible strategies to mitigate adverse effects.

Proposed Applicable Date

If enacted, and subject to certain safe harbor provisions for withholding agents (outlined below), Section 899 would take effect on the first day of the calendar year following the latest of the following events:

1. 90 days after the enactment of Section 899;
2. 180 days after the enactment of the "unfair foreign tax" by the relevant non-U.S. jurisdiction (if enacted more than 90 days after Section 899 is enacted); or
3. The initial effective date of the "unfair foreign tax" (if that date is more than 180 days after such tax is enacted by the non-U.S. jurisdiction).

To ease compliance burdens during the transition period:

- Withholding agents will not be penalized for under-withholding through Dec. 31, 2026, provided they act in good faith to comply with the new requirements.
- This transitional relief is intended to provide limited protection as systems and procedures are adapted to identify impacted payees and apply the appropriate elevated tax rates.

Key Features of Section 899

1. *Increased U.S. Tax Rate on Applicable Foreign Persons*

Proposed Section 899 would significantly increase U.S. federal income tax rates on income and transactions involving non-U.S. persons who are tax residents of—or entities established or effectively managed in—jurisdictions designated as “discriminatory foreign countries.” These are jurisdictions that impose an “unfair foreign tax” as defined in the legislation.

The tax rate increase begins at +5 percentage points and phases in annually to a maximum of +20 percentage points over four years. While this gradual implementation provides affected taxpayers with time to adjust, the resulting financial impact could be substantial.

- U.S. Withholding Taxes

Section 899 would impose higher withholding tax rates on non-business U.S.-source income (e.g., dividends, interest, royalties, and rents) earned by nonresident taxpayers from “discriminatory foreign countries.”

  - Relevant Code Provisions: §§ 871(a), 881(a), 1441(a), and 1442(a)
  - Current Baseline Rate: 30%

- Effectively Connected Income (ECI)

Section 899 would increase the graduated U.S. federal income tax rates on ECI earned by nonresident taxpayers from “discriminatory foreign countries.”

  - Relevant Code Provisions: §§ 871(b), 882(a)
  - Current Baseline Rates: 21% for corporations and up to 37% for individuals and other non-corporate taxpayers.

- FIRPTA Withholding on U.S. Real Property Dispositions

Section 899 would raise the withholding tax on dispositions of U.S. real property interests by nonresident taxpayers from “discriminatory foreign countries.”

  - Relevant Code Provision: § 1445(a)
  - Current Baseline Rate: Generally 15%

- U.S. “Branch Profits” Tax

Section 899 would impose a higher branch profits tax on ECI earned by nonresident corporations from “discriminatory foreign countries.”

  - Relevant Code Provision: § 884(a)
  - Current Baseline Rate: 30%

- Foreign Governments Section 892 Exemption

The proposed legislation also provides that section 892(a) of the Code, which exempts from U.S. federal income taxation certain income of foreign governments, does not apply to any government or governmental entity of a discriminatory foreign country.

  - Relevant Code Provision: § 892(a)
  - Current Baseline Rate: Tax Exemption

- Base Erosion and Anti-abuse Tax (BEAT)

The proposed legislation would adversely modify the application of the base erosion and anti-abuse tax, or BEAT, to corporations primarily owned by tax residents of discriminatory foreign countries.

  - Relevant Code Provision: § 59A

- Private Foundation Excise Tax

Section 899 would increase the excise tax on certain income earned by foreign private foundations from "discriminatory foreign countries."

  - Relevant Code Provision: § 4948(a)
  - Current baseline rate: 4%

2. *Who is an Applicable Foreign Person?*

The heightened tax rates under proposed Section 899 would apply to a broad category of foreign persons associated with jurisdictions designated as "discriminatory foreign countries." Covered persons include:

- Foreign governments, sovereign wealth funds, and public agencies of countries designated as "discriminatory foreign countries";
- Individuals and legal entities (including corporations, partnerships, trusts, and foundations) that are resident in, established in, or effectively managed in a discriminatory foreign country;
- Entities that are substantially owned or controlled, directly or indirectly, by any of the above persons.

In addition, Section 899 includes a broad attribution rule that significantly expands its scope—potentially reaching multinational group structures and investment vehicles with complex or layered ownership arrangements.

3. *How would tax treaties affect the application of proposed Section 899?*

If a different U.S. tax rate applies to a nonresident under existing law—such as a reduced or zero rate provided by an applicable income tax treaty—that rate would serve as the starting point for the rate increases under proposed Section 899.

For example, if interest or royalty payments from a U.S. corporation to a non-U.S. affiliate are currently exempt from U.S. withholding tax under a treaty, the applicable rate under Section 899 would begin at 5% in the first year, increasing incrementally thereafter.

By applying increased rates on top of treaty-based rates, the proposed legislation effectively overrides certain U.S. tax treaty obligations—a significant departure from longstanding treaty commitments.

4. *Criteria for "Unfair Foreign Taxes"*

Section 899 targets tax regimes enacted (or to be enacted) by foreign jurisdictions that, in the administration's view, explicitly or implicitly discriminate against U.S. taxpayers. Examples include:

- Undertaxed Profits Rules (UTPR)
  - The Organisation for Economic Co-operation and Development's UTPR is part of its global minimum tax framework under Pillar Two, designed to ensure that large multinational enterprises (MNEs) pay at least a 15% effective tax rate in every country where they operate. If a group entity is taxed below this rate and the low-taxed income isn't picked up under the Income Inclusion Rule (IIR) at the parent-corporation level, the UTPR allows other jurisdictions where the MNE operates to deny deductions or impose additional tax.
- Digital Services Taxes (DSTs)
  - DSTs are taxes imposed by some countries on revenues earned by large multinational digital companies from certain digital activities, such as online advertising, digital marketplaces, and user data sales. These taxes target companies that generate significant revenue from users in a country without having a physical presence there
- Diverted Profits Taxes (DPTs)
  - DPTs are special tax measures introduced by some countries to counteract aggressive tax avoidance by multinational companies. They target arrangements that artificially shift profits out of a country to low- or no-tax jurisdictions, often through complex structures or transactions lacking genuine economic substance.
- Other unilateral extraterritorial taxes perceived by the administration as retaliatory or anti-competitive
  - This is a catch-all provision intended to apply to tax regimes not specifically identified above.

5. *Exclusions from Section 899 Scrutiny*

Generally, broad-based, non-discriminatory taxes such as income taxes, VAT/GST, or general sales/property taxes enacted (or to be enacted) by a foreign jurisdiction and applied consistently across domestic and foreign taxpayers should not cause a jurisdiction to be designated as a "discriminatory foreign country" for purposes of Section 899.

6. *Discriminatory Foreign Country Designation Process*

Under the proposed Section 899, the U.S. Treasury Secretary, in coordination with other agencies, will designate, maintain, and update a list of "discriminatory foreign countries" on a quarterly basis. Criteria include:

- The substance of foreign tax legislation and enforcement practices.
- Whether the regime disproportionately affects U.S. persons.
- Evidence of tax-treaty violations or lack of good-faith engagement with U.S. authorities.

Wider Implications for Foreign Taxpayers and Governments

Proposed Section 899 has far-reaching consequences that extend beyond immediate tax costs. It raises strategic, operational, and diplomatic challenges for foreign investors and governments with ties to the United States.

1. *Impact on Foreign Government and Sovereign Entities*

Foreign governments and sovereign-linked investors, such as sovereign wealth funds, state-owned enterprises, and public pension funds, are likely to be among the most visibly affected. These entities often benefit from preferential U.S. tax treatment under domestic law or bilateral tax treaties, including exemptions from withholding tax under Sections 892 and 881.

If their home jurisdictions are designated as "discriminatory foreign countries," these benefits could be overridden by the elevated tax rates under Section 899. For instance, a sovereign wealth fund from a country with a DST could see a loss of the Section 892 exemption or a significant increase in tax on its U.S. portfolio income. Similarly, a public pension fund investing in U.S. infrastructure projects may face increased taxation on dividends or interest payments, potentially undermining the after-tax return assumptions underpinning such investments. While the true impact is yet to be seen, this shift could chill bilateral investment flows and may prompt reciprocal measures or treaty challenges.

2. *Heightened Tax Exposure on Effectively Connected Income (ECI)*

Nonresident individuals and foreign corporations earning ECI from U.S. businesses—such as real estate investments, service businesses, retail sales, and infrastructure projects—could face 5% to 20% additional tax on top of the standard applicable rate. While it is yet to be further analyzed, treaty benefits may not apply if the U.S. determines that the relevant treaty is not being applied in good faith or has been undermined by unilateral foreign tax practices. Thus, the measure seems to introduce economic double taxation risks for businesses unable to obtain relief under tax treaties due to discriminatory country designation.

3. *Cross-Border Investment Headwinds*

U.S. real estate, venture capital, and private equity markets could see diminished foreign participation from targeted jurisdictions. Increased uncertainty and compliance complexity may disincentivize long-term capital deployment into the United States.

4. *Compliance and Operational Burden*

Multinational entities and custodians would need to build or adapt systems to track country designations and ownership chains, apply tiered withholding rates dynamically, and ensure cross-border payments and ECI are correctly categorized and taxed under the evolving regime.

For example, an offshore investment fund with limited partners from multiple jurisdictions, including some potentially discriminatory countries, would need to dynamically update tax withholding calculations and segregate distributions. The complexity increases for funds with master-feeder structures or sidecar arrangements tied to U.S. operations.

Considerations for Affected Foreign Individuals, Companies, and Governments

1. Assess Country Exposure: Identify operations, investors, or counterparties linked to potentially designated jurisdictions.

2. Model Financial Impact: Forecast tax costs over a 1–5 year horizon under the escalating Section 899 rate structure.

3. Review Legal Structures: Analyze whether group entities or investments fall within the broad definition of “applicable persons.”

4. Coordinate with Withholding Agents: Ensure banks, custodians, and fund administrators are prepared to comply with new obligations.

5. Monitor Policy Developments: Track updates from Treasury and IRS; assess implications as countries are added or removed from the discriminatory list.

6. Consider Strategic Restructuring: Evaluate alternative jurisdictions or holding structures to mitigate U.S. tax exposure.

Conclusion

Proposed Section 899 represents a major departure from traditional U.S. international tax policy. By authorizing escalating U.S. tax rates on foreign persons linked to jurisdictions deemed to maintain “unfair foreign tax” regimes, the provision introduces significant strategic risks—particularly for inbound investors from countries implementing digital services taxes, global minimum tax rules, or other measures perceived as targeting U.S. interests.

Proactive assessment and planning are essential. Taxpayers with global exposure must evaluate their risk under Section 899, align internal compliance systems, and consider structural changes to mitigate potential impacts. As the U.S. Treasury begins identifying and designating targeted jurisdictions, the ability to monitor developments in real time and respond strategically will be critical—not only for managing tax exposure but for preserving long-term access to the U.S. market amid increasing geopolitical tax tensions.

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