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In this article, the authors explore some of the key issues presented by four retaliatory tax measures now under consideration by President Trump and Congress to respond to discriminatory or extraterritorial taxes imposed by foreign countries.

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I. Introduction

The Trump administration repeatedly has stated its intention to respond more muscularly to discriminatory and extraterritorial tax measures imposed against U.S. multinational groups.[1] This is widely understood as a reference to digital services taxes,[2] which discriminate against U.S. businesses that dominate the tech sector,[3] and the undertaxed profits rule,[4] which is designed to give countries taxing rights over profits realized in other jurisdictions (including the United States) that are determined to be low-taxed and not subject to tax through another pillar 2 charging mechanism.[5] While tariffs are a highly publicized

[1] *See, e.g.*, White House memorandum, "America First Trade Policy" (Jan. 20, 2025); White House memorandum, "The Organization for Economic Cooperation and Development (OECD) Global Tax Deal (Global Tax Deal)" (Jan. 20, 2025); White House memorandum, "Reciprocal Trade and Tariffs" (Feb. 13, 2025); and White House memorandum, "Defending American Companies and Innovators From Overseas Extortion and Unfair Fines and Penalties" (Feb. 21, 2025).

[2] "Defending American Companies," *supra* note 1, identifies seven countries that have implemented DSTs: Austria, Canada, France, Italy, Spain, Turkey, and the United Kingdom.

[3] The administration and congressional Republicans repeatedly have criticized DSTs for discriminating against U.S. businesses. Ways and Means Committee release, "At OECD, Chairman Smith Warns That Congress Will Reject New Job-Killing Global Tax Surrender" (Sept. 1, 2023); White House, "Defending American Companies," *supra* note 1. Further, the U.S. trade representative concluded in numerous section 301 trade investigations into DSTs conducted under the Biden administration that DSTs discriminate against U.S. businesses. *See* Office of the U.S. Trade Representative website, "Section 301 — Digital Services Taxes."

[4] As of April 1, over 30 countries have implemented UTPRs that will be in effect for 2025, including Australia, Canada, most EU countries, New Zealand, South Korea, and the United Kingdom. For a full list of countries, see Digital Gateway — KPMG BEPS 2.0 Tracker.

[5] Both the administration and congressional Republicans have criticized the UTPR as violating U.S. bilateral tax treaties and as an affront to U.S. sovereignty because of its extraterritorial design. Ways and Means release, *supra* note 3; White House, "Defending American Companies," *supra* note 1. In contrast, in a letter to the secretary-general of the OECD, Smith stated his support for countries considering adopting an income inclusion rule that, like the global intangible low-taxed income regime, applies to a parent for its subsidiaries: "We recognize the sovereign right of countries to adopt tax rules for their own companies . . . [and] welcome countries' efforts to enact their own GILTI-type global minimum taxes." Letter from Smith et al. to Mathias Cormann, secretary-general to the OECD (Feb. 10, 2023).

tool for responding to countries' overreach in the tax domain, it is also no secret that the president and Congress are considering retaliatory tax measures.

Of note, the "America First" trade policy memorandum directed the secretary of Treasury, in consultation with the secretary of commerce and the U.S. trade representative, to investigate whether any foreign jurisdiction subjects U.S. citizens or corporations to discriminatory or extraterritorial taxes within the meaning of section 891 of the Internal Revenue Code. Section 896 has been highlighted as another existing provision designed to address the application of discriminatory taxes to U.S. multinationals.

Separately, Republicans on the House Ways and Means Committee have proposed two retaliatory measures that could be included in the broader tax law expected as part of the budget reconciliation process this year.[6] On January 21, Committee Chair Jason Smith, R-Mo., reintroduced the Defending American Jobs and Investment Act (H.R. 591) (the Smith bill), which was cosponsored by all 25 Republican members of Ways and Means and is aimed at both UTPRs and discriminatory taxes like DSTs.[7] In an accompanying statement, Smith said he was reintroducing his bill to "ensure that President Trump has every tool at his disposal to pushback against any foreign country that seeks to undermine America's economic vitality or unfairly target our workers and businesses."[8] More recently, on March 27, Rep. Ron Estes, R-Kan., joined by every other Ways and Means Republican member except Smith, reintroduced the Unfair Tax Prevention Act (H.R. 2423) (the Estes bill), which provides a different retaliatory mechanism and focuses only on the UTPR.[9]

This uniform support from Republicans on the House taxwriting committee indicates that opponents of retaliatory tax measures have not gotten much traction, at least not among key Republicans in the House. Notably, U.S. businesses, through trade organizations, have reluctantly cheered on the use of retaliatory tax measures:

> We recognize that President Trump's Executive Order, as well as [the Smith bill] recently re-introduced, contemplates the possibility that the United States will respond through our income tax system to protect our national interests. Like all businesses that operate in multiple countries around the world, we firmly believe in the long-term reduction of tax barriers to cross-border trade and investment, which will enhance jobs and economic growth in the United States. However, we also believe that it is vital for other countries not to doubt the resolve of the United States in putting a stop to extraterritorial or discriminatory taxation and restoring our sovereign right, acting through our elected representatives, to enact tax policies that serve the interests of the United States.[10]

Regardless of what one thinks about the prudence of these policies, this torrent of activity means these proposals need to be taken seriously. Yet each of the four retaliatory tax measures under consideration present issues that may not make it fit for purpose in its current form. This article explores, without bottoming out, some of the key

[6] Budget reconciliation is a procedure under Title III of the Congressional Budget Act of 1974 by which Congress implements policies affecting mainly spending and revenue programs through a special parliamentary procedure that expedites the passage of federal budget legislation in the Senate. It overrides the Senate's filibuster rules, allowing for a simple majority vote instead of a 60-vote supermajority. The process aligns spending and revenue estimates with the goals outlined in the budget resolution.

[7] Smith previously introduced a version of this bill in 2023. Defending American Jobs and Investment Act, H.R. 3665, 118th Cong. (2023).

[8] Ways and Means Committee release, "Ways and Means Republicans Introduce Legislation to Reinforce Trump Administration's Rejection of Biden Global Tax Surrender" (Jan. 22, 2025).

[9] Unfair Tax Prevention Act, H.R. 2423, 119th Cong. (2025). In a statement accompanying the March 27 release, Estes said, "The bill ensures that if a country moves forward with a UTPR surtax on American workers and businesses, the United States will impose a reciprocal tax measure that will apply as long as the foreign country's unfair tax remains in place." Estes release, "Rep. Estes Reintroduces Legislation to Protect American Taxpayers" (Mar. 27, 2025). Estes introduced an earlier version of his bill on July 18, 2023, which was sponsored by 10 of the 26 Republicans on the committee, including Smith. Unfair Tax Prevention Act, H.R. 4695, 118th Cong. (2023).

[10] Alliance for Competitive Taxation (ACT), letter on the executive order on the OECD global tax deal (Mar. 18, 2025). ACT's membership includes many of the largest companies in the United States. *See* ACT website, "Our Mission."

issues presented by these approaches. We first describe the statutory operation of each proposal, followed by a table summarizing their essential features. Later sections address fundamental design questions, like how to define offending tax regimes that trigger retaliation and interactions with tax treaties and the U.S. Constitution.

II. A Deeper Dive Into Each Potential Measure

A. Section 891

Using tax legislation as a tool to retaliate, or at least threaten retaliation, is not new. In 1934 Congress enacted section 891 in response to France's "double taxation law."[11] A president has never invoked section 891, and even potential supporters have referred to it as "a provision from a bygone era, primarily because the issues it addresses simply have not arisen in decades."[12] But recent comments by the administration have put this bygone provision back on the table.

Section 891 enables the president, by proclamation, to double the tax rates imposed by sections 1, 3, 11, 801, 831,[13] 852, 871, and 881 for citizens and corporations "of [a] foreign country" that the president determines is imposing discriminatory or extraterritorial taxes on citizens or corporations "of the United States." Notably, section 891 does not define the terms "discriminatory" or "extraterritorial," thus providing the president discretion to determine when such a tax exists.

The most significant question regarding section 891 is its interaction with tax treaties, which we explore in Section IV.B, below. To the extent a treaty does not override its application, the effect of certain parts of section 891 are clear. For example, doubling the tax rate imposed by section 11 would increase the rate on a foreign corporation's effectively connected income from 21 percent to 42 percent. This could have a dramatic impact on many businesses, notably inbound banks operating in the United States through branches. Doubling the rate imposed by sections 871(a) and 881 would mean that nonresident aliens and foreign corporations would face a 60 percent rate on their fixed or determinable annual or periodic income,[14] with potentially significant impact on U.S. capital markets and the cross-border flows of inbound groups. Moreover, as discussed below, the tax rate increases apply immediately for the tax year during which the proclamation is made, giving taxpayers little to no warning.

The operation of section 891 presents several issues in addition to the central treaty question.

1. Limited application to withholding taxes.

Significantly, section 891 would not alter the rates applicable to the withholding mechanisms under sections 1441 and 1442 for collecting taxes imposed under sections 871(a) and 881.[15] This raises significant collectability concerns vis-à-vis, for example, individual investors.[16] Large foreign corporations with substantial U.S. operations, on the other hand, would be less likely to exploit an opportunity to evade U.S. tax due on a Form 1120-F, "U.S. Income Tax Return of a Foreign Corporation."

Withholding under section 1446(a) on a foreign partner's ECI, on the other hand, would appear to double because it is tied to the substantive rate.

2. Overbroad application to U.S. persons.

A literal application of section 891 suggests that it would apply to foreign citizens who are tax resident in the United States and dual citizens. This would be extremely disruptive for these U.S.

[11] For an overview of section 891 and its history, see Joseph J. Thorndike, "Threats, Leverage, and the Early Success of Reprisal Taxes," *Tax Notes*, Mar. 21, 2016, p. 1373.

[12] Itai Grinberg, "A Constructive U.S. Counter to EU State Aid Cases," *Tax Notes Int'l*, Jan. 11, 2016, p. 167.

[13] Other than making it clear that insurance companies are also subject to double rates, the inclusion of sections 801 and 831 seems redundant because those sections merely cross-reference section 11, which is already subject to the double rate. Further, the inclusion of section 3 appears redundant because section 3 merely cross-references section 1. *See* Libin Zhang, "The Sword Against Discriminatory Foreign Taxes Is a Bit Rusty," *Tax Notes Federal*, Mar. 17, 2025, p. 2017 (providing a comprehensive discussion of the scope of section 891).

[14] FDAP income consists primarily of investment income, including interest, dividends, rents, and royalties. In contrast, ECI generally consists of income from active trade or business activities.

[15] Despite cross-references to sections 1441 and 1442 in sections 871 and 881, under the canon of statutory interpretation *expressio unius est exclusio alterius*, a list of specific items means that other items are excluded from the list. Although withholding agents can be conservative and may be inclined to withhold at the higher rate specified by section 891, doubling withholding would likely breach the market-standard covenant not to withhold except to the extent required by law.

[16] If a tax on FDAP remained unpaid, the IRS, in theory, could issue a levy to withholding agents that have custody of funds or financial assets to collect on the unpaid tax debt.

residents, as well as for U.S.-parented groups with foreign citizens serving as executives in the United States.[17] Questions also arise regarding application of the rules to citizens of "bad" countries who reside in a third country and to foreign subsidiaries of U.S.-parented groups.[18]

3. Limits on presidential discretion.

The doubling of rates under section 891 is generally considered all or nothing for the tax year in which the presidential proclamation is made and for each year thereafter, until the tax year *beginning after* the president finds that the foreign country has removed the discriminatory or extraterritorial tax. Thus, while the president has considerable discretion in deciding whether to invoke section 891, once invoked, there does not appear to be discretion for the kind of on-again, off-again policy we have seen with tariffs.

Section 891 does not include any specific delegation of regulatory authority to address its rough edges. Query, however, whether regulatory authority under section 7805(a) or the discretion provided to the president under section 891 regarding the making of a proclamation could be interpreted to allow for the exclusion of U.S. residents and U.S.-parented groups. Regardless of how a court would interpret that question, a separate issue is who would have standing to challenge any exercise of presidential discretion providing relief.

B. Estes Bill (Super BEAT)

1. Proposed changes.

The Estes bill would amend the base erosion and antiabuse tax for a "foreign owned extraterritorial tax regime entity," which is any foreign-parented taxpayer[19] if an extraterritorial tax is imposed on any related foreign entity. An extraterritorial tax is defined to focus on UTPRs:

> 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.

Although this definition appears intended to focus on UTPRs, it may be overbroad with respect to certain consolidation regimes and blending regimes, like a qualified domestic minimum top-up tax, that are not "extraterritorial" but impose tax on a corporation by reference, in part, to the income or profits of other persons located in the *same country*. The definition ought to be narrowed to focus only on the taxation of income or profits located outside the country imposing the tax.

The "Super BEAT" would subject foreign-owned extraterritorial tax regime entities to the following BEAT modifications, which would bring all those entities into the scope of BEAT and significantly expand the range of payments caught by the BEAT:

- *Remove the $500 million gross receipts test and the 3 percent (2 percent for banks and registered securities dealers) base erosion percentage threshold*. This would substantially increase the number of foreign-parented groups that have to contend with the BEAT, especially among smaller companies.
- *Treat 50 percent of cost of goods sold as a base erosion tax benefit*. Currently, COGS is treated as a "reduction to gross receipts" rather than

[17] According to the U.S. Census Bureau's 2023 American Community Survey, U.S. residents include at least 676,652 persons from the United Kingdom, 126,236 persons from Australia, and at least 909,430 from countries like Austria and France. *See* B05006: Place of Birth for the Foreign-Born Population in the United States — Census Bureau Table.

[18] Grinberg has asserted that, in determining whether a discriminatory tax has been imposed on "a corporation of the United States," that term may be best understood "to encompass any subsidiary within the worldwide affiliated group" of a U.S. multinational enterprise. Grinberg, *supra* note 12. This logic might suggest an opening to argue that the rate hikes in section 891 do not apply to foreign subsidiaries of a U.S.-parented group.

[19] The Super BEAT limits its application to foreign-parented groups by applying to any taxpayer that is controlled, directly or indirectly, by a foreign entity other than a foreign entity that is controlled by a domestic corporation. Proposed section 59A(i)(2). "Control" is as defined in section 954(d)(3), which requires more than 50 percent vote or value.

as a deduction that can give rise to a base erosion tax benefit.[20] Treating 50 percent of COGS as a base erosion tax benefit would significantly expand the scope of payments caught by the BEAT, potentially driving tax rates above 100 percent. Consider the simple example of a U.S. distributor of a foreign multinational with $100 million of sales, operating expenses of $20 million that are not base erosion payments, and COGS from related-party imports of $75 million. Under current law the entity incurs regular U.S. tax of $1.05 million on its $5 million of taxable income and is not liable for the BEAT. Under the Super BEAT it would incur additional tax of $4.26 million.[21] The distributor's total U.S. tax liability of $5.31 million would exceed its pretax profit, pushing it into an after-tax loss. Moreover, the literal text of the Estes bill could suggest that this disallowance applies regardless of whether the COGS reflects purchases from a related foreign person.[22] It is unclear if this harsh result is intended.

- *Increase the BEAT rate to 12.5 percent and treat all general business credits as preferences that reduce a taxpayer's regular tax liability* for tax years beginning after the date of its enactment. As compared with when the Estes bill was first introduced in 2023, this provision ostensibly would have no impact because these changes are already scheduled to occur for tax years beginning after December 31, 2025. Nonetheless, if "current policy" is used to measure the baseline for the tax bill, the inclusion of this provision in the Super BEAT could mean that taxpayers affected by the Super BEAT would not benefit from the extension.
- *Eliminate the exception for FDAP payments subject to tax under section 871 or section 881*, potentially subjecting payments already subject to 30 percent withholding tax to a double tax because of the denial of a deduction for the payment under BEAT.
- *Eliminate the services cost method (SCM) exception*.[23] Removing the SCM exception would fall heavily on foreign groups that enter into U.S. contracts that depend for their performance on a global network, such as global parcel delivery. Some of these groups would likely need to revisit their contracting model — for example, by entering into new customer contracts using a foreign principal, so that they could make payments into rather than out of the United States, or adopting a "revenue sharing" transfer pricing model to treat each service provider as jointly providing the service — not changes that happen overnight.

2. Multinationals affected.

The Estes bill would apply the Super BEAT broadly to the U.S. taxpayers (including U.S. branches) in a foreign-parented group whenever a UTPR is imposed on *any* foreign entity in that group during the tax year. For example, the Super BEAT would apply to the U.S. subsidiaries of a Chinese-parented group if France imposes its UTPR on a French subsidiary of the Chinese parent to collect top-up tax on low-tax earnings in China.

As of March 26, over 30 countries have enacted a UTPR, including Australia, Indonesia, New Zealand, Norway, South Korea, Thailand, Turkey, the United Kingdom, and all but the

[20] KPMG report, "Analysis of Final Regulations and Additional Proposed Regulations Under Section 59A ('BEAT')" (Dec. 12, 2019).

[21] Calculated as gross receipts of $100 million, less operating expenses ($20 million) and 50 percent of COGS ($37.5 million), for a modified taxable income of $42.5 million. The Super BEAT of $5.31 million ($42.5 million * 12.5 percent) would be offset against a regular tax liability of $1.05 million, resulting in additional BEAT of $4.26 million.

[22] Proposed section 59A(i)(1)(D) provides that 50 percent of any foreign-owned extraterritorial entity's "cost of goods sold shall be treated as a base erosion tax benefit *with respect to a base erosion payment*." Presumably, this provision is intended to add another leg to the definition of base erosion tax benefit in current section 59A(c)(2)(A). The significance of including "with respect to a base erosion payment" at the end of proposed section 59A(i)(1)(D), however, is unclear. "Base erosion payment" is defined in current section 59A(d) as "any amount paid or accrued by the taxpayer to a *foreign person which is a related party* of the taxpayer and with respect to which a *deduction is allowable* under this chapter" (emphasis added). Perhaps the drafters believed they needed to deem COGS to be "with respect to a base erosion payment" because COGS generally is treated for U.S. tax purposes as a reduction to gross income rather than as a deduction. However, in so doing, they appear to have also eliminated any requirement for the COGS to arise from a related-party payment to a foreign person. Query whether this significant expansion was intended.

[23] Under current law, if related-party services meet the requirements for use of the SCM under reg. section 1.482-9 (determined without regard to the business judgment rule), the amounts paid for those services qualify for an exception from the BEAT. Section 59A(d)(5); reg. section 1.59A-3(b)(3)(i). At a high level, this exception is intended to cover low-margin services.

smallest EU member states. Given this penetration, the broad approach taken in the Estes bill would appear to blunt the strength of its incentive for a country unilaterally to remove or not adopt a UTPR. That is, unless all countries remove their UTPR, the unilateral removal by one country would not protect its national champions from the Super BEAT so long as those multinationals continue to operate in any country that imposes a UTPR to the earnings of any other member (as may be likely given the number of countries that have implemented the UTPR). Policymakers could make several tweaks to strengthen the incentive for countries to remove or not adopt a UTPR. A more targeted approach would limit the Super BEAT to apply only to groups headquartered in countries with a UTPR, rather than merely operating in any country that has imposed a UTPR. This would give countries the unilateral ability to protect their national champions by removing their UTPR.

Moreover, there is a question whether the United States should use such a draconian tax to seek the complete elimination of the UTPR, or should impose the Super BEAT only when a jurisdiction has not switched off its UTPR for U.S. multinationals, for both their U.S. income and non-U.S. income (for example, by recognizing global intangible low-taxed income as a qualified income inclusion rule). The Super BEAT takes the former approach. Notably, this is contrary to Estes's release accompanying his reintroduction of the Super BEAT, which said that the Super BEAT would apply to "foreign-controlled entities connected with entities operating in jurisdictions with extraterritorial taxes *aimed at U.S. business operations*" (emphasis added).[24] While lawmakers may have a broader objective of fully eliminating UTPRs on the basis that they undermine international tax norms — and, if retained in any form, could in the future be imposed on U.S. multinationals — they should consider using less draconian means, including nontax measures, to pressure countries to pull back more fully on UTPRs. A measure as harsh as the Super BEAT should be narrowly aimed, focusing on where it is likely to be effective in protecting direct U.S. economic interests, such targeting only companies headquartered in countries that would impose a UTPR on a U.S. group.

The new version of the Super BEAT did narrow the trigger in one respect. The 2023 version would have applied if any related foreign entity was "subject to" an extraterritorial tax, which raised the question of whether it might apply even if no related entity actually paid the tax, because of, for example, the application of a safe harbor. The version introduced in March would apply only if a UTPR is actually imposed on a related entity.

This change, however, creates a separate problem. Foreign multinationals headquartered in jurisdictions that have adopted the IIR will typically not expect to incur tax under the UTPR, which is switched off by the application of the IIR to the ultimate parent entity (UPE). This means that counterintuitively, the Super BEAT could end up applying to foreign multinationals that operate in countries such as France or Germany but have a UPE in a country that has not implemented pillar 2, such as China or India. This seems like the wrong constituency to target for a tax measure designed to change the behavior of countries like France and Germany that have adopted the UTPR. Instead, it could give countries an incentive to adopt the IIR, thereby protecting their multinationals from UTPRs and hence the Super BEAT.

This raises a bigger structural problem with the design of the Estes bill. The Super BEAT's application turns on whether any entity of a foreign group is taxed under a UTPR, not whether a specific country has adopted a UTPR. This leads to the bizarre outcome in which a country could entirely negate the impact of the Super BEAT by limiting its application to U.S.-parented groups, which are outside the scope of the Super BEAT because they are not foreign-owned entities — an outcome that is clearly not intended. To be effective, the Super BEAT would need to be reframed to apply to foreign-parented groups headquartered in a jurisdiction that has adopted a UTPR that could apply to a U.S. multinational.

Later sections of this article consider the Super BEAT's interactions with tax treaties and the constitutional questions posed by treating 50 percent of COGS as a base erosion tax benefit.

[24] Estes release, *supra* note 9.

C. The Smith Bill (Section 899)

Like section 891, the Smith bill would penalize both extraterritorial and discriminatory taxes levied by foreign countries by increasing certain tax rates, in this case those imposed in sections 871(a), 871(b) (but only for gains under the 1980 Foreign Investment in Real Property Tax Act), 881(a), 882(a), 884(a), 1441(a), 1442(a), and 1445. Thus, the Smith bill both addresses a limitation of section 891 by extending the rate increases to U.S. withholding agents and expands the covered taxes to include the branch profits tax. Before considering its interaction with tax treaties, and in contrast to section 891, the Smith bill incrementally raises rates by 5 percentage points each year for four years, after which the full statutory rates would remain elevated by 20 percentage points until the offending tax is repealed.

1. Payments in-scope of tax treaties.

The Smith bill explicitly overrides tax treaties regarding sections 1441(a), 1442(a), and 1445, by providing that, for payments or dispositions after the appliable date, the rate of tax specified in those sections is "determined without regard to any treaty obligation of the United States, and . . . increased by the applicable number of percentage points."[25] While a more incremental approach may have been intended, the literal effect of this language is that in the first applicable year, withholding on an FDAP payment that previously benefited from a reduced rate under a treaty would be 35 percent (30 percent under section 1441(a) or section 1442(a), plus 5 percentage points).[26] At a minimum, the rate increases proposed by the Smith bill should be imposed from the otherwise applicable rate, including a relevant treaty rate, which was likely the intended result.

Including explicit treaty override language only for sections 1441(a), 1442(a), and 1445 arguably implies that Congress does not intend to override treaties regarding the other rate increases. This would produce a substantive disconnect between a withholding agent's requirement to withhold and the underlying tax liability imposed under sections 871(b), 881(a), and 882(a). Taken literally, this could mean that taxpayers can claim a refund for the overwithholding. Alternatively, the IRS and courts could conclude that the Smith bill should be viewed as overriding treaties regarding all provisions under the later-in-time rule, discussed in Section IV.C, *infra*.

Regardless, assuming this is a drafting glitch, it likely would be fixed before enactment. This fix could occur in one of two ways: either making the override language apply consistently, or by removing it altogether and relying instead on an implicit override, perhaps to deal with constraints imposed by the reconciliation process.[27] If an implicit override is pursued, there is at least a formal distinction between, on the one hand, article 10(3) of the U.S. model income tax convention (2016), which says "dividends shall not be taxed in the Contracting State," and article 11(1), which says interest "shall be taxable only in that other Contracting State," and on the other hand, treaty provisions that prescribe a maximum rate of tax. If there is no explicit treaty override, there is at least an argument that section 899 would not apply to provisions that fully cede taxing rights, though the government likely would disagree. Query as well whether, in the absence of explicit override language, it is possible to restructure section 899 to achieve the incremental approach of increasing the otherwise applicable rate (including a treaty rate) by only 5 percentage points each year.

2. Definition of discriminatory taxes.

The same definition of extraterritorial tax is used in the Smith bill and the Super BEAT. The Smith bill, however, also would apply to "discriminatory taxes," using an extremely broad disjunctive test to define that term. Dating back to

[25] Defending American Jobs and Investment Act, H.R. 591, section 899(c)(1)(B)(i), (ii), and (iii) (2025).

[26] For example, under the U.K.-U.S. tax treaty, dividends paid from a U.S. corporation are subject to tax at between 0 percent and 15 percent, while there is no U.S. tax on interest paid from the United States to a resident of the United Kingdom. U.K.-U.S. tax treat, art. 10 (dividends) and art. 11 (interest) (July 24, 2001). In contrast, under section 881, those payments are subject to tax at a 30 percent rate, which the Smith bill would increase to 35 percent in the first applicable year, and eventually to 50 percent in the fourth year.

[27] See the discussion of treaties and reconciliation in Section IV.C, *infra*.

the years spent on pillar 1, countries have struggled to define discriminatory taxes. Any definition must be sufficiently broad to cover existing DSTs and any future variations that would continue to discriminate against U.S. businesses, while simultaneously avoiding bringing a range of traditional or new, but nondiscriminatory, taxes into scope.

The Smith bill enters this fray with a disjunctive, four-prong definition of a discriminatory tax.[28] A fifth prong excludes specific taxes from the definition, including withholding tax on amounts described in sections 871(a)(1) and 881(a), VATs, and other similar taxes identified by the secretary.

Under the first prong, a tax is discriminatory if it applies to income in a foreign country that would not be considered sourced in that country under the principles of the IRC. The tax community is now all too aware that many countries' source rules differ from the U.S. rules following Treasury's misguided effort to deny foreign tax credits for taxes premised on source rules that deviate from the U.S. rules. As just one example, many countries source royalties based on the payer's residence rather than the U.S. approach of looking to where the intellectual property rights are used.[29] This prong is ill-suited to a disjunctive definition because the U.S. rules cannot be relied on as establishing so-called international norms.

The second prong of the disjunctive definition includes as discriminatory any tax imposed on a base other than net income. The definition relies on the exceptions under the fifth prong to exclude gross-basis taxes on FDAP income. Again, beyond the realm of FDAP income, gross-basis taxes are common. In the telecom sector, countries often apply regulatory or license fees calculated as a percentage of revenue.[30] The Ohio commercial activity tax is a gross receipts tax.[31] While gross receipts taxes often represent bad tax policy, they are only discriminatory when, as is the case for DSTs, they primarily target inbound businesses.

The third prong targets taxes that, in practice, apply "exclusively or predominantly" to nonresident corporations or partnerships, determined by reference to the IRC and treating the foreign country as the United States. While this could be a useful factor for other taxes, DSTs are unlikely to meet this condition because they typically do not discriminate between domestic and foreign corporations. It is also worth pausing on the language "exclusively or predominantly." Given the history of DSTs being designed to target U.S. multinationals, they should not be insulated just because they apply to some domestic groups if most of the revenue is from U.S. groups.[32]

Finally, the fourth prong identifies as discriminatory taxes that are not treated as income taxes or are otherwise treated by the imposing jurisdiction as outside the scope of tax treaties. That DSTs are inconsistent with international tax norms and designed to not be covered taxes under tax treaties has been cited as a reason to view them as discriminatory.[33] However, while this is a symptom of the problem, it is not the cause. As with the second prong, this prong risks bringing in many taxes that do not discriminate against U.S. businesses.

In its current form, the Smith bill's overbroad definition of discriminatory tax is less problematic because retaliation is triggered only if Treasury identifies a tax, and Treasury is granted authority to issue guidance "necessary or

[28] The Smith bill resembles the definition of DSTs and relevant similar measures in OECD, "The Multilateral Convention to Implement Amount A of Pillar One" (Oct. 11, 2023). However, the multilateral convention (MLC) adopted a conjunctive test and thus was more targeted. As the U.S. Council for International Business highlighted in its December 2023 comments to Treasury on the draft amount A MLC, this definition was too narrow and may not have captured existing DSTs.

[29] KPMG report, "Proposed Foreign Tax Credit Regulations" (Nov. 21, 2022).

[30] GSMA "Rethinking Mobile Taxation to Improve Connectivity" (Feb. 20, 2019).

[31] Ohio Department of Taxation, "Commercial Activity Tax (CAT) — General Information."

[32] Italy has already proposed removing the revenue threshold for its DST, presumably with the aim of qualifying it as nondiscriminatory. *See* Caleb Harshberger, "Italy's Digital Services Tax Tweaks Seek to Allay US Objections," *Daily Tax Report*, Nov. 7, 2024. Given the history, this step should not be sufficient to remove it from the scope of any retaliatory measure given that the revenue almost certainly will still come overwhelmingly from U.S. groups.

[33] *See, e.g.*, Office of the U.S. Trade Representative, "Section 301 Investigation: Report on the United Kingdom's Digital Services Tax" (Jan. 13, 2021).

appropriate to carry out the purposes of this section."[34] If the provision were revised to be self-executing, however, significant work would be needed to refine the definition of discriminatory taxes.

3. Reliance on Treasury and timing of rate increases.

Considering the Smith bill's overbroad definition of discriminatory taxes, it is fortunate that it is not self-executing in its present form. Instead, it would require the Treasury secretary to report to Congress within 90 days of its enactment on the foreign countries that have enacted discriminatory or extraterritorial taxes, and to update this report every 180 days. Once a country is listed, 180 days are allowed for negotiation and the removal of those taxes before rate increases begin.

Thus, the "applicable date" for any country is one day after the 180-day period ends. Increases to the rates imposed under sections 871, 881, 882, and 884(a) are made for the tax year beginning after the applicable date. As a result, for calendar-year taxpayers, 2027 is the earliest the Smith bill is likely to result in increased rates for substantive tax obligations.[35] This deferred application is a favorable feature of the bill that is aligned to its ultimate purpose — as it allows time for other countries to respond before the retaliatory measure takes effect.

In contrast, increases to withholding rates under sections 1441(a), 1442(a), and 1445 apply to any payments or dispositions that occur after the applicable date. This creates a potential mismatch when the withholding rate applied to an outbound payment is higher than the rate imposed on the recipient, such that recipients could file for refunds, adding compliance and administrative burden and potentially increasing the risk of fraudulent refund claims.

Significantly, once invoked, the elevated substantive rates remain in effect until the tax year beginning after the country repeals its extraterritorial and discriminatory taxes. This creates a comparable, though opposite, timing mismatch with withholding. The increased rates will fall away for purposes of withholding as soon as the country is determined to have repealed its offending taxes, but they will remain in place for the recipient's substantive tax liability until the end of the tax year. Like section 891, this appears to preclude the on-again, off-again policy we have seen with tariffs.

Because the secretary is required to deliver a report to Congress to identify countries with extraterritorial or discriminatory taxes, the Smith bill appears not to be self-executing. We explore the implications of this for a potential reconciliation bill in Section III.B, below.

4. Applicable persons.

The Smith bill's definition of applicable persons includes (1) individuals who are citizens of an offending country but *excluding citizens or residents of the United States*; (2) any corporation created or organized in an offending country or subject to its income tax laws, unless it is a "specified 10-percent-owned foreign corporation as defined in section 245A(b)"; and (3) for withholding tax, foreign partnerships to the extent provided by the Treasury secretary. These clarifications address several problems inherent in section 891, ensuring that the Smith bill would not apply to foreign citizens tax resident in the United States or to the foreign subsidiaries of U.S. groups.

The latter exception is achieved through a carveout for "specified 10-percent-owned foreign corporations," which very generally applies to any foreign corporation for which any domestic corporation is a U.S. shareholder. Understanding the breadth of this carveout requires following a series of cross-references in the code, ending at section 958(a) and (b).[36] In particular, section 958(b) requires stock ownership in a foreign

[34] Proposed section 899(e). Following *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (2024), some have questioned whether such a broad delegation of authority is constitutional, even if confined to a single code section. For a brief discussion of this issue, see Ellen P. Aprill, "Unpacking the Most Important Paragraph in Loper Bright," *Yale J. Regul.* blog, Jan. 15, 2025. At least under existing Supreme Court precedent, this delegation ought to be constitutional under the "intelligible principle" test. *See J.W. Hampton Jr. & Co. v. United States*, 276 U.S. 394 (1928).

[35] There are 270 days between April 5 and December 31.

[36] Section 245A(b) defines a specified foreign corporation as any foreign corporation with a domestic corporation as a U.S. shareholder, defined in section 951(b) by reference to ownership of the vote or value of 10 percent of the stock of the foreign corporation. The determination of stock ownership is determined by reference to section 958(a) and (b).

corporation to be determined constructively by reference to section 318, importing principles of upward and downward attribution.[37] Because of downward attribution, even foreign affiliates outside a U.S. group can satisfy the carveout. For example, if a foreign parent owns both a foreign subsidiary and a U.S. subsidiary, the foreign parent's ownership of the foreign subsidiary would be attributed to the U.S. subsidiary, rendering the foreign subsidiary a 10-percent-owned foreign corporation.

Before its repeal in the Tax Cuts and Jobs Act,[38] section 958(b)(4) prevented downward attribution of stock owned by a foreign person to a U.S. person. Both parties in Congress have tried to enact legislation to restore section 958(b)(4).[39] It remains to be seen how this Congress will address section 958(b)(4) in any new tax bill.

D. Section 896

Section 896, like section 891, enables the president to impose retaliatory measures "if it is in the public interest" and the president finds that foreign taxes are "more burdensome" or "discriminatory." Because section 896 was enacted in 1966, any attempt to apply it would raise treaty questions like those raised by section 891. Regardless, even if section 896 could apply, DSTs and UTPRs are unlikely to be considered more burdensome or discriminatory.

The definition of "more burdensome" taxes considers whether U.S. citizens or U.S. corporations are subject to more burdensome taxes by a foreign country on any item of income sourced to that country as compared with the U.S. taxes imposed on similar income derived from U.S. sources by residents or citizens of that country. The definition of "discriminatory taxes" considers whether a foreign country subjects U.S. citizens or U.S. corporations (or a subset thereof) to higher effective tax rates on any item of income as compared with the taxes imposed by that country on its own citizens or corporations. Because DSTs typically apply equally to U.S. and foreign corporations, it seems unlikely that a DST would be considered more burdensome or discriminatory under this definition.[40] Similarly, the UTPR is unlikely to be considered more burdensome or discriminatory under section 896 because it applies to foreign corporations and not U.S. corporations (unless the U.S. corporation has a permanent establishment in the country). Thus, section 896 is unlikely to be an effective response to DSTs or UTPRs.

If a tax were determined to be more burdensome under section 896, the president could proclaim that pre-1967 tax provisions apply to the U.S.-source income of foreign corporations, effectively amending subchapter N (taxes based on income from sources within or without the United States) and chapter 3 (withholding tax on NRAs and foreign corporations) through executive action.

In response to discriminatory taxes, the president could, by proclamation, adjust the U.S. ETRs on similar income of foreign corporations to be substantially equal to the ETR imposed by the foreign country on the income of U.S. corporations, incorporating a principle of proportionality into the U.S. retaliatory response.

[37] Section 318(a)(3).

[38] TCJA section 14213(a)(1).

[39] *See* former Rep. Kevin Brady, then-chair of the Ways and Means Committee, "Tax Technical and Clerical Corrections Act Discussion Draft" (Jan. 2, 2019); Build Back Better Act, H.R. 5376, section 128128(b)(3) (Senate Finance Committee text released Dec. 11, 2021). Treasury and the IRS have also issued proposed regulations to reinstate section 958(b)(4) for very limited purposes not relevant here. REG-104223-18.

[40] India's equalization levy on online advertising services is an exception because it applies only to nonresident companies without a PE in India. However, India has recently indicated an intent to remove its equalization levy. *See* Natalie Choy, "India Likely to Withdraw 6% Equalization Levy From April 1: Mint," *Daily Tax Report*, Mar. 24, 2025.

Title	Targeted Taxes	Retaliatory Measure	Key Issues
Section 891 — Doubling of Tax Rates (enacted in 1934)	Discriminatory taxes (undefined) Extraterritorial taxes (undefined)	Doubles the tax rates specified in the following sections for foreign citizens and foreign corporations of the offending country: • Section 1 — individual income tax up to 37 percent on ordinary income and 20 percent on capital gains • Section 11 — 21 percent corporate income tax • Section 871(a) — 30 percent tax on FDAP of nonresident individuals • Section 871(b) — 37 percent/20 percent rates for individual ECI • Section 881 — 30 percent tax on non-ECI FDAP of corporations Tax not to exceed 80 percent of taxable income Double rate is imposed immediately	• All or nothing • Collected by self-assessment • Interaction with tax treaties • Impact on foreign citizens resident in the United States and foreign subsidiaries of U.S.-parented groups
Amendment to BEAT (Super BEAT) (proposed)	Extraterritorial taxes only (defined; same definition as Smith bill) Self-executing — does not require Treasury to identify exterritorial taxes	Super BEAT would apply to any foreign-parented multinational that operates in a country with an extraterritorial tax, with the following adjustments to the BEAT: • Remove the $500 million gross receipts test and the 3 percent (2 percent for banks and registered securities dealers) base erosion percentage threshold • Treat 50 percent of COGS as a base erosion tax benefit • Accelerate the increase in the BEAT rate to 12.5 percent and treat all general business credits as a preference item that can drive BEAT liability • Eliminate exceptions for SCM and for payments subject to withholding tax	• Constitutional issue re: treating 50 percent of COGS as a base erosion tax benefit • Application to foreign-parented groups because *any* member is in a jurisdiction with a UTPR • Interaction with tax treaties
Defending American Jobs and Investment Act (Smith bill (proposed)	Discriminatory taxes (defined) Extraterritorial taxes (defined) Treasury must report on discriminatory and extraterritorial taxes based on overly broad definitions, regardless of whether the tax applies to U.S. groups	Increases tax rates specified by the following sections by 5 percent each year for four years for residents (with certain exclusions) of jurisdictions with discriminatory or exterritorial taxes: • Section 871(a) — above • Section 871(b) — above, but limited to FIRPTA gains • Section 881 — above • Section 882 — ECI of corporations • Section 884(a) — BPT • Section 1441(a) — withholding on individual FDAP • Section 1442(a) — withholding on FDAP of corporations • Section 1445 — withholding on disposition of U.S. real property interests	• Explicitly overrides treaties, but only in part • Uncertain whether an explicit override can be enacted through reconciliation without violating the Byrd rule in the Senate • Appears to not be self-executing, so may not be eligible for reconciliation due to the lack of revenue effect absent a change

Title	Targeted Taxes	Retaliatory Measure	Key Issues
Section 896 — Adjustment to Taxes (enacted in 1966)	More burdensome taxes (defined) Discriminatory taxes (defined)	• Residents of a country with more burdensome taxes are subject to tax on similar U.S.-source income based on certain pre-1967 tax provisions • For a country with a discriminatory tax, the ETR imposed on similar income of its nationals, residents, or corporations is adjusted to achieve a similar ETR	• Interaction with treaties • Likely ineffective because of focus on inconsistent taxation of U.S. and foreign residents

III. Design Considerations for Retaliatory Measures

A. Why a Retaliatory Measure May Be Viewed as Helpful

The objective of a retaliatory response to DSTs and the UTPR is to impose additional costs to pressure foreign countries to abandon these policies. Any retaliatory response should be narrowly tailored to achieve this objective and avoid imposing needless tax barriers to cross-border trade and investment.

As such, retaliatory measures should not impose disproportionate costs on U.S. businesses, for example, by terminating tax treaties or eliminating FTCs. These responses would be disruptive, difficult to reverse, and disproportionately affect a constituency (U.S. businesses) that is not best placed to advocate for changes to foreign countries' tax policies.

Another consideration is whether any response should be proportionate to the impact of the offending tax. Customary international law provides that countermeasures for wrongful acts committed by another state should be proportionate, bearing in mind both the injury suffered and the gravity of the act.[41] This may be relevant if the administration or Congress is concerned about identifying a legal justification for the United States to override its tax treaties. A proportionate response is also more likely to avoid escalation, reducing the risk of spillover damage to other parts of the economy.

If the objective is a proportionate response and proportionality is measured by the magnitude of injury, the revenue-raising potential of DSTs and UTPRs could be relevant. The U.K. DST raised £358 million for the 2020-2021 tax year,[42] rising to £567 million for the 2022-2023 tax year.[43] Canada's DST is expected to raise C $1.2 billion in annual revenue for its 2024-2025 fiscal year, after an initial windfall in its 2023-2024 fiscal year because of its retroactive application.[44] Data on the revenue that UTPRs are expected to raise is limited, in part because it is highly dependent on how pillar 2 is implemented globally, which has led some countries to be conservative. For example, the United Kingdom forecast in September 2023 that its UTPR would raise no revenue.[45] That said, the UTPR feasibly could raise material revenue if major economic powers, such as China and the United States, do not implement pillar 2.

As noted above, however, the gravity of the act, and not only the injury, is relevant when determining whether a retaliatory response is proportionate. The principal concerns of the sponsors of the retaliatory tax bills are likely more ideological than economic. Moreover, a disproportionate response may be a stronger inducement for countries to come to the negotiating table than a tit-for-tat strategy. A "shock and awe" measure could also increase the revenue score and its utility as a pay-for for other U.S. tax cuts promised by Trump on the campaign

[41] Andrew D. Mitchell, "Proportionality and Remedies in WTO Disputes," 17 *Eur. J. Int'l L.* 985 (2006).

[42] HM Revenue and Customs, "Investigation Into the Digital Services Tax" (Nov. 23, 2022). The U.K. tax year runs from April 6 to April 5 of the following calendar year.

[43] "DST Revenues Up as Pillar One Deadline Expires," *Tax Journal*, July 3, 2024.

[44] Office of the Parliamentary Budget Officer, legislative costing note, Digital Services Tax (Oct. 17, 2023). Canada's fiscal year begins on April 1 and ends on March 31 of the following calendar year.

[45] HMRC policy paper, "Multinational Top-Up Tax: Undertaxed Profits Rule and Other Amendments" (Sept. 27, 2023).

trail, while at the same time satisfying a Republican desire to take an ideological stand.

Perhaps more important than proportionality is for any retaliatory measure to allow time for it to be effective in inducing withdrawal of the offending measure before any draconian results kick in. The Smith bill does this with an "applicable date" that is 180 days after a country is listed by Treasury. In contrast, the Super BEAT, which is quite draconian, applies to tax years beginning after its enactment, which could be disastrous if enacted late in a taxpayer's tax year. Consideration should also be given to providing for the removal of retaliatory measures, including potentially retroactively to the beginning of a tax year, as soon as the harmful tax is repealed. Conversely, the Super BEAT would apply to a group if a UTPR was imposed on any foreign related entity at any point during the year, such that revoking a UTPR midyear would not produce relief until the following year. Similarly, the Smith bill would only remove its elevated rates for tax years beginning after the secretary reports that the country no longer has a discriminatory or extraterritorial tax, though relief from withholding applies to payments after the date of the report.

B. Design Considerations for Including Retaliatory Measures in Reconciliation

Regardless of how the cost of extending the TCJA is measured (using a "current law" or a "current policy" baseline) and Congress's willingness to use some deficit financing, the taxwriting committees in Congress are in search of revenue to help pay for some of the tax cuts promised by Trump on the campaign trail that are expected to be included in a budget reconciliation bill later this year.

1. Scoring conventions.

Administrative action generally does not score,[46] so presidential proclamations under existing measures such as section 891 or section 896 would not technically contribute revenue to this effort. The Smith bill and the Super BEAT, however, are being discussed as potential revenue raisers for the reconciliation bill.

Provisions must have a revenue effect to be included in reconciliation.[47] Perhaps more importantly, to be helpful as a pay-for in reconciliation, any retaliatory tax measure would need to have a positive revenue score, which may mean it needs to be self-executing.[48] The Super BEAT takes a narrow aim at UTPRs and so can be self-executing. The more ambitious Smith bill, which targets both DSTs and UTPRs, may not be considered sufficiently self-executing to score.

Conventional revenue estimates by the Joint Committee on Taxation are dynamic in that they consider anticipated taxpayer behavioral responses to proposed changes in tax law.[49] If a statute includes regulatory authority that is not self-executing, the JCT's revenue estimates generally do not consider what it thinks Treasury might do with that authority. As drafted, the Smith bill relies on Treasury to identify the foreign taxes targeted by the measure. As such, it may not raise revenue under traditional scoring conventions, seemingly making it ineligible for reconciliation.

The general understanding that the JCT, when using a conventional revenue estimate, only scores the self-executing aspects of a proposal could be challenged in the context of the Smith bill. In contrast to many grants of discretionary regulatory authority, the Smith bill *requires* Treasury to issue a report in 90 days listing taxes that meet its overbroad definition (discussed in Section II.C, above). Further, a member could request a revenue estimate that takes into account anticipated Treasury actions because, at a minimum, it appears preordained that the Treasury report would list UTPRs and DSTs. The question arises whether, in this unique context, the JCT might release a revenue estate that takes into account that anticipated Treasury action.

The flip side of these conventions is that a retaliatory measure that is treated as self-

[46] The amount of revenue raised from a proposal is often referred to as how much the proposal "scores."

[47] A provision is subject to the so-called Byrd rule as extraneous to a reconciliation bill if it does not produce a change in outlays or revenues. Congressional Budget Act of 1974, section 313(b).

[48] *See* JCT, "The Joint Committee on Taxation Revenue Estimating Process" (Jan. 28, 2025) for an overview of the JCT's revenue estimating process.

[49] *Id.* at 13.

executing will be scored based on current law in other countries, generally without regard to whether the measure might succeed in persuading countries to rescind the offending taxes. It is understandable that the JCT does not want to be in the business of speculating what Treasury, let alone other countries, will do in response to a measure. As a result, a revenue score that treated a disproportionate retaliatory measure as self-executing could raise eye-popping sums, even if the bill provides time for countries to respond before the retaliatory tax takes effect, such that the tax is ultimately not expected to be collected. It remains to be seen, however, if an eye-popping revenue score will be produced, let alone released.

To avoid a risk that the Smith bill could be treated as too dependent on Treasury action to score, lawmakers may choose to make it self-executing. This change would make it imperative to get the definitions of the targeted taxes right, which, especially for DSTs, turns out to be hard. The experience of working on such a definition in the context of pillar 1 suggests that it may not be realistic to draft a comprehensive, self-executing definition of taxes that captures DSTs and other problematic measures but is not overbroad.

A hybrid approach may be the solution. That is, a targeted definition could limit any self-executing retaliatory measure to DSTs and UTPRs, while the measure could also include a broader definition of discriminatory and extraterritorial taxes that opens the door for executive action to apply the provision to other taxes after a notice and comment process. The Smith bill and the Super BEAT both include a definition of "extraterritorial tax" that provides the basis for a self-executing prong with respect to UTPRs, provided the definition is amended to focus on taxes that are in fact extraterritorial (as discussed above). For DSTs, drafters might consider simply referring to the existing regimes by name in the self-executing prong. To prevent sharp-penciled lawmakers from avoiding such a targeted approach, each of those measures could be presumed to remain in scope even if modified, unless Treasury provides otherwise, including through subregulatory guidance.[50]

2. What foreign taxes might the Smith bill be trying to capture with a broad definition of discriminatory tax?

It is worth considering whether Congress should provide Treasury with non-self-executing authority to cast a broader net than DSTs and UTPRs. As presently drafted the definition of discriminatory tax in the Smith bill would give the administration the ability, through the mere expedient of issuing a report, to identify virtually any country as warranting the imposition of the retaliatory tax. While one can hope for restraint, the current experience with expansive executive authority to impose tariffs ought to lead Congress to carefully consider such a broad grant of authority.

However, an example of why Congress might want to arm Treasury to cast a wider net is Australia's attempt to expand the definition of royalties subject to withholding, which was publicly criticized by the prior administration as contrary to the Australia-U.S. tax treaty.[51] While more aptly described as an extraterritorial tax measure, Australia's approach would appear caught by the first prong of the definition of discriminatory tax in the Smith bill, referring to taxes imposed based on sourcing rules that don't align with the U.S. rules. That prong similarly would arm Treasury to retaliate if some of the countries that are advocating to expand taxing rights on imported services at the UN incorporate withholding taxes on services into their domestic law. Other extraterritorial taxes that would fall under this prong are the U.K.'s diverted profits tax and Australia's equivalent, the Multinational Anti-Avoidance Law.[52] A third could be the aggressive application of transfer pricing rules to

[50]This presumption would prevent changes like Italy's proposal to remove the revenue threshold from its DST from taking that DST out of scope unless Treasury made an affirmative judgment that the modification rendered the tax no longer discriminatory. *See supra* note 32.

[51]Letter from Scott Levine, acting U.S. Treasury deputy assistant secretary for international tax affairs, to the Australian Taxation Office regarding the latter's draft taxation ruling (TR2024/D1) (Apr. 5, 2024).

[52]For an example of criticism of the diverted profits tax, see Grinberg, "International Taxation in an Era of Digital Disruption: Analyzing the Current Debate," *Taxes* 85 (Mar. 2019).

U.S. multinationals, such as those pursued through the European Commission's state aid investigations.

Further, while Smith previously indicated comfort with other countries imposing GILTI-like controlled foreign corporation rules,[53] the United States should be concerned about the application of the IIR to the U.S. income of inbound groups when triggered by the detrimental treatment of the U.S. research tax credit under pillar 2. As such, the United States should work to ensure that any internationally agreed upon CFC regime, such as the IIR, treats the U.S. research tax credit on par with refundable tax credits.

Thus, arguably there is value in a broader definition like that in the Smith bill, so long as it is not self-executing and requires a notice and comment process for Treasury to administer the measure in the national interest.

IV. Interactions With Tax Treaties

A. The Supremacy Clause and 'Later in Time'

The U.S. Constitution's supremacy clause provides that federal statutes and treaties have coequal status.[54] As such, when a treaty and statute relate to the same topic, courts, as well as the legislative history to sections 894(a) and 7852(d), provide that they should be reconciled to the extent possible.[55] In the case of unavoidable conflict, courts generally rely on the later-in-time rule,[56] which provides that the most recently enacted statute or ratified treaty controls.[57] The later-in-time rule has also been explicitly acknowledged by Congress.[58]

This rule is a potentially significant constraint to the application of section 891 and is relevant for both the Smith bill and the Super BEAT.

B. Section 891 and Tax Treaties

There are two primary ways section 891 could be understood to interact with treaties.

The most straightforward argument is that because section 891 was enacted in 1934 before any U.S. tax treaties were ratified, all existing treaties supersede conflicting provisions in section 891. Under this approach if section 891 were invoked it would apply only to persons not covered by a bilateral tax treaty. For example, Croatia,[59] Hungary, and North Macedonia have implemented the UTPR and do not have tax treaties in force with the United States. Although it has been suggested that tax treaties do not limit U.S. tax on ECI that is considered business profit attributable to a U.S. PE or on the sale of a U.S. real property interest,[60] the nondiscrimination clause in the U.S. model treaty would prevent discriminatory tax rates from applying to nationals of a treaty partner (article 24(1)) and to PEs of a resident of a treaty partner (article 24(2)).

Although section 891 was amended four times since its enactment, most recently in 1986, those amendments were housekeeping changes to update section 891 for other changes in the code.[61] In *Cook*[62] the Supreme Court dealt with the reenactment of section 581 of the Tariff Act of 1930 in the identical terms of the act of 1922. The Supreme Court found that nothing about the

[53] *See* Smith letter, *supra* note 5.

[54] U.S. Const. Art. VI, cl. 2; *see also* section 7852(d) ("For purposes of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or law."); *Samann v. Commissioner*, 313 F.2d 461, 463 (4th Cir. 1963); and *American Trust Co. v. Smyth*, 247 F.2d 149, 153 (9th Cir. 1957).

[55] *Whitney v. Robertson*, 124 U.S. 190, 194 (1888) ("The courts will always endeavor to construe them so as to give effect to both, if that can be done without violating the language of either.").

[56] *Id.*

[57] *See, e.g.*, *Lindsey v. Commissioner*, 98 T.C. 672 (1992), *aff'd without published opinion*, 15 F.3d 1160 (D.C. Cir. 1994) (citing section 7852(d) and holding that the Swiss-U.S tax treaty must "yield" to the application of section 59(a), which was enacted in 1986, after ratification of the treaty); and Rev. Rul. 80-223, 1980-2 C.B. 217 (ruling that the enactment of sections 901 and 907 "supersede inconsistent provisions" of previously enacted tax treaties and that one needs to examine congressional intent in passing the legislation to determine what controls).

[58] S. Rep. No. 100-445, at 321-322 (1988) (stating in the legislative history to section 7852, "the committee does not intend this codification to alter the initial presumption of harmony between, for example, earlier treaties and later statutes. . . . Nor does the committee intend that this codification blunt in any way the superiority of the latest expression of the sovereign will in cases involving actual conflicts, whether that expression appears in a treaty or a statute.").

[59] The Croatia-U.S. tax treaty was signed on December 7, 2022, but it has not been ratified.

[60] Zhang, *supra* note 13.

[61] *See* 68A Stat. 283 (Mar. 13, 1956) (inserting a reference to section 811); P.L. 86-69, section 3(f)(1) (June 25, 1959) (striking out the reference to section 811); P.L. 98-369, section 211(b)(12) (July 18, 1984) (substituting "801" for "802"); and P.L. 99-514, section 1024(c)(13) (Oct. 22, 1986) (striking the reference to section 821).

[62] *Cook v. United States*, 288 U.S. 102, 107 (1933).

reenactment evinced an intent by Congress to abrogate the treaty.[63]

A Senate report in the legislative history of the Technical Corrections Act of 1988 analyzed *Cook*:

> Properly construed, therefore, the committee believes that *Cook* stands not for the proposition that Congress must specifically advert to treaties to have later statutes given effect, but that for purposes of interpreting a reenacted statute, it may be appropriate for some purposes to treat the statute as if its effect was continuous and unbroken from the date of its original enactment.[64]

Professors H. David Rosenbloom and Fadi Shaheen, in a discussion of the BEAT's interaction with treaties, assert that this Senate report inappropriately narrowed the Court's holding in *Cook* to the reenactment context, despite the Court's broader reasoning that the treaty prevailed because there was no clear expression of congressional intent to override the treaty.[65] Regardless, we expect that even the drafters of the Senate report would agree that housekeeping amendments such as those made to section 891, without more, should not invoke the later-in-time rule.

The other approach is to try to reconcile section 891 and our tax treaties. In proposing section 891 as a response to EU state aid investigations, professor Itai Grinberg suggested that holdings against the U.S. companies could be considered incompatible with existing U.S. tax treaties, with the result that applying section 891 as a response may be reconcilable with those treaties.[66] Under this view, if DSTs and UTPRs are violations of U.S. tax treaties, it is not inconsistent with our commitments under those treaties to apply section 891 as a response.

Although DSTs are understood not to be a covered tax under tax treaties, article 24 of the U.S. model treaty (nondiscrimination) applies to "taxes of every kind and description."[67] An argument that DSTs are discriminatory might be premised on a combination of paragraphs 24(1) and 24(5), on the basis that DSTs are designed to tax the profits of U.S. groups, whether earned directly through a nonresident or through a resident corporation owned indirectly by the U.S. parent.[68] Leaving the technicalities aside, DSTs have stretched international tax norms because of countries' dissatisfaction with the existing status quo — a status quo thought to be protected through bilateral tax treaties.

The arguments that the UTPR is incompatible with tax treaties are more straightforward. Articles 7 (business profits) and 9 (associated enterprises) of the U.S. model treaty generally limit each country's taxing rights to income that has a sufficient nexus with that country, such that it is hard to argue why, for example, the France-U.S. tax treaty does not prevent France from imposing tax on the business profits of a U.S. corporation that has no taxable presence in France.[69]

Thus, there is at least a colorable claim that even if section 891 is generally overridden by tax treaties, its purpose of providing a mechanism to respond to countries that impose discriminatory or extraterritorial taxes against U.S. businesses survives for purposes of responding to a treaty partner's imposition of discriminatory or extraterritorial taxes in contravention of the tax treaty. In any event, if the executive branch adopted this view, affected taxpayers could seek resolution of their claims for treaty relief in the U.S. courts, but there would be much disruption in the meantime.

[63] *Id.* at 120.

[64] S. Rep. No. 100-445, at 325 (citation omitted).

[65] Rosenbloom and Shaheen, "The BEAT and the Treaties," *Tax Notes Int'l*, Oct. 1, 2018, p. 53.

[66] Grinberg, *supra* note 12.

[67] U.S. model income tax convention (2016), art. 24(7).

[68] Chris Forsgren, Sixian (Suzie) Song, and Dora Horváth, "Digital Services Taxes: Do They Comply With International Tax, Trade, and EU Law?" Tax Foundation (May 26, 2020). As noted in this article, DSTs are designed to be assessed at the group level, such that a DST is imposed on every company in a group.

[69] Letter from Sen. Mike Crapo, R-Idaho, et al., to then-Treasury Secretary Janet Yellen (Dec. 14, 2022). For a summary of the arguments in support of the UTPR, see Heydon Wardell-Burrus, "Four Questions for UTPR Skeptics," *Tax Notes Int'l*, Nov. 7, 2022, p. 699.

C. Tax Treaties and Reconciliation — The Smith Bill

As discussed above, the Smith bill includes an explicit treaty override for sections 1441 and 1442 but omits this language in the provision increasing the tax rate on substantive income. This disconnect is likely unintentional, but it nevertheless creates an ambiguity whether, if the bill is enacted as is, a strict constructionist court would find a negative inference regarding the substantive tax, or whether the later-in-time rule would apply such that the Smith bill would also override treaties regarding the substantive tax provisions.

This question is likely academic. If a version of the Smith bill is included in legislation to be enacted through the budget reconciliation process, the explicit treaty override language likely would be removed based on Senate rules. Without delving too deeply into the Byrd rule, the application of which would be decided by the Senate parliamentarian, treaty override language generally would be foreclosed because a reconciliation bill cannot include matters outside the jurisdiction of the committee that submitted the provision for inclusion in the reconciliation measure.[70] Treaties fall within the domain of the Senate Foreign Relations Committee, making problematic any reference to them in reconciliation legislation (including any amendment or conference report) that does not instruct that committee.

If the explicit treaty override language is removed, the intent would be for the later-in-time rule to provide the override. As discussed above, consideration should be given to how to ensure that the (seemingly intended) incremental approach is in fact achieved for treaty jurisdictions, which may require a reference to the "otherwise applicable rate," but also considering the situations in which U.S. treaties do not cap the rate but instead foreclose taxing rights in the source country.

D. Is the Super BEAT Compatible With Tax Treaties?

Though less important than the questions of treaty compatibility raised by section 891, commentators have also questioned whether the BEAT is compatible with tax treaties.[71] Rosenbloom and Shaheen have argued that the BEAT conflicts with the nondiscrimination clauses of U.S. tax treaties and that the TCJA's legislative history does not indicate that Congress intended the BEAT to override treaties, such that BEAT would not trump treaties under the later-in-time rule. Though to date we are not aware that the treaty compatibility of the BEAT has been challenged, and there are arguments in favor of compatibility,[72] this issue could see renewed focus if the Super BEAT is enacted.

The Super BEAT raises a more acute conflict with the nondiscrimination articles in U.S. tax treaties because it applies only to a "foreign entity (other than a foreign entity controlled by any domestic corporation)." This limitation appears to violate article 24(5) of the U.S. model treaty, which provides:

> Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith that is more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned Contracting State are or may be subjected.

As drafted the Super BEAT could apply to a treaty partner that is resident in a jurisdiction with no UTPR but has an affiliate resident in a jurisdiction with a UTPR. In contrast, a U.S.-parented group that similarly has a subsidiary in

[70] Congressional Budget Act of 1974, section 313. *See* S. Prt. 117-23, "The Congressional Budget Process," at 704 (2022). *See also* Congressional Research Service, "Points of Order Limiting the Contents of Reconciliation Legislation: In Brief" (Feb. 18. 2025).

[71] Rosenbloom and Shaheen, *supra* note 65.

[72] *See* Reuven S. Avi-Yonah and Bret Wells, "The BEAT and Treaty Overrides: A Brief Response to Rosenbloom and Shaheen," *Tax Notes Int'l*, Oct. 22, 2018, p. 383; Avi-Yonah, "Pacta Sunt Servanda? The Problem of Tax Treaty Overrides," U. of Mich. Public Law Research Paper No. 22-022 (2022); Avi-Yonah, "The Dubious Constitutional Origin of Treaty Overrides: A Response to Rosenbloom and Shaheen," 26 *Fla. Tax Rev.* 282, 287 (2022).

a country with a UTPR is unaffected. This would appear to be clear (and unjustified) discrimination based on ownership of capital. Avoiding such a clear treaty conflict is another reason why the drafters should consider narrowing the scope of the Super BEAT so that it applies only when the foreign parent is resident in a jurisdiction that has enacted a UTPR.

V. Is Treating 50 Percent of COGS as a Base Erosion Tax Benefit Constitutional?

If the Super BEAT were enacted, the constitutionality of not allowing a full reduction for COGS would be an obvious and consequential area for taxpayer challenge.

The 16th Amendment, ratified in 1913, establishes the constitutional authority for Congress to levy direct taxes, including income taxes, without apportioning them among the states based on population. What constitutes income has been subject to debate in the context of the sale of marijuana (or more legalistically, the trafficking in Schedule I and Schedule II controlled substances). The Supreme Court has held that income in the context of a reseller or producer means gross income, not gross receipts, whereas deductions are a matter of legislative grace.[73] Thus, even drug dealers are entitled to a reduction for COGS because an "income tax" within the meaning of the 16th Amendment may not tax capital.

A 1982 Senate report accompanying the enactment of section 280E, which generally disallows all deductions for businesses dealing in controlled substances, acknowledged this limitation:

> All deductions and credits for amounts paid or incurred in the illegal trafficking in drugs listed in the Controlled Substances Act are disallowed. To preclude possible challenges on constitutional grounds, the adjustment to gross receipts with respect to effective costs of goods sold is not affected by this provision of the bill.[74]

A 2014 IRS memorandum (ILM 201504011) interprets this allowance for COGS to be limited to costs that would be inventoriable costs using the inventory-costing regulations under section 471 as they existed when section 280E was enacted, which has the effect of denying a benefit for overhead expenses capitalized under section 263A.

When section 280E was enacted, it applied predominantly to sole proprietorships. The BEAT, however, applies exclusively to corporations,[75] which could open the door to an argument that allowing a reduction for COGS is not required because the corporate income tax is an excise tax. In *Stone Tracy*,[76] a pre-16th Amendment case, the Supreme Court held that a 1 percent corporate income tax was "an excise upon the particular privilege of doing business in a corporate capacity" and not a direct tax "upon property solely by reason of its ownership," which would have been subject to the apportionment clause. The Constitution empowers Congress "to lay . . . Excises" so long as they are "uniform throughout the United States."[77] This has been interpreted to include taxes on "privileges" and "particular business transactions."[78] In *Moore*[79] the government argued in the alternative that section 965 was constitutional as an excise tax on CFCs even if it was not an income tax on shareholders.[80] In her concurrence Justice Ketanji Brown Jackson cited this argument as worth consideration in the event other arguments upholding the tax were rejected,[81] but the rest of the Court did not engage with it.

[73] *See, e.g.*, *Doyle v. Mitchell Brothers Co.*, 247 U.S. 179, 185 (1918) ("As was said in *Stratton's Independence v. Howbert* [citation omitted], 'Income may be defined as the gain derived from capital, from labor, or from both combined.'"); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934) ("The power to tax income like that of the new corporation is plain and extends to the gross income. Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed."). *See also* ILM 201504011.

[74] S. Rep. No. 97-494 (Vol. I), at 309 (July 12, 1982).

[75] Section 59A(a)(1).

[76] *Flint v. Stone Tracy*, 220 U.S. 107, 150-151 (1911).

[77] U.S. Const. Art. I, section 8, cl. 1.

[78] *Thomas v. United States*, 192 U.S. 363, 370 (1904). *See also Knowlton v. Moore*, 178 U.S. 41, 78-83 (1900) (holding that an inheritance tax is not a tax on property but on the privilege of succession).

[79] *Moore v. United States*, 602 U.S. 572 (2024).

[80] Brief for the United States at 46-47, *Moore*, 602 U.S. 572 (2024) (No. 22-800).

[81] *Moore*, 602 U.S. at 601.

A counterargument to analyzing the corporate income tax as an excise tax is that *Stone Tracy*'s elastic reading of the constitutional term "excises" grew out of a line of cases limiting *Pollock*,[82] which in a decision later nullified by the 16th Amendment, held that income taxes are direct taxes that must be divided among states according to population. Professor Calvin H. Johnson's amicus brief in *Moore* explains:

> "Excise" was a narrow term at the time of the Constitution. . . . After *Pollock*, the "excise" expanded elastically from its humble whiskey-tax roots to encompass every tax that came before the Court. Taxes on trades on the Chicago Board of Trade were labelled an excise. *Nicol v. Ames*, 173 U.S. 509, 519 (1899). A progressive tax on estates was an excise. *Knowlton v. Moore*, 178 U.S. 41, 78-79 (1900). A progressive tax on gifts was an excise. *New York Tr. Co. v. Eisner*, 256 U.S. 345, 349-350 (1921). A tax on mining gross income was an excise. *Stanton v. Baltic Mining*, 240 U.S. 103 (1916). A corporate income tax was an excise because it was just a tax (much like a license fee) on the privilege of doing business as a corporation. *Flint v. Stone Tracy Co.*, 220 U.S. 107, 151-152 (1911).[83]

The *Stone Tracy* reasoning was, however, cited favorably in *Penn Mutual Indemnity*,[84] a 1960 Tax Court case holding that the denial of underwriting losses did not render a gross-basis alternative tax for insurance companies unconstitutional. The basis for the holding is not clear, but the majority opinion suggested that the tax was an indirect tax, determining that it was inconsequential whether the tax was an excise or an impost[85] because "the source of the taxing power is not the 16th amendment; it is article I, section 8, of the Constitution."[86] In so holding the Tax Court cited favorably *Stone Tracy* and other early Supreme Court cases that had narrowed the meaning of direct taxes.

The drafters of the Super BEAT may also have justified including 50 percent of COGS as a base erosion tax benefit because the BEAT, at least as originally framed, was an antiabuse measure. In form, it is not a primary tax but rather an alternative minimum tax. Though for many companies, denying 50 percent of COGS would easily elevate the BEAT to a primary tax, not least of which because the BEAT does carry forward as a credit against the regular income tax. This issue would be exacerbated if the Super BEAT applies to all COGS rather than just purchases from foreign related parties.

The constitutional argument that COGS is protected quickly blends into the policy argument that COGS should be allowed because otherwise a tax on gross receipts can exceed the taxpayer's net income, similar to why DSTs are problematic.

VI. Conclusion

The administration's current toolbox of responses to the application of discriminatory and extraterritorial tax measures to U.S. groups, while seemingly mighty, may require some retooling to achieve its desired effect.

Section 891 provides the administration with a tool to respond immediately to foreign countries' implementation of DSTs and UTPRs. Tax treaties could constrain its application, and doubling the tax rates of foreign citizens resident in the United States or foreign subsidiaries of U.S. businesses seems like an unintended outcome. However, a presidential proclamation could perhaps limit section 891's rough edges, and the president has repeatedly shown his willingness to take action that is open to legal challenge and then take his fight to court. This fighting spirit could also be relevant to the question of whether subsequent treaties have overridden section 891. The Smith bill provides an alternative that addresses some of section 891's limitations; and with adjustments it could be a potential revenue raiser for budget

[82] *Pollock v. Farmers' Loan and Trust Co.*, 157 U.S. 429 (1895).

[83] Brief of Amicus Curiae Calvin H. Johnson in Support of Respondent, *Moore*, 602 U.S. 572 (2024) (No. 22-800).

[84] *Penn Mutual Indemnity v. Commissioner*, 32 T.C. 653 (1959), *aff'd*, 277 F.2d 16 (3d Cir. 1960).

[85] *Id.* at 660-661 ("The 'terms duties, imposts and excises are generally treated as embracing the indirect forms of taxation contemplated by the Constitution.' *Flint v. Stone Tracy Co.*, 220 U.S. 107, 151. Therefore, if a tax is not a direct tax, it falls within the general category of indirect taxes, and it is a matter of no moment whether its classification be further refined as a duty, or an impost, or an excise.").

[86] *Id.* at 659.

reconciliation, while its delayed effective date might allow it to achieve its bidding without detrimental impacts on inbound investors. The Super BEAT, on the other hand, would have a significant detrimental effect on foreign businesses if it includes 50 percent of COGS as a base erosion benefit. While there are questions about whether this is constitutional, the constitutional question would take significant time to resolve.

The retaliatory measures available to the administration and congressional Republicans might not be perfect, but they might still be enough to spur countries to respond. Taxpayers may be able to successfully challenge section 891 as incompatible with treaties or the Super BEAT as unconstitutional. However, if it takes a year or more for the courts to reach that conclusion, in the intervening period foreign countries will face significant pressure to revoke their DSTs and UTPRs. ■