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Take 2: Evaluating the Revised Retaliatory Measures in the House Bill

by Danielle Rolfes, Alistair Pepper, Daniel Winnick, and Casey Caldwell

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In this follow-up report, the authors analyze the revised versions of two proposed retaliatory tax measures, consolidated in proposed section 899, now before the Senate as part of the budget reconciliation package, assessing whether the more significant modifications to those now-combined proposals are consistent with Congress's stated policy goals in responding to "unfair" taxes imposed by foreign countries.

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On May 22 the House passed a sprawling budget reconciliation package, the One Big Beautiful Bill Act (H.R. 1). The tax title includes provisions to prevent the expiration of many of the tax cuts originally enacted in the Tax Cuts and Jobs Act and to deliver on several new tax benefits proposed by President Trump during his campaign.[1] The revenue cost of the taxpayer-favorable changes would be offset in part by several revenue-raising provisions. As expected, among them are revised versions of the retaliatory tax measures previously introduced by House Ways and Means Committee Chair Jason Smith, R-Mo.,[2] and committee member Ron Estes, R-Kan.,[3] which would impose punitive taxes on certain persons to retaliate against foreign countries ("discriminatory foreign countries") that have implemented an "unfair foreign tax."

The tax title would add new section 899, "Enforcement of Remedies Against Unfair Foreign Taxes," which would provide two retaliatory mechanisms: (1) increases to the rates of tax imposed on certain non-U.S. individuals and entities (drawing from Smith's proposal); and (2) modifications to the base erosion and antiabuse tax (drawing from Estes's proposed Super BEAT).[4] Unfair foreign taxes include the UTPR (formerly known as the undertaxed profits rule) of pillar 2, digital services taxes, diverted profits taxes (DPTs), and potentially others.

We recently published a close examination of the Smith and Estes bills, in which we pointed out aspects of each proposal that could frustrate their policy objective of encouraging countries to remove the offending tax regimes.[5] Many of these issues were addressed in the revised versions of the measures included in the tax title, although some new issues have emerged. This report builds on that prior work by discussing the more significant modifications and their implications for the policy objectives, including considerations for the Senate when it takes up the bill this month. As with our prior article, our intention is to assess the implications of proposed section 899 in light of its stated policy objectives and not to opine on the merits or demerits of retaliatory action.

I. Definition of Unfair Foreign Taxes

Several changes were made in combining the separate proposals into a single code section eligible for inclusion in reconciliation legislation, including unifying the diverging definitions and mechanisms for when a country is considered to have an offending tax.

A. UTPRs, DSTs, and DPTs

UTPRs, DSTs, and DPTs would be treated as per se unfair foreign taxes under the bill without further action by Treasury, but only if they apply to U.S. persons or controlled foreign corporations that are more than 50 percent owned, by vote or value, by U.S. persons.[6] Prior versions of the Smith

[1] The bill was supplemented with a report from the House Budget Committee (H.R. Rep. No. 119-106), an estimate of the bill's revenue effects by the Joint Committee on Taxation (JCX-22-25 R), and the JCT's estimated distribution of the revenue effects (JCX-23-25).

[2] Defending American Jobs and Investment Act, H.R. 591, 119th Cong. (2025). Smith previously introduced a version of this bill in 2023: H.R. 3665, 118th Cong. (2023).

[3] Unfair Tax Prevention Act, H.R. 2423, 119th Cong. (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. H.R. 4695, 118th Cong. (2023).

[4] H.R. 1 section 112028, 119th Cong. (2025) (as passed by the House) (proposed section 899).

[5] Danielle Rolfes, Casey Caldwell, and Alistair Pepper, "Evaluating Possible U.S. Retaliatory Tax Measures," *Tax Notes Federal*, Apr. 21, 2025, p. 493.

[6] Proposed section 899(c)(1)(A) and (B). While at first blush it may seem redundant to refer to the non-U.S. subsidiaries that must be excluded from a tax as CFCs that are "more than 50 percent owned, by vote or value, by United States persons," the quoted language is required to prevent so-called faux CFCs from being included after the repeal of section 958(b)(4) in the TCJA. Any reference to CFCs herein should be understood to refer only to non-U.S. subsidiaries that are more than 50 percent owned (within the meaning of section 958(a)), by vote or value, by U.S. persons.

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bill required Treasury to first identify and submit to Congress a list of extraterritorial and discriminatory taxes before the rate increases could take effect. In contrast, the Super BEAT, which applied only to UTPRs, was self-executing. The House-passed version of section 899 would automatically apply the rate increases proposed in the Smith bill and Super BEAT (both with the modifications discussed below) in response to UTPRs, DSTs, and DPTs, while giving Treasury discretionary authority to identify additional taxes. Accordingly, the provision is self-executing for UTPRs, DSTs, and DPTs, such that it can be scored and potentially be eligible for reconciliation legislation.[7]

As of May 13, 30 countries have implemented the UTPR, including Australia, most EU countries, Indonesia, Japan, New Zealand, South Korea, Turkey, and the United Kingdom. The February 21 White House memorandum, "Defending American Companies and Innovators From Overseas Extortion and Unfair Fines and Penalties," identified seven countries (Austria, Canada, France, Italy, Spain, Turkey, and the United Kingdom) as having DSTs, all of which (except for Canada) have enacted a UTPR, and two countries (Australia and the United Kingdom) that also have DPTs.[8] Proposed section 899 would be expected to treat each of these countries as a discriminatory foreign country.

As drafted, proposed section 899 refers to UTPRs, DSTs, and DPTs by name but does not define them. The accompanying House Budget Committee report, however, provides an overview of UTPRs and DSTs.[9] The section on DSTs discusses "traditional" DSTs, such as those introduced by the seven countries identified above, as well as significant economic presence (SEP) concepts introduced by countries such as Colombia.[10] It is not clear whether SEPs or other taxes that clearly target the digital economy but are not labeled as DSTs are captured by the self-executing reference to DSTs. In addition to SEPs, the most notable taxes about which there may be uncertainty are streaming taxes and cultural levies, which have been introduced by, among others, Canada, Denmark, and France. These taxes target digital businesses but are not badged DSTs.[11] The breadth of taxes described in the Budget Committee report suggests that the reference to DSTs is to be interpreted broadly and as going beyond "traditional" DSTs. In addition to the reference to SEPs, the report states that, "as of February 27, 2025, over 30 countries . . . have enacted DSTs, and several others have proposed legislation or announced an intention to implement DSTs."[12] In light of Treasury's ample authority to expand the taxes that are treated as unfair foreign taxes under the discretionary arm of the definition, and the short timeline provided for negotiation,[13] we suggest the Senate adopt a narrower approach that focuses on traditional DSTs for the self-executing arm of the definition.

The United Kingdom's DPT may provide an interesting case study for relying on a tax's name to identify it as an unfair foreign tax. Before the publication of proposed section 899, the United Kingdom announced that it intended to replace its DPT with a new charging provision to corporation tax for "unassessed transfer pricing profits."[14] As part of these reforms, the United Kingdom will provide access to tax treaties and modify some elements of its DPT, notably removing the avoided permanent establishment

[7]The amount of revenue raised from a proposal is often referred to as how much the proposal "scores." As discussed in our prior article, administrative action generally does not score, hence the need to make a provision self-executing. *See* JCT, "The Joint Committee on Taxation Revenue Estimating Process" (Jan. 28, 2025).

[8]The United Kingdom introduced its DPT in 2015 to target two types of arrangements to divert profits from the country: (1) entities or transactions that lack economic substance to exploit tax mismatches and (2) arrangements that avoid a U.K. PE. The DPT was introduced as a tax separate from the general corporate tax, so the United Kingdom asserted that it was not within the scope of the country's existing tax treaties. HM Revenue & Customs, "INTM489510 — Diverted Profits Tax: introduction and Overview" (May 16, 2025).

[9]*See* H.R. Rep. No. 119-106, pt. 6, at 389-393.

[10]*Id.* at 390.

[11]Notably, differences in both the scope and design of streaming taxes and cultural levies may make it less straightforward to determine whether they are borne disproportionately, directly or indirectly, by U.S. persons. Because they apply to a base other than net income, however, they appear on their face to meet the definition of discriminatory tax under proposed section 899.

[12]H.R. Rep. No. 119-106, pt. 6, at 391. KPMG maintains this tracker of developments in the taxation of the digital economy: "Taxation of the Digitalized Economy — Developments Summary." It tracks direct and indirect changes that have direct relevance to the digitalized economy, and it does not consider whether these taxes are extraterritorial or discriminate against U.S. businesses.

[13]Proposed section 899(e)(2).

[14]HMRC, "Reform of UK Law in Relation to Transfer Pricing, Permanent Establishment and Diverted Profits Tax" (Apr. 28, 2025).

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leg of the DPT charge.[15] If these changes are implemented and the DPT is renamed "unassessed transfer pricing profits," the United Kingdom's new measure would no longer be identified as a per se unfair foreign tax. Although the unassessed transfer pricing profits measure ultimately could still be identified as an unfair foreign tax under the discretionary arm of the definition, removing the avoided PE leg and providing access to tax treaties arguably means the measure should no longer be viewed as discriminatory or extraterritorial.

B. Other Extraterritorial and Discriminatory Taxes

An unfair foreign tax also would include, to the extent provided by the Treasury secretary, any tax that is extraterritorial, discriminatory, or "enacted with a public or stated purpose indicating the tax will be economically borne . . . disproportionately" by U.S. persons (disproportionate taxes).[16] Proposed section 899 includes definitions of extraterritorial taxes and discriminatory taxes that largely track those provided in the Smith bill,[17] with refinements to exclude certain taxes that should not be considered extraterritorial or discriminatory, consistent with some of the observations in our prior article.[18]

The disjunctive definition of discriminatory tax remains incredibly broad, but because this definition is not self-executing, there arguably is less pressure to get it perfect. In fact, our prior article discussed the challenges of drafting a self-executing definition of discriminatory tax that includes DSTs and their progeny (for example, various streaming taxes) without also having unintended consequences. Accordingly, identifying the known targets by name and leaving it to Treasury to identify the next generation of offending taxes may strike a reasonable balance for achieving the provision's policy objectives, including the desire for it to be sufficiently self-executing to garner a positive revenue score such that it is eligible for inclusion in budget reconciliation and can help meet the deficit instructions.

Still, the broad definition vests significant discretionary power in Treasury to identify discriminatory and extraterritorial taxes.[19] The grant of authority in proposed section 899(e) instructs the secretary to issue regulations "or other guidance" as may be necessary or appropriate to carry out the purposes of the provision, and proposed section 899(e)(2) requires the secretary to publish a quarterly list of discriminatory foreign countries, along with the relevant applicable dates. It isn't clear what — if any — procedure is required for a country to be identified as having an unfair foreign tax based on the non-self-executing arm of the definition of unfair foreign tax. A footnote in the committee report refers to the requirement for the secretary to maintain the list of discriminatory foreign countries and states that the list "is not required to be included in regulations or other formal guidance to take effect."[20] But if the list is the mechanism for Treasury to exercise its authority to identify additional unfair foreign taxes, some process should be required.[21] This concern is especially acute because, as discussed in Section

[15] KPMG UK, "UK TP, PE and DPT Reform Moves Ahead With Release of Draft Legislation" (May 1, 2025). As of March 2024, HMRC was carrying out 74 reviews into multinationals that it considered had arrangements in place to divert profits, with total tax under consideration of £4.5 billion. Thus, HMRC may be reluctant to abandon the DPT concept altogether. *See* HMRC, "Transfer Pricing and Diverted Profits Tax Statistics: 2023 to 2024" (Jan. 27, 2025).

[16] Proposed section 899(c)(1). The quoted language is new and provides a mechanism for Treasury to identify discriminatory taxes that may not meet the definition of discriminatory tax provided in the legislation.

[17] Proposed section 899(c)(2)-(3).

[18] For example, to be an unfair foreign tax, the tax must be imposed "more than incidentally" on income that is not sourced to the foreign country under U.S. principles. Proposed section 899(c)(3). Also, the exceptions to the definitions of extraterritorial tax and discriminatory tax in proposed section 899(c)(4) have been expanded, although notably, those exceptions apply "except as otherwise provided by the Secretary." Significantly, the preexisting *exception* for taxes on amounts described in section 871(a)(1) or section 881(a) has been curtailed to be unavailable for "any withholding tax, or other gross basis tax, imposed with respect to services performed by persons other than individuals," signaling congressional disapproval of the U.N. proposals to expand gross basis withholding tax on services.

[19] Extraterritorial, discriminatory, and disproportionate taxes are unfair foreign taxes "to the extent provided by the Secretary." Proposed section 899(c)(1).

[20] H.R. Rep. No. 119-106, pt. 6, at 398 n.1537.

[21] Despite the assertion in footnote 1537 of the committee report, *id.*, the notice and comment process under the Administrative Procedure Act may be required for Treasury to exercise its authority to expand the taxes that are treated as unfair foreign taxes. *See Green Rock LLC v. IRS*, 104 F.4th 220 (11th Cir. 2024), *acq.* AOD 2024-01 (holding that listed transaction notices require notice and comment rulemaking procedures under the APA).

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V.C, the statute does not include any built-in delays when an "old and cold" tax is identified.

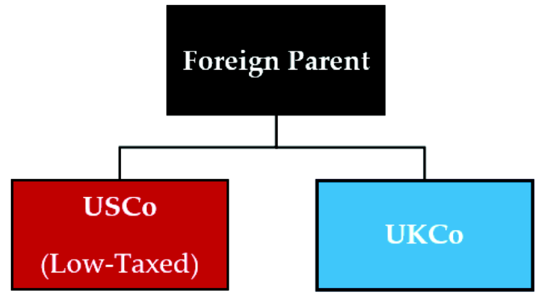
C. Unfair Foreign Taxes That Don't Affect U.S. Groups

A significant change from the prior bills is that taxes that do not apply to any U.S. person, including a trade or business of a U.S. person, or to CFCs that are owned (within the meaning of section 958(a)) more than 50 percent by vote or value by a U.S. person, would not be unfair foreign taxes.[22] Prior versions of both the Smith and Estes bills would have imposed retaliatory measures on a country with a UTPR regardless of whether the UTPR applied to the income of U.S.-parented groups, effectively making the United States the global policeman of UTPRs.

The committee report explains that proposed section 899 is intended to treat a UTPR as an unfair foreign tax only if it applies to the income of U.S. corporations and their subsidiaries.[23] As discussed further in Section VII, this is consistent with Treasury's negotiating position at the OECD inclusive framework. The second sentence of proposed section 899(c)(1) should be clarified to ensure it achieves this objective.

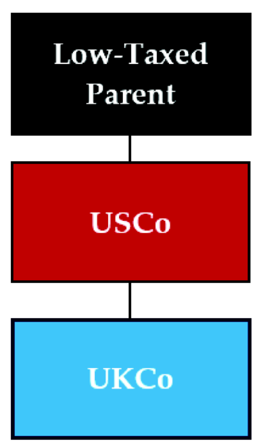
To explain why, we need to briefly recap how the UTPR operates. A country imposing a UTPR for low-taxed income imposes the tax on a local entity rather than directly on entities resident in the low-tax jurisdiction. For example, Figure 1 depicts Foreign Parent, which is resident in a country that has not implemented the income inclusion rule and owns USCo and UKCo. If USCo were low-taxed for pillar 2 purposes, the United Kingdom's UTPR would impose tax on UKCo for the low-taxed profits of USCo. Proposed section 899 is intended to prevent this scenario, but a tax is not an unfair foreign tax if it never "applies" to a U.S. person or CFC. Here, the United Kingdom is *applying* its UTPR to UKCo in respect of the U.S. profits of USCo.

Figure 1. U.K. UTPR Applies to U.S. Profits but Not to a U.S. Corporation or a CFC of a U.S. Corporation



Conversely, consider the scenario in Figure 2, in which Low-Taxed Parent owns USCo, which in turn owns UKCo. Is the United Kingdom's UTPR an unfair foreign tax if it *applies* to UKCo, a CFC, but for the non-U.S. income of Low-Taxed Parent? If so, this outcome would appear inconsistent with the objectives of proposed section 899, as set out in the committee report, and with Treasury's negotiating position at the inclusive framework, which is that pillar 2 should not apply when the United States is taxing the income, including under our CFC rules.

Figure 2. U.K. UTPR Applies to the Profits of a Foreign Corporation That Is Not a CFC of a U.S. Corporation



Proposed section 899(c)(1) should be clarified by amending the lead-in to the last sentence as follows: "Such term shall not include any tax which neither applies *in respect of the income of . . .*" Although Treasury may also be able to implement this clarification using the broad grant of

[22] Proposed section 899(c)(1)(A) and (B).

[23] H.R. Rep. No. 119-106, pt. 6, at 392.

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regulatory authority in proposed section 899(e), given the tight timeline and draconian consequences if it's missed, Congress ought to make its intention clear from the outset regarding the modifications countries must make to remove their UTPR from the scope of the per se unfair foreign taxes.

II. Who Is Caught by Proposed Section 899?

A. Foreign Persons Subject to the Increased Rates

Proposed section 899 applies the rate increases to an "applicable person," defined as any:

- government of a discriminatory foreign country;
- individual (other than a citizen or resident of the United States) who is a tax resident of a discriminatory foreign country;
- foreign corporation that is resident in a discriminatory foreign country, other than a U.S.-owned foreign corporation within the meaning of section 904(h)(6);
- private foundation created or organized in a discriminatory foreign country;[24]
- foreign corporation (other than a publicly held corporation)[25] that is more than 50 percent owned within the meaning of section 958(a) by one or more applicable persons;
- trust whose majority of beneficial interests is held by applicable persons; and
- foreign partnership, branch, or any other entity identified by Treasury regarding a discriminatory foreign country.[26]

Thus, corporations resident in a discriminatory foreign country and their subsidiaries[27] will be subject to the increased rates. This is a significant expansion of the original scope of the Smith bill, which would have applied only to individuals and corporations resident in a discriminatory foreign country.

Another expansion is that proposed section 899 would explicitly apply to income earned by a foreign government, including through government pension plans and other controlled entities. As part of this expansion, proposed section 899(a)(1)(D) would turn off section 892 benefits for foreign governments that impose unfair foreign taxes, potentially imposing tax on dividends, interest, and gains that otherwise would be exempt. In the absence of an income tax treaty, the tax rate on U.S.-source fixed or determinable annual or periodic payments would increase from 0 percent to 35 percent, a significant increase on existing investment. If the foreign government also qualifies for the benefits of a tax treaty, the increase may be reduced, as discussed in Section III, below. Structures that rely on section 892(a) would need to be reviewed to determine whether any applicable persons qualify for reduced withholding for some other reason.

While the increased rates helpfully would not apply to U.S. citizens and residents, foreign nationals on temporary assignment in the United States are treated as nonresident aliens unless they are a lawful U.S. permanent resident (green card holder), meet the substantial presence test, or, if eligible, make a specific election to be treated as a U.S. resident.[28] As NRAs, those employees could be applicable persons subject to the increased tax rates. If they receive significant U.S.-source FDAP income or effectively connected income, they may wish to elect to be treated as a U.S. tax resident if they meet the requirements for the election, and after taking into account other income that would become subject to U.S. tax as a U.S. resident.

B. Foreign-Parented Groups Subject to Super BEAT

Proposed section 899 would apply the Super BEAT to any domestic corporation that is more than 50 percent owned, within the meaning of section 958(a), by one or more applicable persons. This reflects a significant narrowing of and

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[24] Taxes levied on private foundations were not included in prior versions of section 899. Foreign private foundations generally are taxed at 4 percent under section 4948, so a 5 percentage point increase would more than double that rate. Some tax treaties (*e.g.*, the Canada-U.S. tax treaty) exempt foreign private foundations.

[25] The term "publicly held corporation" is not widely used in the code. It is defined in section 162(m)(2), though that definition is specifically limited to section 162(m).

[26] Proposed section 899(b)(1)(A)-(G).

[27] Proposed section 899(b)(1)(E).

[28] *See* section 7701(b)(1); and reg. sections 301.7701(b)-1 through -7.

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improvement to the initial scope of the Estes bill. As originally proposed, the Super BEAT would have applied to any U.S. corporation that shared common ownership with (that is, is a sister company of) any other entity resident in a country with a UTPR, regardless of the UTPR's scope. As discussed in our prior article, increasing the taxes of a U.S. corporation because *a sister company* is resident in a country with an offending tax is unlikely to motivate that country to change its law. Thus, the revamped Super BEAT is more likely to achieve its objective with less collateral damage by taking aim at the U.S. subsidiaries of groups parented in, or with intermediate holding companies in, countries with unfair foreign taxes.

Proposed section 899(b)(1)(E) excludes "publicly held corporations" from being treated as applicable persons because of ownership by applicable persons. For purposes of the Super BEAT, this has the effect of excluding all domestic public corporations regardless of their share ownership. By contrast, a widely held (but not "publicly held") corporation may have to conduct significant diligence to determine whether it is subject to the Super BEAT based on its direct and indirect ownership.

C. Exclusion for U.S.-Parented Groups

An applicable person also would exclude "United States-owned" foreign corporations within the meaning of section 904(h)(6),[29] which in turn would exclude the direct and indirect subsidiaries of U.S.-parented groups from the scope of both retaliatory measures. This exclusion may also extend to foreign-parented groups if more than 50 percent of their stock, by vote or value, is owned directly or indirectly by U.S. persons, including U.S. individuals. Thus, a foreign-parented group whose shareholder base is primarily U.S. persons would be protected from proposed section 899. Taxpayers might seek to rely on statistical sampling to determine if they meet the definition of a "United States-owned" foreign corporation. This could create uncertainty — about both whether a person is an applicable person and whether there is a change in a person's status — if a U.S. shareholder sells shares to a foreign person.

D. Challenges in Identifying In-Scope Taxpayers

To apply the prong of proposed section 899 that increases tax rates for applicable persons, the tax residence of both the payee and its direct and indirect owners must be identified. This change from prior versions of the Smith bill would limit a group's ability to circumvent proposed section 899 by interposing entities not located in discriminatory foreign countries to earn U.S.-source FDAP income.[30] This approach means, however, that proposed section 899 would override U.S. tax treaties with countries that have not implemented an unfair foreign tax when the direct payee is otherwise eligible to claim treaty benefits.[31]

III. Significant Changes to the Smith Bill's Tax Rates

Proposed section 899 would increase the "specified rates of tax" for any applicable person by an "applicable number of percentage points."[32] The specified rate of tax is the statutory rate of tax, or "any rate of tax in lieu of such statutory rate."[33] Our prior article outlined the specified rates of tax that would have increased under the Smith bill.

The Smith bill explicitly overrode tax treaties regarding the withholding taxes imposed by sections 1441(a), 1442(a), and 1445, without a similar override for the underlying substantive tax rates. Presumably to deal with constraints imposed by the reconciliation process, proposed section 899 resolves this inconsistency by

[29]Proposed section 899(b)(1)(C).

[30]Proposed section 899(b)(1)(E) determines ownership by applying section 958(a). Section 958(a)(2) attributes stock ownership through foreign entities only, so, for example, a partner in a domestic partnership would not be treated as owning stock held by the partnership. *But see* proposed section 899(e)(1) (providing antiavoidance authority for branches, partnerships, and other entities).

[31]This situation may occur when the payee is a treaty resident that conducts an active trade or business in the treaty partner's jurisdiction or when the applicable limitation on benefits clause is otherwise satisfied.

[32]The applicable number of percentage points is 5 for the first calendar year after the applicable date, with 5 additional percentage points added for each subsequent year. Proposed section 899(a)(4)(A)(i)-(ii).

[33]Proposed section 899(a)(3)(A).

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removing all explicit treaty override language and relying instead on a reference to "any rate of tax in lieu of such statutory rate" to effectuate the intent that any rate increase be applied by starting with the treaty rate.[34] This change is a considerable improvement over the Smith bill. Also, in describing the statutory cap that generally limits the increase to 20 percentage points, a parenthetical provides that the cap is "determined without regard to any rate applicable in lieu of such statutory rate."

As discussed in our previous article, there is a distinction between, on the one hand, treaty articles that cede taxing jurisdiction to the residence state (such as article 10(3) of the U.S. model income tax convention (2016), which says that "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. Provisions in the nature of the former category are not naturally read as prescribing a *rate of tax*.[35] Questions also arose regarding the interaction of the Smith bill with the portfolio interest exemption.[36] A footnote in the committee report clarifies the intended interaction of proposed section 899 with treaties and the portfolio interest exemption:

> Because the provision only increases the specified rates of tax, it does not apply to income that is explicitly excluded from the application of the specified tax. Thus, for example, the provision does not apply to portfolio interest, to the extent that portfolio interest is excluded from the tax imposed on FDAP income. See section 871(h). Contrast certain categories of income that are subject to a reduced or zero rate of tax in lieu of the statutory rate, such as amounts that are exempted or subject to a reduced or zero rate of tax under a treaty obligation.[37]

It is hard to identify a textual basis, or what its limits might be, for the distinction drawn between interest that is eligible for the portfolio interest exemption and income that the United States cannot tax under a treaty. The portfolio interest exemption provides that "no tax shall be imposed" under the relevant code provisions on qualifying interest.[38] This is very similar to the treaty language described above, providing that amounts shall not be taxed. Nonetheless, the reference to "zero rate of tax" must be intended to describe situations such as articles 10(3) and 11(1), in which the model treaty cedes taxing jurisdiction on U.S.-source income to the residence state.

Withholding agents are unlikely to accept uncertainty about how the rate increases apply to various categories of income. The need for clear withholding guidance may motivate Treasury and the IRS to provide guidance to coordinate various code and treaty-based exemptions with the rate increases. That guidance may be subject to challenge if it imposes tax on income that is completely exempt from U.S. federal income tax under a treaty obligation.

IV. The Super BEAT

A. Significant Changes to the Super BEAT

Proposed section 899 would largely maintain the modifications to the BEAT included in the Estes bill and outlined in our prior article, with one significant change: The Estes bill would have modified the BEAT to treat 50 percent of cost of goods sold as a base erosion tax benefit, with uncertainty about whether this adjustment was

[34] The committee report is more explicit, stating, "If another rate of tax applies in lieu of such statutory rate, *such as pursuant to a treaty obligation of the United States*, such other rate is increased by the applicable number of percentage points" (emphasis added). H.R. Rep. No. 119-106, pt. 6, at 395.

[35] Further, the first sentence of reg. section 1.894-1(a) provides that "income of any kind is not included in gross income and is exempt from tax under Subtitle A . . . to the extent required by any income tax convention to which the United States is a party." This exclusion from gross income differs, at least in form, from applying a zero rate to an item of gross income.

[36] Very broadly, this exemption allows non-U.S. investors to receive interest income from certain U.S. debt investments without the standard 30 percent withholding tax, making U.S. debt securities, including U.S. Treasuries, more attractive to foreign investors. Sections 871(h), 881(c).

[37] H.R. Rep. No. 119-106, pt. 6, at 395 n.1533.

[38] The portfolio interest exemption is unique because it is identified in the introductory clauses to sections 871(a)(1) and 881(a) as an exception from the imposition of tax. By contrast, the exemptions provided by section 871(i)-(k) are not specifically referenced in section 871(a). Because the footnote refers to portfolio interest as an example of an exclusion rather than the only such exclusion, it seems likely that the drafters intended for each of the exemptions in section 871 to be treated similarly.

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limited to related-party purchases or all purchases. Proposed section 899 instead would continue to allow the purchase price of inventory to be treated as a reduction to gross income for Super BEAT purposes, but it would treat amounts other than the purchase price of depreciable or amortizable property or inventory that would have been a base erosion payment but for the fact that the amount is capitalized as nonetheless giving rise to a base erosion payment and base erosion tax benefit.[39] Stated differently, the provision would subject to the Super BEAT any related-party payment that would be deductible but for a requirement or election to capitalize it, such as under section 263A or section 266.

Read alongside the existing BEAT regulations, this modification appears to treat the entire base erosion payment as if it were deducted in the year it is capitalized, solely for BEAT purposes. This creates a disconnect between cost recovery for regular tax purposes and cost recovery under the Super BEAT. For example, if interest paid to a foreign related party is capitalized under section 266 into depreciable property, the capitalized cost would be recovered as the property is depreciated for regular tax purposes, but the entire amount would give rise to a base erosion tax benefit in the year it was capitalized. Thus, Treasury is granted authority to prevent this provision from resulting in double counting of amounts for purposes of the denominator of the base erosion percentage.

Limiting the Super BEAT's impact on COGS to otherwise deductible payments that are capitalized into inventory aligns it with section 280E, which generally disallows all deductions for businesses dealing in controlled substances, but, to avoid constitutional challenges, does not disallow COGS as that term was understood before the enactment of section 263A.[40] As revised, the Super BEAT is consistent with the notion that deductions are a matter of legislative grace rather than an entitlement.[41] Removing the treatment of 50 percent of COGS as a base erosion tax benefit shields proposed section 899 from potential constitutional challenges.

For sellers of goods, the revised Super BEAT is significantly less onerous than the original denial of 50 percent of COGS in the Estes bill, which would have been disastrous for taxpayers that sell low-margin goods. For taxpayers in the services sector, however, the revised provision is more burdensome.

B. Disproportionate Impact on Groups With Significant U.S. Operations

The treatment of related-party costs that otherwise would be capitalized under section 263A will disproportionately affect inbound companies with significant U.S. manufacturing operations. Pure importers that locate only distribution activities in the United States will be able to continue to reduce their BEAT modified taxable income by the purchase price of the imported goods. In contrast, an inbound company that produces goods in the United States but must, consistent with section 482, pay outbound royalties to compensate foreign affiliates for trademark and product IP developed outside the United States will face additional BEAT tax. This could give those companies an incentive to instead import the goods that are sold into the United States.

Further, sandwich structures, which typically result from foreign acquisitions of significant U.S. groups, will be disproportionately affected by the removal of the 3 percent threshold for being in the scope of the BEAT because of the cliff effect of losing their foreign tax credits. Companies for which the 3 percent threshold was important for avoiding this cliff effect, almost by definition, have significant U.S. operations such that they have significant FTCs and related-party payments

[39] Proposed section 899(a)(2)(D).

[40] S. Rep. No. 97-494 (Vol. I), at 309 (July 12, 1982). *See also* ILM 201504011 (addressing capitalized expenses under section 280E).

[41] *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.

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that represent less than 3 percent of all deductible payments. Disproportionately harming companies with this profile, which are typically significant employers in the United States, seems like unintended collateral damage from removing the 3 percent threshold. Consideration should be given to restoring this threshold, even if it is only for purposes of determining whether the taxpayer's regular tax liability must be reduced by FTCs in calculating the BEAT liability.[42]

C. Impact for Funds

The proposed BEAT changes pose particular concerns for fund entities and portfolio companies. Many of those are not "applicable taxpayers" subject to the regular BEAT because they do not satisfy the average annual gross receipts test, which generally requires $500 million in gross receipts for members of an aggregated group of entities under common control. That exception would be eliminated for companies subject to the Super BEAT.

The use of corporate blockers will be a common area of concern. Corporate blockers are used to block ultimate investors from being taxed on the income or gains from their underlying investments. Blockers typically do not meet the gross receipts threshold to be scoped into the regular BEAT. Blockers that are majority U.S.-owned would not be applicable persons, but changes in ownership could cause a blocker's status as an applicable person to fluctuate between tax years. If a blocker is subject to the Super BEAT and an investor in the blocker qualifies as a foreign related party under the BEAT rules (generally an investor who owns 25 percent or more of the blocker entity by vote or value), interest payments from the blocker corporation to the investor would be treated as base erosion payments.

V. Timing Implications

A key design consideration for any retaliatory measure is to allow time for it to be effective in inducing withdrawal of the offending measure before any draconian results kick in. Although the effective date of proposed section 899 would be the date of enactment, the application of the retaliatory measure is delayed, with the stated goal of allowing time for countries to remove their unfair foreign taxes.[43]

Under the proposal, the increased rates and the Super BEAT would apply to all *tax years* of an applicable person beginning after the later of (1) 90 days after the date of enactment of proposed section 899, (2) 180 days after the date the unfair foreign tax is enacted, or (3) the first date that the unfair foreign tax begins to apply (the reference date).[44]

Importantly, the increased rates only apply for calendar years starting on or after this date (with January 1 being the applicable date for that discriminatory foreign country).[45] The rate then increases at the beginning of each succeeding calendar year so long as the country remains a discriminatory foreign country. Even though the applicable percentage point increase for a discriminatory foreign country applies by reference to the calendar year, the increase to an applicable person's rate of tax would be determined by that person's tax year. If the tax year includes multiple calendar years with different numbers of percentage points, the increase for the tax year is determined based on a weighted average rate. The determination of the increase in rates by reference to the "applicable date," which always falls on January 1, will defer the impact of the rate increases depending on the enactment date of the bill or of the offending tax.

In contrast, for any corporation that is more than 50 percent owned by an applicable person,

[42] Although, as drafted, the base erosion percentage would not apply in determining whether an applicable person is subject to the BEAT, a taxpayer's base erosion percentage would remain relevant for determining the amount of any addback to BEAT modified taxable income for the net operating loss deduction allowed under section 172. Thus, an applicable person that generates NOLs in a year in which proposed section 899 applies would need to compute a base erosion percentage with these new categories of base erosion payments and base erosion tax benefits, and they would need to apply that percentage to determine the addback for the base erosion percentage of NOLs in the year(s) used.

[43] H.R. Rep. No. 119-106, pt. 6, at 392 ("The provision creates an incentive for foreign countries to remove the unfair treatment of U.S.-headquartered or otherwise U.S.-parented companies, since it ceases to apply to these entities if the country revokes its discriminatory or extraterritorial tax or if the country provides that the discriminatory or extraterritorial tax does not apply to U.S. persons and their subsidiaries[.] Finally, the provision is designed to encourage foreign countries to act quickly by increasing in effect over time.").

[44] Proposed section 899(a)(5).

[45] Proposed section 899(a)(4)(C).

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Table 1. Effective Dates

Date of Enactment	Reference Date — Rate Increases and Super BEAT Apply to Tax Years *Beginning After*	Applicable Date — First 5% Increase in Tax Rates Occurs On	Calendar-Year Taxpayers First Impacted by Rate Increases and Super BEAT
July 2, 2025	Sept. 30, 2025	Jan. 1, 2026	2026
Oct. 2, 2025	Dec. 31, 2025	Jan. 1, 2026	2026
Oct. 3, 2025	Jan. 1, 2026	Jan. 1, 2026	2027
Oct. 4, 2025	Jan. 2, 2026	Jan. 1, 2027	2027

the full sting of the Super BEAT will apply to any tax year beginning after the reference date and before the unfair foreign tax is repealed.

A. Impact for Countries With Existing UTPRs, DSTs, or DPTs

For countries with an existing and applicable UTPR, DST, or DPT, the date of enactment is critical.[46] If section 899 is enacted before July 2, 2025, the increased rates and the Super BEAT would apply to tax years beginning after September 30, 2025.[47] A taxpayer with a tax year beginning October 1, 2025, would be subject to the Super BEAT for that tax year, and the percentage point increase for that year would be 3.74 if the unfair foreign tax is not removed during the tax year.[48] If section 899 is enacted before October 2, 2025, the increased rates and the Super BEAT would apply for calendar-year taxpayers for 2026. If enactment slips to October 3, the increased rates and the Super BEAT would apply to tax years beginning after January 1, 2026, taking calendar-year taxpayers out of scope for 2026. Confusingly, because the applicable date is the first day of the first calendar year beginning on or after the reference date, it is only if enactment was further delayed until October 4, 2025, that the increase in tax rates would be delayed until January 1, 2027. These various dates are summarized in Table 1.

This creates three dates of potential interest. First, if any country ceases to apply its UTPR to U.S. companies and their CFCs and removes any DST or DPT, as applicable, before the bill is enacted, the revenue score would be reduced. Second, if section 899 is enacted, countries would have 90 days to remove their unfair foreign taxes before the increased rates and the Super BEAT potentially kick in, with the Super BEAT possibly being more urgent given that its applicability does not require crossing January 1. Third, if section 899 is enacted before October 3, 2025, there will be considerable pressure on countries to amend their domestic legislation before December 31, 2025, to prevent calendar-year taxpayers from being subject to the Super BEAT for 2026 and to increased tax rates for the portion of the year that the unfair foreign taxes continue to apply.

B. Impact When Countries Remove Unfair Foreign Taxes

Though the hope is that countries would remove their unfair foreign taxes before proposed section 899 is triggered, this may not be achievable for all countries. Particularly for the Super BEAT, even a small delay could have a dramatic effect.

The Super BEAT would apply for the duration of a tax year if a taxpayer was an applicable person at the start of the year. If an unfair foreign

[46] Japan is the only country with a UTPR that is enacted but not yet applicable, because the UTPR applies to financial years beginning on or after April 1, 2026. This would significantly delay the impact of proposed section 899 for Japanese-parented groups. If Japan retains its UTPR, it would be a discriminatory foreign country after April 1, 2026, with an applicable date of January 1, 2027 (the beginning of the calendar year beginning on or after the first date its UTPR applies). Japanese-parented groups, which typically have tax years running April 1 to March 31, would be subject to the increased tax rates and the Super BEAT only from April 1, 2027, because both provisions apply only to tax years beginning *after* the first date an unfair foreign tax begins to apply, not on or after that date. *Compare* proposed section 899(a)(5)(A) (defining the tax years to which section 899 applies as "each taxable year beginning . . . *after* . . . the first date that an unfair foreign tax of such country begins to apply") *with* proposed section 899(a)(4)(C) (defining applicable date as "the first day of the first calendar year beginning *on or after* . . . the first date that an unfair foreign tax of such country begins to apply") (emphasis added).

[47] President Trump has set July 4, 2025, as the deadline for Congress to pass the reconciliation legislation. While this deadline is ambitious, the enactment of proposed section 899 by July 2, 2025, cannot be entirely discounted.

[48] The weighted average rate would be 0 percent for the period October 1, 2025, to December 31, 2025, and 5 percent for January 1, 2026, to September 30, 2026, giving a weighted average of 3.74 percent.

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tax is repealed midway through a tax year, the Super BEAT still would apply through the end of the tax year, although Treasury regulations could soften its impact in those circumstances. By contrast, there would be some immediate relief for the increase in tax rates when a country removes its unfair foreign tax. Upon removal, the country ceases to be a discriminatory foreign country, and the "applicable number of percentage points" from that point forward would be zero when computing a taxpayer's weighted average increase.

By way of example, if France is a discriminatory foreign country on January 1, 2026, but ceases to be one on July 1, 2026, a French-parented group's calendar-year U.S. subsidiaries would be subject to the Super BEAT for all of 2026, but a French entity receiving U.S.-source dividend payments would be subject to a rate increase of only 2.5 percent for 2026.[49]

C. Immediate Impact for Newly Identified Unfair Foreign Taxes

Treasury has broad authority to identify unfair foreign taxes beyond UTPRs, DSTs, and DPTs. As noted in Section I.B., it is unclear whether any notice and comment process is required for Treasury to exercise this discretionary authority. This lack of process is compounded by an apparent immediate effect. That is, the statutory structure does not include any built-in delays if, more than 90 days after section 899 is enacted, Treasury identifies as an unfair foreign tax a tax that has been in existence for more than 180 days.

Generally, the identification of a tax as an unfair foreign tax should not have retroactive effect, as Treasury's ability to issue retroactive regulations is limited.[50] This limitation, however, includes an exception for regulations issued within 18 months of the enactment of a statute.[51] Therefore, if, within this time frame, Treasury identifies as an unfair foreign tax a tax that has been in existence for more than 180 days, the retaliatory measures of proposed section 899 could apply retroactively, on a timeline parallel to the one imposed for UTPRs, DSTs, and DPTs currently in force. This risk may be greatest for countries that have taxes targeted at digital businesses that might be considered outside the scope of the self-executing reference to DSTs, as discussed in Section I.A. Congress should rectify this omission to give taxpayers and foreign governments ample notice that a tax is viewed as an unfair foreign tax. While one can hope that Treasury would choose to give fair warning, in light of the draconian consequences of proposed section 899, Congress should require it.

D. Impact on Withholding Agents

Although weighted average percentage points can apply in determining the underlying tax for non-calendar-year taxpayers, increases to the withholding rates are determined based on the percentage point increase that applies on the date payment is made to an applicable person. This mismatch could necessitate refunds or additional tax payments.

A safe harbor provides that the obligation to withhold is triggered only when a country is included on the list of discriminatory foreign countries published by Treasury.[52] This is welcome relief particularly in light of the uncertainty regarding what is intended by the reference to DSTs. Interestingly, the inclusion of this affirmative statement for withholding agents suggests a negative inference that taxpayers generally cannot rely on the omission of a country from the list. This outcome may have been necessitated by the need to make the proposal self-executing with respect to UTPRs, DSTs, and DPTs for purposes of reconciliation. That is, it is uncertain whether making the taxes depend on a *mandatory* requirement for Treasury to publish the list of countries with UTPRs, DSTs, and DPTs would be sufficiently self-executing to be scored. In any event, one hopes that Treasury would swiftly issue guidance expanding this safe harbor to the substantive tax.

[49] There are 181 days between January 1, 2026, and July 1, 2026, and 184 days between July 1, 2026, and December 31, 2026. This gives a weighted average tax rate of 2.5 percent, the sum of 2.5 percent (5 percent multiplied by 49.6 percent) and 0 percent (0 percent multiplied by 50.5 percent).

[50] Section 7805(b)(1).

[51] Section 7805(b)(2).

[52] Proposed section 899(a)(5)(C).

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Proposed section 899 is intended to impose additional costs on foreign individuals and inbound groups, but the costs of implementing it likely would fall on withholding agents. The biggest challenge for withholding agents would relate to payments to foreign entities that are applicable persons because they are owned by another applicable person, such as the Swiss subsidiary of a French entity.[53] In a partial recognition of this challenge, withholding agents are given an additional 90 days after a country is listed to withhold on entities that are in scope because of their ownership.[54] This accommodation will probably be insufficient. Withholding agents are unlikely to collect currently the type of ownership information needed to determine whether a payee is an applicable person subject to increased withholding under proposed section 899, and they would need payees to self-report this information, including refreshing it if ownership modifications result in a change to the person's chapter 3 withholding status. If proposed section 899 is enacted, Treasury and the IRS likely would need to provide guidance, including potentially updating forms (for example, Form W-8BEN-E, "Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)") to include information on ultimate beneficial owners, and withholding agents would need to establish new processes and systems to both collect and report any additional information. Withholding agents are often unable (or encounter great difficulty) to secure budget for speculative system modifications, and typically need years to implement these kinds of system changes once the requirements are finalized.

To provide interim relief, a temporary safe harbor would eliminate penalties and interest for withholding agents that fail to withhold amounts required by proposed section 899 before January 1, 2027, if the withholding agent demonstrates that it made best efforts to comply in a timely manner. This transitional relief is limited to penalties and interest from underwithholding but does not provide relief from liability for underwithheld amounts. This limited transitional rule would depart from the relief Treasury has provided withholding agents in the past as they implement new regimes.[55] Because of the complexity of collecting additional information from potentially millions of customers, withholding agents may struggle to put sufficient systems in place by that date. Satisfying the "best efforts" standard before then will also impose significant costs. Moreover, the intention of proposed section 899 is to change foreign countries' behavior such that the threat of increased withholding rates never takes effect, creating a risk that withholding agents are forced to invest in new systems that are never used. Extending the temporary safe harbor to cover any incremental liability for underwithholding attributable to proposed section 899 and extending the timing for the transitional rule by two more years to January 1, 2029, would mitigate the risk that the only persons the proposed section ultimately imposes additional costs on are U.S. withholding agents.

VI. Revenue Impact of Proposed Section 899

The Joint Committee on Taxation has estimated that proposed section 899 would raise \$116 billion between 2025 and 2034, making it the largest revenue raiser in the tax title after the curtailment of the Inflation Reduction Act credits.[56] As can be seen from the JCT table, reproduced as Table 2, the revenue is not evenly distributed across the 10-year budget window. Section 899 is projected to raise no revenue in 2025, when it would have limited application (depending on timing), and to raise only \$12.6 billion in 2026, a period when, as a result of the applicable dates, the increased rates and the Super BEAT would not apply to all taxpayers. The revenue would then stabilize at around \$30 billion in 2027 to 2029, before declining rapidly to \$160 million in 2032. The provision is then projected to lose money beginning in 2033.

[53] Proposed section 899(b)(1)(E). This issue is also present for trusts, which are applicable persons if a majority of the beneficial interests are owned by applicable persons. Proposed section 899(b)(1)(F).

[54] Proposed section 899(a)(5)(C)(ii).

[55] *See, e.g.*, Notice 2014-33, 2014-20 IRB 1033 (providing that withholding agents that use reasonable efforts to implement FATCA withholding would not be subject to enforcement actions).

[56] *See* JCT revenue estimate, JCX-22-25 R, *supra* note 1.

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Table 2. JCT Revenue Projections for Proposed Section 899 (amounts in $ millions)

2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2025-2029	2025-2034
0	12,560	28,721	31,810	27,259	19,241	9,514	160	-4,828	-8,134	100,351	116,303

The JCT estimates generally don't account for future executive action or changes in foreign law that may be expected to occur if section 899 is enacted, but they do consider taxpayer behavioral responses.[57] Therefore, the projected revenue assumes that countries with UTPRs, DSTs, and DPTs retain them, contrary to the intent of proposed section 899, and the estimates presumably do not include revenue that could be raised if Treasury identified additional unfair foreign taxes. Scoring a tax in those circumstances is an impossible task. However, the negative revenue projected for 2033 and 2034 is still striking, because it implies either that taxpayers are expected to undertake extensive restructuring to mitigate the effects of the measures or that foreign businesses and individuals reduce their investment in the United States or exit altogether if those investments no longer generate sufficient after-tax returns. This raises the question of whether the Senate could increase the score by revising section 899 to make it less penal.

VII. Switching Off Retaliatory Measures

Proposed section 899 is intended to strengthen Treasury's hand as it seeks to negotiate concessions from other countries on pillar 2 and to pressure countries to remove their DSTs and DPTs, building on the Trump administration's partial success in this area with respect to New Zealand,[58] India,[59] Italy,[60] and the United Kingdom.[61] Section 899 leaves little room to negotiate on DSTs or DPTs; they need to be removed or substantially amended.[62] Although countries have the option to remove their UTPR, this may not be their preferred approach if they believe removing it would undermine the effectiveness of the broader pillar 2 framework.

Rebecca Burch, Treasury deputy assistant secretary for international tax affairs, has said that the United States is seeking for the U.S. system of

[57] Our previous article included a discussion of how JCT scoring conventions could interact with proposed section 899. *See* Rolfes, Caldwell, and Pepper, *supra* note 5.

[58] Reporting has linked New Zealand's removal of a DST from its legislative agenda as, in part, a response to proposed section 899. *See, e.g.*, Stephanie Soong, "New Zealand Considered Trump Before Scrapping Digital Tax Bill," *Tax Notes Int'l*, May 26, 2025, p. 1251; and Soong, "New Zealand Withdraws Draft Digital Services Tax Legislation," *Tax Notes Int'l*, May 26, 2025, p. 1249.

[59] In July 2024 India announced the repeal of its 2 percent equalization levy on e-commerce supplies and services and then, in March 2025, announced it intended to repeal its 6 percent equalization levy on online advertising, with Finance Minister Nirmala Sitharaman citing a desire to "address the uncertainty in the international economic conditions." *See, e.g.*, Soong, "India to Scrap Equalization Levy to Pave Way for OECD Tax Deal," *Tax Notes Int'l*, July 29, 2024, p. 748; Aftab Ahmed and Manoj Kumar, "India to Scrap Digital Ad Tax, Easing U.S. Concerns," Reuters, Mar. 25, 2025; and Soong, "U.S. Trade Group Cheers India's Equalization Levy Rollback," *Tax Notes Int'l*, Apr. 7, 2025, p. 106.

[60] Italy is in discussions with the United States on DSTs and has agreed that a "non-discriminatory environment" is necessary to enable investments in technology. However, to date, Italy has not announced it intends to repeal or modify its DST. Sarah Paez, "Italy, U.S. Agree Tech Firms Should Not Face Discriminatory DSTs," *Tax Notes Int'l*, Apr. 28, 2025, p. 592. Italy already proposed removing the revenue threshold for its DST, presumably with the aim of making it nondiscriminatory. As our prior article noted, however, U.S. businesses likely pay most of the revenue generated by the Italian DST, such that we remain skeptical that a DST can be modified to be nondiscriminatory. *See* Caleb Harshberger, "Italy's Digital Services Tax Tweaks Seek to Allay US Objections," *Daily Tax Report*, Nov. 7, 2024.

[61] The United Kingdom also has suggested it would explore removing its DST in response to U.S. tariffs, although the recent U.K.-U.S. trade deal did not address DSTs. A U.K. government statement noted: "The Digital Services Tax remains unchanged as part of today's deal. Instead the two nations have agreed to work on a digital trade deal that will strip back paperwork for British firms trying to export to the US — opening the UK up to a huge market that will put rocket boosters on the UK economy." This statement does not commit the United Kingdom to remove its DST but indicates that its removal could be part of a broader digital trade deal that delivers other benefits to the country. *See, e.g.*, Santhie Goundar, "U.K. Admits Ongoing Talks to Secure Carveout From U.S. Tariffs," *Tax Notes Int'l*, Mar. 31, 2025, p. 2213; U.K. Government release, "Landmark Economic Deal With United States Saves Thousands of Jobs for British Car Makers and Steel Industry" (May 8, 2025).

[62] Given the objective of DSTs, it would not be realistic to amend them to exclude U.S. groups. For DPTs, the United Kingdom's proposal to remove the avoided PE prong and to subject the remaining transfer pricing prong to tax treaties could suffice for it to no longer be viewed as an unfair foreign tax.

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Table 3. Proposed Changes to Pillar 2

	Proposed Changes to Pillar 2	EU Options Paper	U.S. Treasury Request	Resolution to Section 899
1.	Side-by-side treatment of U.S. tax system		√	Yes
2.	Optional GILTI priority over QDMTT		√	No direct relevance
3.	Revised treatment of nonrefundable tax credits	√	(√)[a]	No direct relevance
4.	UTPR removal	√		Yes
5.	Extend UTPR safe harbor	√		No
6.	Treat GILTI as a qualified IIR	√		No

[a]Treasury previously has indicated support for this proposal, but it would have no impact on businesses operating in the United States if Treasury succeeds in negotiating for the U.S. tax system to stand side by side with pillar 2.

taxation to stand "side by side" with pillar 2.[63] The starting point for this approach is that the U.S. system of taxation for worldwide income — including the global intangible low-taxed income, subpart F, and foreign branch regimes — is sufficiently comprehensive such that the UTPR and IIR should not apply to U.S. persons and their foreign subsidiaries. Acceptance by other countries of the UTPR aspect of this proposal ought[64] to be sufficient to switch off proposed section 899. Treasury also has indicated that countries should be allowed to choose to implement domestic top-up taxes that include a pushdown of any related GILTI tax when determining top-up tax liability and still be eligible for treatment as a qualifying domestic minimum top-up tax (QDMTT) — a proposal that, like the request to turn off the IIR for inbound U.S. groups,[65] has no direct impact on the application of proposed section 899.

Separately, the EU presidency has outlined three alternatives to finding a path forward with the United States on pillar 2: (1) amending the global anti-base-erosion treatment of nonrefundable tax credits; (2) limiting the application of the UTPR, potentially by extending the UTPR transitional safe harbor or removing it entirely; or (3) treating the U.S. GILTI regime as a qualified IIR.[66] While these alternatives are being considered by the EU, there is no consensus on which, if any, should be selected.

Would any of these proposals, other than removing the UTPR, be sufficient for proposed section 899? Amending the treatment of nonrefundable credits would reduce the likelihood that U.S. tax credits, such as the research credit, push a group's U.S. effective tax rate below 15 percent for pillar 2 purposes. However, because this does not actually turn off the UTPR for U.S. groups, it would not switch off proposed section 899. Extending the UTPR safe harbor, which exempts income attributable to the jurisdiction of the ultimate parent entity from the UTPR if the headline rate of tax in that jurisdiction is greater than 20 percent, is consistent with the objectives of proposed section 899 but would not go far enough because it would not prevent the UTPR from applying to the non-U.S. subsidiaries of U.S. corporations or to U.S. subsidiaries of inbound groups. Finally, if GILTI were simply treated as a qualified IIR, there are scenarios in which the foreign subsidiaries of a U.S. person could still be subject to another country's UTPR, making this insufficient for proposed section 899.

Table 3 summarizes the various changes to pillar 2 that have been discussed by Treasury and

[63]Soong, "GILTI Equivalence, Longer UTPR Safe Harbor Not Enough for U.S.," *Tax Notes Int'l*, May 19, 2025, p. 1051.

[64]We use "ought" in light of the discussion in Section I.C, *supra*, regarding the ambiguity of when a UTPR should be considered to *apply* to a U.S. person or a CFC.

[65]Whether countries decide to disapply their IIRs consistent with Treasury's position has no bearing on the application of proposed section 899, because IIRs are not an unfair foreign tax described in the bill. In fact, proposed section 899(c)(4)(B)-(C) explicitly excludes from the definition of that term a tax that is imposed on residents of a jurisdiction by reference to the income of a corporate subsidiary.

[66]Elodie Lamer, "EU Presidency Lays Out Options to Address U.S. Pillar 2 Concerns," *Tax Notes Int'l*, Apr. 28, 2025, p. 600.

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the EU, as well as our assessment of their ability to resolve proposed section 899.

VIII. Conclusion

Proposed section 899 is intended to take foreign multinationals and investors hostage to put pressure on their home jurisdictions to remove or revise their UTPRs, DSTs, and DPTs. If you are going to take hostages, you must take the right ones. In this regard, proposed section 899 gets much closer than the earlier Smith and Estes bills to hitting this objective.

The increased tax rates and Super BEAT would be very punitive for some taxpayers, as shown in the revenue score, so foreign businesses are taking them seriously. For some, this may be a board-level issue. Although we, like both the proponents and potential victims of these retaliatory mechanisms, hope the retaliatory measures will never apply, Congress should not legislate with its fingers crossed. The timing for reaching an accommodation on UTPRs, DSTs, and DPTs is tight, and the risk of missteps is high.

Predicting the future is always dangerous, but negotiations on any issue at the inclusive framework usually takes time. Treasury's request for the U.S. tax system to operate side by side with pillar 2 is a change from both the Biden administration and the first Trump administration, which presents challenging questions for other countries to consider regarding the interaction of GILTI and pillar 2. Resolution of the application of UTPRs to U.S. groups may have to await this more comprehensive solution. Moreover, other countries will need at least some time to enact legislation to amend their pillar 2 rules to reflect the negotiated outcome and to repeal any DSTs or DPTs, potentially leaving taxpayers exposed to increased tax rates and Super BEAT even as countries are legislating to adapt their laws.

Treasury has broad authority under proposed section 899 to restrict or expand it through regulations or other guidance, including, very generally, to carry out the purposes of proposed section 899,[67] as well as specific authority to adjust the definition of applicable person[68] and to develop exceptions to the definition of unfair foreign tax.[69] This broad authority may be viewed by Congress as an emergency escape hatch through which Treasury could temporarily delay the impact of section 899 if negotiations are progressing but have not yet reached a successful conclusion.[70] Affected companies, however, will be under pressure to plan for the possibility that proposed section 899 could be triggered; it will not be enough for them to brief their boards that they are "hopeful" that Treasury will issue regulations to save the day.

It is frequently said that Trump's tariff policies are a throwback to another era, a characterization that is also true for proposed section 899. As when section 891 was enacted,[71] foreign countries have introduced taxes that Congress views as extraterritorial and discriminatory against U.S. businesses, and the proposed congressional response is retaliation, not negotiation. The door for negotiations with Treasury, however, remains open. That said, when Germany is considering introducing a DST with a 10 percent rate, having never previously indicated support for such a tax, the risk of escalation should be taken seriously.[72]

Accordingly, Congress should extend the 90-day period provided after enactment for unfair foreign taxes to be removed to allow more time both for Treasury to provide clarity regarding which taxes are considered DSTs for this purpose, as well as for countries to ensure that their offending taxes no longer apply to U.S. companies and their subsidiaries. It appears that any such extension would not hurt the revenue score, given that it turns negative in the last two budget window years. Moreover, Congress should also provide for a delayed timeline and process for when Treasury chooses to exercise its discretionary authority to identify additional

[67] Proposed section 899(e) (general regulatory authority).

[68] Proposed section 899(b)(1) (providing a definition of applicable person that applies "except as otherwise provided by the Secretary").

[69] Proposed section 899(c)(4) (providing a list of exceptions to the definition of unfair foreign tax that culminates in a catchall exception for "any other tax identified by the Secretary").

[70] Proposed section 899(e)(2).

[71] *See* Rolfes, Caldwell, and Pepper, *supra* note 5; and Joseph J. Thorndike, "Threats, Leverage, and the Early Success of Reprisal Taxes," *Tax Notes*, Mar. 21, 2016, p. 1373.

[72] William Hoke, "Germany Mulls Online Platform Tax to Combat 'Clever Tax Avoidance,'" *Tax Notes Int'l*, June 2, 2025, p. 1394.

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unfair foreign taxes. While one can hope that Treasury would self-impose a process that gives fair warning, in light of the draconian consequences of proposed section 899, Congress should require it. Although Congress may not be inclined to extend this legislative grace to countries that enact unfair foreign taxes, the direct targets of proposed section 899 are investors in the United States and inbound groups doing business here. ■

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