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International tax provisions in "One Big Beautiful Bill Act" and insights on their impact on foreign companies and investors

KPMG analysis and observations

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Introduction

This article is dedicated to assisting foreign companies and investors doing business in the United States to understand how the new tax bill may impact them. The House of Representatives on May 22, 2025, passed H.R. 1 (House bill), the budget reconciliation bill known as the "One Big Beautiful Bill" (read *TaxNewsFlash*). On July 1, 2025, the Senate passed its version of H.R. 1 (Senate bill), which made various amendments to the bill, including changes to the tax subtitle that was included in the House bill (read *TaxNewsFlash*). On July 3, 2025, the House passed the Senate bill without amendment, and the bill was signed into law by President Trump on July 4, 2025. The descriptions of the provisions in the Senate bill below thus reflect the enacted provisions.

Among the important business provisions of the enacted Senate bill are provisions that:

- Reinstate and make permanent expensing of R&D costs, the higher EBITDA cap on the deduction for interest, and 100% bonus depreciation (the House bill would only extend these provisions for five years)
- Make permanent the section 199A deduction for passthrough business income (but at the current 20% rate instead of the higher 23% rate of the House bill)
- Renew and reform the Opportunity Zone program
- Add a 100% first-year depreciation deduction for real property used in a production activity

Importantly, the House bill included a proposed retaliatory tax that would have been harmful to certain foreign corporations under new section 899 that was removed in the Senate bill following the announcement of a political agreement with the other G7 countries regarding certain Pillar 2 taxes (read *TaxNewsFlash*). The political agreement provided that U.S. parented groups will be excluded from the imposition of any Pillar Two IIR or UTPR taxes, in exchange for removing the proposed new section 899 from the budget reconciliation bill. While foreign-parented groups may take comfort from not having retaliatory taxes under proposed section 899 imposed on their operations and investments in the United States, these groups do not appear to be covered by the Pillar 2 political agreement and foreign-owned U.S. constituent entities may still be subject to the Pillar 2 taxes. Multinational groups will need to continue to monitor the progress of the OECD Inclusive Framework on reaching a solution to implement this agreement with all members of the Inclusive Framework.

The enacted Senate bill also includes revenue-raising provisions that:

- Make extensive reforms to the U.S. international tax regime, including to foreign-derived intangible income (FDII), global intangible low-taxed income (GILTI), and the base erosion anti-abuse tax (BEAT), and permanently extend the CFC look-through rule of 954(c)(6)
- Impose a 1% tax on remittances to a recipient outside the United States (would have been 3.5% under the House bill)
- Temporarily increase the $10,000 cap on the state and local tax (SALT) deduction to $40,000, with no significant changes to the treatment of passthrough entity taxes
- Repeal or phase out energy tax credits created by the Inflation Reduction Act (IRA) (though in some cases extending the credits further than the House bill)

This report includes analysis and observations regarding the international tax provisions in the bill, specifically as relevant to foreign corporations and investors doing business in the United States. That is, foreign corporations or investors that engage in business directly the United States or indirectly through U.S. subsidiaries (or partnerships) may want to take stock of how the bill will affect their U.S. federal income tax liability with respect to their U.S. activities. Please note that some of the provisions covered herein, e.g., those relating to changes in the subpart F, GILTI, and foreign tax credit rules, remain relevant for those foreign corporations and investors that own a U.S. company, which in turn, owns foreign subsidiaries.

Modifications to BEAT

Prior law

The BEAT applies to "applicable taxpayers." Under current law, a taxpayer must determine whether it is an applicable taxpayer annually. An applicable taxpayer is a corporation (other than a regulated investment company (RIC), real estate investment trust (REIT), or S corporation) that, together with certain related parties, has: (1) average annual gross receipts of at least $500 million for the three preceding tax years (the gross receipts test); and (2) a base erosion percentage (BE%) for the tax year in excess of the applicable threshold (the "BE% test"). The applicable threshold for the BE% test generally is 3% but is decreased to 2% for taxpayers that are members of an affiliated group that includes a bank or a registered securities dealer.

For an applicable taxpayer, the BEAT imposes an additional tax to the extent 10% of modified taxable income (MTI) exceeds the taxpayer's regular tax liability. For this purpose, regular tax liability is reduced by some, but not all, tax credits. In particular, the section 41(a) research credit and a certain portion of "applicable section 38 credits" (i.e., the low-income housing credit under section 42(a), renewable electricity production credit under section 45(a), and the energy credit under section 48) do not reduce regular tax liability for purposes of computing a BEAT liability. An applicable taxpayer determines MTI under current regulations by "adding back" to its regular taxable income (1) its base erosion tax benefits for the year, and (2) the BE% of any net operating loss (NOL) deduction allowed for the year.

Under current law, for tax years beginning after December 31, 2025, section 59A(b)(2) increases the rate applied to MTI from 10% to 12.5% and eliminates the carve-out of the research credit and a portion of applicable section 38 credits in the BEAT formula. The elimination of this credit carve-out would generally result in an increased BEAT liability by reducing the amount of the regular tax liability to which 12.5% of MTI is compared.

Senate bill as enacted (sec. 70331)

The Senate bill retains the favorable treatment for the research credit and the portion of the applicable section 38 credits, as under current law, but slightly increases the BEAT rate to 10.5% for tax years beginning after December 31, 2025.

KPMG observation

Although the Senate bill's changes to BEAT may seem minor at first glance, foreign-parented groups should be aware of the modifications to sections 163(j) and 174, discussed below, because the interactions among these provisions could significantly impact a taxpayer's BEAT liability.

KPMG observation

A prior release of the Senate bill would have modified BEAT in a number of ways, including by increasing the rate to 14%, reducing the BE% threshold to 2%, and providing a new exemption for payments subject to a sufficiently high rate of tax (i.e., a foreign effective tax rate of over 18.9%). Although the changes appeared to have both taxpayer favorable and unfavorable elements, the revenue score for the prior version would have cost approximately $48 billion in revenue over the 10-

year budget window, based on the Senate's current policy baseline, whereas the version in the final Senate bill would cost approximately $30.5 billion relative to current law *but raises* approximately $2 billion relative to current policy.

Other relevant changes

Section 174

Prior law

Before 2022, research and experimental (R&E) expenditures were allowed as an immediate deduction. Since 2022, R&E expenditures have been subject to capitalization and amortization ratably over a five-year period, beginning with the midpoint of the tax year in which such expenditures are paid or incurred. In the case of expenditures attributable to research that is conducted outside of the United States, amortization is allowed over a 15-year period (also using a mid-year convention).

Senate bill as enacted (sec. 70302)

The Senate bill *permanently* restores the prior rules allowing immediate expensing of domestic R&E expenditures (or elective capitalization for not less than 60 months but beginning in the month in which the taxpayer first realizes benefits from the expenditures) for amounts paid or incurred in tax years beginning after December 31, 2024. The Senate bill also permits taxpayers to elect to accelerate any unamortized domestic research expenditures (incurred in tax years beginning before January 1, 2025, and after December 31, 2021) over a period of one or two years.

Under the Senate bill, foreign research remains subject to 15-year amortization under section 174. Additionally, the Senate bill modifies section 174(d) to preclude accelerated basis recovery for any unamortized amount of foreign research with respect to property disposed, retired, or abandoned after May 12, 2025.

KPMG observation

As noted above, taxpayers that have been managing their regular tax liability as a means to manage BEAT should model the effects of immediate expensing for domestic R&E expenditures, including the election to accelerate unamortized amounts of prior year domestic R&E expenditures, and potentially consider capitalization options under proposed section 174A(c), allowing a period of recovery of no less than five years, or section 59(e), allowing for a 10-year recovery period (but only for domestic R&E expenditures that would otherwise be deducted under proposed section 174A(a)). Taxpayers that are "applicable corporations" for purposes of the corporate alternative minimum tax (CAMT) should also consider capitalization in managing their CAMT liability. For foreign-parented groups managing BEAT by staying below the BE% test, the immediate expensing of domestic R&E could be beneficial as it may increase the total deductions in the denominator of the calculation, reducing the BE%. Modeling is essential.

Section 163(j)

Prior law

Interest expense deductions are limited, in part, to 30% of "adjusted taxable income" (ATI), generally defined as earnings before reduction for interest and taxes (EBIT). Before 2022, ATI was also computed without regard to deductions allowable for depreciation, amortization or depletion. Removing these deductions in ATI generally increases the interest expense limitation relative to the EBIT limitation.

Senate bill as enacted (secs. 70303, 70341, and 70342)

The Senate bill permanently restores the computation of ATI for purposes of the section 163(j) business interest expense limitation without regard to any deduction allowable for depreciation, amortization, or depletion for tax years beginning after December 31, 2024. This change will generally increase the amount of interest expense currently deductible and will be significant for foreign companies investing in the United States and growing their operations.

The Senate bill, however, also introduced other changes that are generally less favorable for taxpayers. The bill excludes subpart F and GILTI inclusions, section 78 gross-up amounts, and inclusions under section 956 from the computation of ATI for purposes of the section 163(j) business interest expense limitation for tax years beginning after December 31, 2025.

In addition, for tax years beginning after December 31, 2025, the Senate bill provides that interest that is capitalized (other than interest subject to mandatory capitalization under sections 263(g) or 263A(f)) is treated as business interest expense for purposes of section 163(j)(1). As a result, business interest allowed under section 163(j) is determined after taking into account capitalized interest first, with the residual, if any, applied to deductible interest. In general, the effect of this ordering rule is to reduce the amount of allowable interest expense deduction for tax years beginning after December 31, 2025. Any capitalized interest expense that is disallowed in a prior year is not treated as capitalized in the carryforward year. The Senate bill includes regulatory authority for Treasury to coordinate the new capitalization rule in section 163(j) with the stacking rule in section 59A(c)(3) for BEAT.

KPMG observation

Similar to immediate expensing for domestic R&E expenditures, increasing the amount of deductible interest expense in the year would reduce regular tax in the BEAT and CAMT liability computations, thereby potentially increasing a taxpayer's BEAT and CAMT liability. Being able to claim more deductions for interest expense could also have the effect of increasing a taxpayer's base erosion tax benefits in the year if that interest is paid to a foreign related party. Thus, taxpayers will want to model the effects of any changes to section 163(j) on MTI as well as the BE%.

KPMG observation

Whereas the provision that increases the deductibility of interest expense (i.e., computing ATI without depreciation, amortization, or depletion) would apply to 2025 tax years, the provisions restricting deductibility of interest expense (i.e., subjecting capitalized interest to the section 163(j) limitation and computing ATI without GILTI and subpart F inclusions) would apply to 2026 tax years. This timing mismatch generally results in more interest expense being deductible in 2025 as compared with 2024, but also as compared with 2026 and onward.

KPMG observation

Congress appears to have left the interaction of the new capitalization rule in section 163(j) with the BEAT rules primarily to the discretion of the Treasury. Section 59A(c)(3) allocates the disallowed amount under section 163(j) to unrelated party interest first, meaning that capitalized interest expense paid to a foreign related party would seem to be similarly treated as going first for BEAT as it would for purposes of section 163(j), potentially crowding out other foreign related party interest expense that is deductible (and would be a base erosion payment) with capitalized interest (that would not be a base erosion payment). For this reason, Treasury might consider using its new regulatory authority in section 163(j) to provide a different coordination rule for capitalized interest expense as compared with deductible interest expense.

Read the Accounting Methods report located on KPMG's dedicated webpage for more details on the proposed modifications to sections 174, 174A, and 163(j).

Sourcing certain income from the sale of inventory produced in the United States

Prior law

Under section 863(b)(2), income from the sale of inventory produced in the United States is sourced solely on the basis of the production activities with respect to the property. Accordingly, income from the sale of inventory manufactured in the United States by a foreign owned U.S. subsidiary and sold to a foreign person is treated as solely U.S. source income.

House bill

No provision.

Senate bill as enacted (sec. 70313)

Solely for purposes of the FTC limitation under section 904, the Senate bill would add section 904(b)(6), which would treat as foreign source the portion of the income from a taxpayer's sale of inventory that it produced in the United States that is attributable to the seller's foreign office or other fixed place of business. The amount treated as foreign source would be capped at 50% of the taxable income from the sale of the inventory. Current section 863(b)(2) would continue to apply for non-FTC purposes. This proposal would apply to tax years beginning after December 31, 2025.

KPMG observation

Prior to the TCJA, section 863(b) generally provided that income from the sale of inventory produced in one jurisdiction and sold in another jurisdiction was sourced 50% to the place of production and 50% to the place of sale (generally determined based on title passage). The Senate proposal would allow up to 50% of the income from the sale of self-produced inventory to be treated as foreign source for FTC limitation purposes, but the analysis would depend on how much income is in fact attributable to the foreign office or fixed place of business, determined under rules similar to section 864(c)(5), rather than title passage. Also, in contrast to the pre-TCJA rules, the treatment of a portion of the income as foreign source would apply only for purposes of section 904. Foreign owned U.S. entities that produce inventory in the United States that is attributable to its foreign office or other fixed place of business may would benefit from the modified sourcing rules for purposes of the FTC limitation.

Changes to the subpart F rules

Restoration of limitation on downward attribution of stock ownership in applying constructive ownership rules and new 951B

Prior law

Former section 958(b)(4) prior to the TCJA prevented "downward attribution" of stock ownership from a foreign person to a U.S. person for purposes of determining whether a U.S. person is a U.S. shareholder and whether a foreign corporation is a CFC. The TCJA repealed section 958(b)(4) effective for the last tax year of CFCs that began before January 1, 2018, and the tax year of U.S. persons in which or with which such tax year ends.

Senate bill as enacted (sec. 70353)

The Senate bill reinstates section 958(b)(4). The effective date of the provision is tax years of foreign corporations beginning after December 31, 2025.

KPMG observation

The legislative history of the TCJA indicates that the repeal of section 958(b)(4) was aimed at certain "de-control" transactions in which a foreign corporation controlled by a foreign-parented U.S. shareholder ceased to be a CFC by reason of a dilutive investment (e.g., foreign parent contributes property to the foreign corporation for a 51% interest in the corporation). Thus, according to the legislative history, the repeal of section 958(b)(4) was not intended to cause a foreign corporation to be treated as a CFC with respect to a U.S. shareholder if such U.S. shareholder is unrelated to the U.S. person to which ownership of stock in the foreign corporation is attributed. Nonetheless, the enacted statutory language did not contain any restriction on downward attribution.

As a result of the repeal of section 958(b)(4), the number of foreign corporations treated as CFCs has proliferated. Any foreign corporation in a foreign-parented group, other than the foreign parent itself, is a CFC (sometimes referred to as a "faux CFC") if that group includes at least one U.S. subsidiary. If a U.S. shareholder owns stock under section 958(a) in such CFC, that U.S. shareholder is generally required to include amounts in income with respect to the CFC under sections 951, 951A, 956 and 965 (collectively the "CFC inclusion rules"), regardless of whether such U.S. shareholder or the CFC are related. For instance, a U.S. person that owns 10% of the stock in a foreign parent, but is otherwise unrelated to such foreign parent, is a U.S. shareholder of that foreign parent's wholly owned foreign subsidiaries if the foreign parent has one U.S. subsidiary. In that situation, the U.S. person could be required to include the income of such foreign subsidiaries into its gross income under the CFC inclusion rules. Although Treasury provided some relief through a 2019 Revenue Procedure, section 958(b)(4) repeal has increased compliance burdens due to the information reporting provisions that are triggered by U.S. shareholder of CFC status.

The Senate bill addresses the policy concerns that motivated the repeal of section 958(b)(4) with the addition of new section 951B, discussed in more detail below. Section 951B gives effect to the legislative history by only subjecting U.S. shareholders that are related to faux CFCs to the CFC inclusion rules.

The Senate bill also adds new section 951B, which applies the CFC inclusion rules to “foreign controlled U.S. shareholders” (F-USSHs) of “foreign controlled CFCs” (F-CFCs). First proposed in connection with the restoration of section 958(b)(4) as part of the technical corrections package to the TCJA in 2019 and included in the House-passed BBBA in 2022, this provision defines F-USSHs and F-CFCs based on the existing definitions of U.S. shareholder and CFC, but with two important differences. First, the ownership thresholds for F-USSHs are increased to more than 50%, rather than at least 10%, of vote or value. Second, constructive ownership for purposes of determining both F-USSH and F-CFC status is determined without regard to section 958(b)(4) (i.e., as if section 958(b)(4) were repealed), which, as discussed above, is otherwise generally reinstated. As a result, downward attribution from foreign persons is taken into account in determining whether a U.S. person is an F-USSH and a foreign corporation is an F-CFC.

Generally, an F-USSH of an F-CFC is subject to the CFC inclusion rules in the same manner as a U.S. shareholder is subject to those rules with respect to a CFC. Accordingly, an F-USSH would be subject to the CFC inclusion rules (that is, subpart F and GILTI), under section 951B only if, and to the extent, it owns stock in the F-CFC directly or indirectly within the meaning of section 958(a).

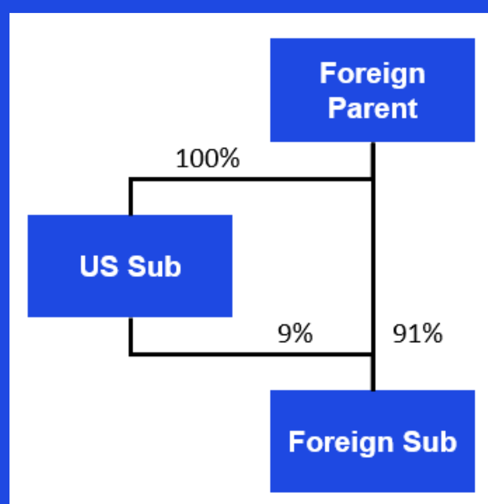
Section 951B provides Treasury and the IRS authority to issue regulations or other guidance that may be necessary or appropriate to carry out the purposes of the section, including regulations or other guidance (1) to treat F-CFCs as CFCs and F-USSH as U.S. shareholders, respectively, for other purposes of the Code (e.g., sections 245A and 1248), including any reporting requirement; and (2) with respect to the treatment of F-CFCs that are also passive foreign investment companies (PFICs) as defined in section 1297.

Similar to the reinstatement of section 958(b)(4), section 951B is effective for tax years of foreign corporations beginning after December 31, 2025.

KPMG observation

Section 951B, in conjunction with the reinstatement of section 958(b)(4), ensures that U.S. subsidiaries in a foreign-parented group that have a direct or indirect interest in a foreign subsidiary of that group will continue to be subject to the CFC inclusion rules, while relieving unrelated U.S. shareholders from the CFC inclusion rules. In other words, it restores pre-TCJA law for unrelated U.S. shareholders, while ensuring that related U.S. shareholders cannot escape the CFC inclusion rules through de-controlling transactions, the intended target of the repeal of the section 958(b)(4) in the first place.

The diagram illustrates the scope of section 951B under the Senate bill:



In this diagram, U.S. Sub owns (under section 958(a)) 9% of Foreign Sub. Based solely on the reinstatement of section 958(b)(4), U.S. Sub would not be treated as owning the Foreign Sub stock owned by Foreign Parent. Thus, without section 951B, U.S. Sub would not be a U.S. shareholder of Foreign Sub and Foreign Sub would not be a CFC. But under section 951B, U.S. Sub would constructively own the remaining 91% of Foreign Sub as a result of downward attribution of Foreign Parent's ownership of Foreign Sub for purposes of qualifying U.S. Sub as an F-USSH and Foreign Sub as an F-CFC. Therefore, consistent with current law, U.S. Sub would be subject to the CFC inclusion rules based on its 9% ownership in Foreign Sub by reason of the application of section 951B.

KPMG observation

Section 951B provides that, with respect to subpart F inclusions other than GILTI inclusions, the provision applies "separately from, and in addition to" the normal CFC inclusion rules with respect to F-USSHs and F-CFCs. Thus, section 951B is the operative provision for subpart F inclusions with respect to F-CFCs. In contrast, with respect to GILTI inclusions, section 951B simply expands the scope of section 951A to include F-USSHs and their F-CFCs. Specifically, section 951B provides that section 951A is applied by treating any reference to a U.S. shareholder or a CFC as including a reference to a F-USSH or a F-CFC respectively. By expanding the scope of section 951A, as opposed to creating a separate operative provision for GILTI inclusions with respect to F-CFCs in section 951B, the Senate provision appears to permit an F-USSH that is also a U.S. shareholder of actual CFCs to share tested losses between its F-CFCs and CFCs and provide for a single computation for deemed paid GILTI taxes under section 960(d) that takes into account both F-CFCs and CFCs.

Permanent extension of look-thru rule for controlled foreign corporations

Prior law

Section 954(c)(6) was first enacted as a temporary provision in 2005. Prior to the Senate bill it was scheduled to expire for tax years of foreign corporations beginning on or after January 1, 2026. The provision allows dividends, interest, rents, and royalties received from a related CFC to be excluded from foreign personal holding company income if paid out of earnings that are neither subpart F income nor income that is effectively connected with a U.S. trade or business.

Senate bill as enacted (sec. 70351)

The Senate bill makes permanent the look-through rule of section 954(c)(6).

Repeal of election for one-month deferral in determination of tax year of specified foreign corporations

Prior law

Under current section 898, "specified foreign corporations" (SFCs) (generally defined as CFCs that are majority owned by a single U.S. shareholder, including a U.S. shareholder owned by a foreign person) are generally required to follow the tax year of their majority U.S. shareholder. A notable exception, however, allows an SFC to elect a tax year beginning one month earlier than the majority U.S. shareholder's tax year (the "one-month deferral election"). For example, if a foreign-owned U.S. subsidiary is a calendar year majority U.S. shareholder of an SFC, the SFC will default to the December 31 year-end of its shareholder. Alternatively, the SFC can make a one-month deferral election to use a tax year ending November 30.

Senate bill as enacted (sec. 70352)

Similar to an earlier proposal in the House-passed “Build Back Better Act” (BBBA), the Senate bill will eliminate the one-month deferral election for an SFC’s first tax year beginning after November 30, 2025. After this change, SFCs must conform to the majority U.S. shareholder’s year. A special transition rule provides that SFCs with one-month deferral elections in place will have, for their first year beginning after November 30, 2025, a one-month short year as the mechanism to conform to the majority U.S. shareholder year. For calendar year taxpayers this means that any in-scope SFC will have a short year from December 1, 2025, to December 31, 2025, and then will have its first calendar tax year in 2026. The transition rule also provides that any required change in tax year will be treated as having been initiated by the corporation and made with the Secretary’s consent. Further, the statute grants authority for the Secretary to issue guidance for allocating foreign taxes accrued between the short tax year required under the transition rule and the following tax year.

KPMG observation

The potential mismatch in the tax years of foreign owned U.S. shareholders and their SFCs that had made a one-month deferral election created numerous anomalies in the application of changes made by the “Tax Cuts and Jobs Act” (TCJA), including the applicable tax rates for section 965 and the divergence in the effective dates for the section 245A dividends received deduction (the “section 245A DRD”) and the (then-) new GILTI rules. The bill forecloses the potential for similar anomalies in the future, including by reason of the Senate bill’s changes to the CFC rules discussed below.

KPMG observation

The regulatory authority to allocate foreign tax credits (FTCs) between the short period occurring by reason of the transition rule and the subsequent year will prevent an over-accrual of such taxes for the short period. For example, consider a CFC indirectly owned by a foreign corporation through a wholly owned U.S. corporation. The CFC, which currently has a November 30 year-end for U.S. tax purposes and a December 31 year-end for local tax purposes, accrues its foreign income taxes for deemed paid FTC purposes on December 31, the last day of the foreign tax year. Thus, the CFC’s foreign income taxes for 2025 will accrue during the CFC’s one-month short period created by the transition rule, potentially causing a tested loss (if the accrued taxes exceed tested income before taxes), resulting the taxes being permanently stranded. Alternatively, if the accrued taxes in the short period do not create a loss, the U.S. shareholder could obtain an artificially high effective tax rate with respect to its GILTI inclusion for its 2025 tax year based on thirteen months of tested income (the tested income for the year ended November 30, 2025, and the short period ending December 31, 2025) as compared to two full years of tax accruals (December 31, 2024, and December 31, 2025). This could produce additional GILTI FTCs to cross-credit against low-tax tested income or excess GILTI FTCs that are permanently lost. However, Treasury’s exercise of its authority could also lead to anomalous results. If future regulations were to allocate the tax accruals during the short period between the short year and the subsequent year based on the relative length of each year (1/13th to the short year and 12/13th to the 2026 tax year), then there would be, taking into account the actual accruals for the 2026 tax year, an over-allocation of taxes to the 2026 tax year, again possibly producing a tested loss or “hyping” up FTCs.

Modifications to the pro rata share rules

Prior law

A U.S. shareholder, including a U.S. shareholder owned by a foreign person, determines its subpart F inclusion based on its *pro rata share* of subpart F income. Under current law prior to enactment of the Senate bill, a U.S. shareholder has a pro rata share of subpart F income only if it owns, directly or indirectly under section 958(a), the stock of a foreign corporation on the last day of the year on which the corporation is a CFC. A U.S. shareholder's pro rata share of the subpart F income of a CFC is generally determined based on the amount of the CFC's current earnings and profits the shareholder would receive in a hypothetical distribution with respect to its shares. For this purpose, the pro rata share of a CFC's subpart F income is reduced to the extent the CFC is not a CFC for the entire year. In addition, under section 951(a)(2)(B), a U.S. shareholder's pro rata share of subpart F income with respect to a CFC is reduced by distributions with respect to shares of the CFC while owned by another person. Similar rules generally apply for purposes of determining a U.S. shareholder's pro rata share of tested items for GILTI inclusion purposes.

Senate bill as enacted (sec. 70354)

The Senate bill requires a U.S. shareholder that owns (under section 958(a)) stock in a CFC on *any* day during the tax year to include in income its pro rata share of that CFC's subpart F income even if the shareholder does not own such stock on the last day of the year on which the foreign corporation is a CFC (i.e., it eliminates the "last day" rule of section 951(a)(1)). However, a U.S. shareholder will continue to have a section 956 inclusion with respect to a foreign corporation only if it owned stock in such corporation on the last day in the corporation's tax year on which such corporation is a CFC.

In addition, the Senate bill provides that a U.S. shareholder's pro rata share of a CFC's subpart F income for a "CFC year" (i.e., a tax year in which a foreign corporation is a CFC at any time during the year) is the portion of such income which is attributable to (A) the stock of such corporation owned (under section 958(a)) by such shareholder, and (B) any period of the CFC year during which (i) such shareholder owned such stock (ii) such shareholder was a U.S. shareholder, and (iii) such corporation was a CFC.

The bill provides that a CFC inclusion for a CFC year is included in a U.S. shareholder's gross income for the shareholder's tax year which includes the last day during such CFC year on which the shareholder owns the stock in the CFC.

In addition, the bill provides authority for the Secretary to prescribe necessary or appropriate guidance to carry out the purposes of the provision, including by regulations or other guidance allowing or requiring a foreign corporation to close its tax year upon a direct or indirect disposition of stock of such corporation.

The bill makes conforming changes to section 951A, ensuring that the new rules are also generally used for calculating a U.S. shareholder's pro rata share of CFC tested items for GILTI inclusion purposes.

The provision generally applies to tax years of foreign corporations beginning after December 31, 2025, with no inference as to the application of the Code to earlier tax years. A special transition rule, however, provides that, except as provided by the Secretary, a dividend paid by a CFC is not treated as a dividend for purposes of applying section 951(a)(2)(B) (as in effect before the Senate bill proposals) if the dividend does not increase the taxable income of a U.S. person that is subject to U.S. federal income tax for the tax year and either (1) the dividend was paid on or before June 28, 2025, during the tax year of the CFC which includes such date and the U.S. shareholder did not own the stock of such CFC during the portion of such tax year on or before June 28, 2025, or (2) the dividend was paid after June 28, 2025, and before such CFC's first tax year beginning after December 31, 2025.

KPMG observation

The Senate bill eschews the mechanical approach of the current rules for determining pro rata share, including the hypothetical distribution construct and the reduction for distributions under section 951(a)(2)(B), in favor of an approach based on the subpart F income "attributable" to the U.S. shareholder's shares in the foreign corporation while owned by the U.S. shareholder and while the foreign corporation was a CFC. Importantly, though, the provision does not define "attributable." It is possible that Treasury could generally continue the approach in the current regulations for purposes of determining a shareholder's pro rata share, which generally relies on the relevant "facts and circumstances" to determine the shareholder to which the subpart F income economically inures, though without the current law "last day rule" and the reduction for distributions.

KPMG observation

The newly enacted pro rata share rules, in conjunction with the reinstatement of section 958(b)(4), appear to render obsolete the "extraordinary reduction" (ER) rules in Treas. Reg. §1.245A-5. Those rules generally deny a section 245A DRD for dividends from a CFC to a controlling U.S. shareholder in a year that a CFC experiences an ER, which is generally a more than 10% reduction in the U.S. shareholder's interest in the CFC, unless the U.S. shareholder elects to close the CFC's tax year. Corresponding rules would prevent the application of section 954(c)(6)'s exclusion from subpart F income for related CFC dividends (other than section 964(e) dividends) upon the occurrence of an extraordinary reduction with respect to a lower-tier CFC. These rules were intended to prevent a controlling U.S. shareholder from disposing of its interest in a CFC (potentially preceded by a taxable asset sale by the CFC to generate additional E&P) and (1) not taking into account a CFC inclusion with respect to the CFC target because the CFC does not cease to be a CFC (either because the acquirer is U.S. person or the acquirer is foreign but has a U.S. subsidiary to which the CFC stock could be attributed because of section 958(b)(4) repeal) and (2) obtaining a section 245A DRD with respect to the resulting section 1248 amount (or section 964(e) dividend in the case of a lower-tier CFC). Moreover, after the disposition, a foreign acquirer would have no CFC inclusion because it is not a U.S. shareholder and a U.S. acquirer's CFC inclusion would be reduced by section 951(a)(2)(B). The result, absent the ER rules, would potentially be non-taxation of current and future CFC income by reason of the disposition. The Senate bill makes these rules unnecessary, because a disposing controlling U.S. shareholder in an ER will be required to take into account all the CFC income "attributable" to its shares, which presumably would include at least a proportional amount of the CFC income for the year of the disposition. Similarly, a U.S. acquirer will also include the CFC income "attributable" to its shares, unreduced under the revised pro rata share rules by any section 1248 or section 964(e) dividend to the disposing U.S. shareholder or CFC, which would occur under section 951(a)(2)(B) prior to the enactment of the bill.

GILTI changes

Prior law

A U.S. shareholder of a CFC, including a U.S. shareholder owned by a foreign person, is required to annually include in income a GILTI inclusion based in part on the CFC's tested income, regardless of whether the income is repatriated to the U.S. shareholder. A U.S. shareholder's GILTI inclusion with respect to its CFCs is equal to the excess of its net CFC tested income over its net deemed tangible income return (NDTIR). Net CFC tested income is equal to the excess of the U.S. shareholder's aggregate pro rata share of tested income of all its CFCs over its aggregate pro rata share of tested losses of such CFCs. NDTIR is 10% of the shareholder's aggregate pro rata share of its CFCs' qualified business asset investment (QBAI), reduced generally by its pro rata share of the excess of certain interest expense over certain interest income taken into account in determining net CFC tested income. QBAI is determined at the separate CFC level as the quarterly average of the CFC's adjusted basis in specified tangible property used in a trade or business for which a section 167 depreciation deduction is allowable. Specified tangible property is generally tangible property used in the production of tested income.

GILTI is currently taxed at a rate of 10.5% by means of a 50% deduction under section 250. However, section 250(a)(3) prior to the Senate bill provided that the deduction related to GILTI (the "GILTI deduction") was to be reduced for tax years beginning after December 31, 2025, such that it would decrease from 50% to 37.5% (resulting in a 13.125% rate for GILTI).

Senate bill as enacted (secs. 70321 and 70323)

The Senate bill makes permanent a 40% GILTI deduction (resulting in a 12.6% rate) applicable to tax years beginning after December 31, 2025.

The Senate bill also eliminates the NDTIR exclusion from the GILTI calculation for purposes of determining the income inclusion under section 951A. Instead of a GILTI inclusion, a U.S. shareholder will include net CFC tested income (i.e., the shareholder's aggregate pro rata share of its CFCs' tested income reduced by its aggregate pro rata share of its CFCs' tested losses) in its income, and the term "GILTI" is replaced with "net CFC tested income" throughout the Code. (For stylistic purposes, we continue to refer to taxation under section 951A as amended by the Senate bill as GILTI throughout this discussion.) These amendments apply to tax years of foreign corporations beginning after December 31, 2025.

Rules for allocation of certain deductions for purposes of FTC limitation and changes to certain cross-references

Prior law

A taxpayer computes its FTC limitation separately for the foreign source income in each of the four categories described in section 904(d). These categories include: (1) non-passive income included under section 951A (i.e., a U.S. shareholder's GILTI inclusion), (2) foreign branch income, (3) passive category income, and (4) general category income. A U.S. shareholder generally allocates and apportions deductions between U.S. source income and foreign source income in each category.

Senate bill as enacted (sec. 70311)

The Senate bill adds new section 904(b)(5) to limit the deductions that a U.S. shareholder must allocate to section 951A category income, by providing that only the following deductions are allocable thereto: (1) the section 250 deduction with respect to the section 951A inclusion (i.e., the GILTI deduction), (2) the deduction allowed under section 164(a)(3) for certain taxes (e.g., state and local taxes) imposed on section 951A category income, and (3) any other deduction that is directly allocable to such income *other than* interest expense and research or experimental expenditures. Any deductions that, absent this new rule, would have been allocated or apportioned to income in the section 951A category for section 904 purposes are allocated and apportioned only to U.S. source income. These changes apply to tax years beginning after December 31, 2025.

KPMG observation

It is not clear whether the allocation of deductions to U.S. source income under proposed section 904(b)(5) applies for purposes of the overall domestic loss rules in section 904(g). Under these rules, the allocation of expenses away from income in the section 951A category and to U.S. source income can still have adverse FTC limitation consequences. If a taxpayer's deductions allocable to U.S. source gross income exceed that gross income, section 904(g) would require the taxpayer to proportionately offset such "overall domestic loss" (ODL) against its foreign source income within each section 904(d) category, including the section 951A category. This application of the ODL rules could result in a reduction to a taxpayer's FTC limitation for the section 951A category as if some or all of the deductions were actually allocated to GILTI income.

The Senate bill also changes four important cross-references in the FTC rules, all of which apply to tax years beginning after December 31, 2025.

First, the Senate bill modifies the rules that allocate foreign taxes to section 904(d) categories. Before enactment of the Senate bill, a foreign tax imposed on an item by a foreign jurisdiction that was not viewed as income tax under U.S. federal income tax principles was assigned under section 904(d)(2)(H) to the income category in section 904(d)(1)(B), that is, the foreign branch income category. The Senate bill provides that such foreign taxes are instead treated as imposed on income in the section 904(d)(1)(D) category, that is, the general category.

KPMG observation

This change was proposed in 2019 by Congressman Kevin Brady, then the chairman of the Ways and Means Committee, as part of a package of technical corrections to the TCJA. The cross-reference in section 904(d)(2)(H) to the foreign branch category is widely understood to be a typo in the TCJA; this change returns taxes related to "base differences" to the general category, consistent with pre-TCJA law.

Second, the Senate bill modifies the treatment of dividends from noncontrolled 10% foreign corporations for section 904 purposes. Under prior section 904(d) before the Senate bill, dividends from noncontrolled 10% owned foreign corporations were generally treated as income in a category based on the underlying E&P from which the dividends were distributed. If a taxpayer could not adequately substantiate the character of the underlying E&P, section 904(d)(4)(C)(ii) provided that the dividend was treated as income described in section 904(d)(1)(A), that is, the section 951A category. The Senate bill instead provides that such dividends are treated as income in the passive category.

KPMG observation

Prior to 2017, section 904(d)(1)(A) referred to the passive category such that the reference in prior section 904(d)(4)(C)(ii) to the section 951A category appears to have been a mistake.

Third, the Senate bill modifies section 951A(f)(1)(A) which provides that GILTI inclusions are treated in the same manner as subpart F inclusions for purposes of applying various other sections in the Code. Specifically, one of these referenced provisions under pre-enactment law was section 904(h)(1). Section 904(h) provides several sourcing rules relating to U.S.-owned foreign corporations. Section 904(h)(1) provides that certain dividend, interest, and income inclusions are treated as U.S. source to the extent attributable to or properly allocable to U.S. source income of the foreign corporation. The Senate bill changes the reference in section 951A(f)(1)(A) to section 904(h), instead of section 904(h)(1), such that the other sourcing rules in section 904(h) also apply to GILTI.

Finally, the Senate bill strikes the reference to deemed paid credits under section 960(b) in section 78. As a result, withholding taxes imposed on a distribution of previously taxed earnings and profits (PTEP) through tiers of CFCs that are ultimately deemed paid by the U.S. shareholder do not produce an additional section 78 gross-up to such shareholder.

KPMG observation

This change was proposed in 2019 by Congressman Kevin Brady, then the chairman of the Ways and Means Committee, as part of a package of technical corrections to the TCJA. A section 78 gross-up for a deemed paid credit under section 960(a) and (d) is necessary to prevent a U.S. shareholder from receiving the benefit of both a credit (i.e., the FTC) and a deduction (i.e., a reduction in the tested income or subpart F income of a CFC). In contrast, a section 78 gross-up for a deemed paid credit under section 960(b) does not produce a double benefit because the foreign income tax that gives rise to the credit reduces solely exempt income (i.e., the PTEP to which the foreign income tax relates).

Modifications to determination of deemed paid credit for taxes properly attributable to tested income

Prior law

Pursuant to current section 960(d), a U.S. shareholder that is a U.S. corporation is deemed to pay certain foreign income taxes paid or accrued by a CFC that are properly attributable to the CFC's tested income that is taken into account by the U.S. shareholder in determining its GILTI inclusion. Current section 960(d)(1) imposes two reductions to the amount of such taxes that are deemed paid. First, foreign taxes attributable to tested income are reduced to the extent that the U.S. shareholder's inclusion percentage is less than 100%, by multiplying the amount of such taxes by the inclusion percentage. A U.S. shareholder's inclusion percentage is the ratio of its GILTI inclusion to its aggregate pro rata share of its CFCs' tested income. Second, only 80% of the foreign income taxes remaining after the application of the inclusion percentage are deemed paid by the U.S. shareholder. The application of the inclusion percentage and 20% "haircut" reduce the amount of foreign income taxes attributable to tested income that may be claimed as an FTC within the section 951A category of section 904.

Senate bill as enacted (sec. 70312)

The Senate bill reduces the 20% haircut to 10%, increasing the percentage of tested foreign income taxes that are creditable. The modification applies to tax years of foreign corporations beginning after December 31, 2025.

KPMG observation

A CFC will need to pay foreign income taxes on tested income at an effective rate of at least 14% (21% corporate rate x (100% - 40% deduction) / 90%)) to eliminate U.S. residual tax on the U.S. shareholder's GILTI inclusion. The legislative history to the TCJA suggested that there should be no U.S. residual tax under current law GILTI for earnings subject to a foreign effective tax rate of 13.125% (21% corporate rate x (100% - 50% deduction) / 80%), which failed to account for expense allocation to the section 951A category at the U.S. shareholder level. In light of the Senate's change to substantially reduce the expenses allocated to GILTI (other than the section 250 deduction, state and local taxes imposed on a section 951A inclusion, and any other deductions directly allocable to the shareholder's section 951A inclusion), it is much more likely that no residual U.S. tax will be imposed on GILTI inclusions when the underlying tested income is subject to at least a 14% effective tax rate.

KPMG observation

Due to the elimination of the exclusion for QBAI and the resulting change from "GILTI" to "net CFC tested income," the Senate modification generally increases a U.S. shareholder's inclusion percentage relative to prior law. Under law prior to enactment of the Senate bill, the inclusion percentage may be decreased by both tested losses and NDTIR; under the Senate version as enacted, only tested losses reduce the inclusion percentage.

The Senate bill also disallows an FTC for 10% of any foreign income taxes paid or accrued on GILTI PTEP, which applies to foreign income taxes paid or accrued with respect to any amount excluded from gross income under section 959(a) by reason of a GILTI inclusion after June 28, 2025.

KPMG observation

The 10% haircut for foreign income taxes paid on GILTI PTEP appears to apply only with respect to distributions of PTEP arising from GILTI included by a U.S. shareholder in a tax year ending after June 28, 2025. Therefore, a distribution of GILTI PTEP created in 2025 would always be subject to the haircut, even if the distribution occurred on or before June 28, 2025 (e.g., for a calendar year taxpayer, January 1, 2025), but a distribution of PTEP arising in any tax year ending on or before June 28, 2025, would never be subject to the haircut. There is a possible alternative interpretation of the effective date based on the view that "after June 28, 2025" modifies "any amount excluded from gross income under section 959(a)" (i.e., the PTEP distribution) rather than the GILTI inclusion. Under this interpretation, any distribution of GILTI PTEP occurring after June 28, 2025, would be subject to the 10% haircut, regardless of when such PTEP arose, including PTEP that arose before 2025. However, that is a disfavored reading of the effective date for two reasons. First, grammatically, "June 28, 2025" is most naturally read to modify its most proximate clause, which is the GILTI inclusion. Second, an earlier version of the Senate bill (released on June 27, 2025) provided that the 10% haircut "shall apply to amounts distributed after June 28, 2025," which effective date would have been consistent with the alternative interpretation. While there is no legislative history that explains this change to the effective date language, it is reasonable to assume that the change was intended to limit the haircut to 2025 GILTI PTEP.

KPMG observation

As discussed above, elimination of the section 78 gross-up for foreign taxes deemed paid under section 960(b) is effective for tax years beginning after December 31, 2025. Thus, a 2025 distribution of current year GILTI PTEP could be subject to both the 10% haircut of the FTCs paid under section 901 (including deemed paid under section 960(b)) under the enacted bill and the section 78 gross-up with respect to the remaining FTCs deemed paid under section 960(b) under prior law. To avoid this punitive result, taxpayers that are excess limit in the section 951A category and have 2025 GILTI PTEP with associated section 960(b) deemed paid FTCs might consider delaying distributions of such PTEP until 2026.

Modifications to FDII

Prior law

Very generally, the section 250 deduction for FDII (the "FDII deduction") is calculated by reference to foreign-derived deduction eligible income (FDDEI), which is a subset of a taxpayer's deduction eligible income (DEI). Under current law, DEI is defined as all gross income of a U.S. corporation, less certain excluded categories of income—dividends, CFC inclusions, financial services income, branch income, and domestic oil and gas extraction income—and then reduced by allocable expenses. Under current law, to determine the FDII deduction, DEI is reduced by DTIR, which is generally 10% of QBAI, to calculate deemed intangible income (DII). In the context of the FDII deduction, QBAI is generally the quarterly average of the adjusted basis in tangible property that produced DEI. FDII under current law DII is multiplied by the ratio of FDDEI to DEI.

FDII is currently taxed at a rate of 13.125% by means of a 37.5% deduction under section 250.

Prior to enactment of the Senate bill, section 250(a)(3) provided that the FDII deduction was to be reduced from 37.5% to 21.875% for tax years beginning after December 31, 2025, resulting in a 16.406% rate for FDII.

Senate bill as enacted (secs. 70321, 70322, and 70323)

The Senate bill makes permanent a 33.34% FDII deduction (resulting in a 13.9986% rate), applicable to tax years beginning after December 31, 2025.

The Senate bill also makes several changes to the determination of DEI for purposes of FDII, including eliminating the allocation of certain expenses to DEI.

Determination of DEI (sec. 70322)

The Senate bill excludes from DEI any income or gain from the sale or other disposition (including pursuant to a deemed sale or deemed disposition or a transaction subject to section 367(d)) of intangible property (as defined in section 367(d)(4)) or other property that is subject to depreciation, amortization or depletion. Stated differently, income from the *outbound* sale or disposition of intangible property, or other property subject to depreciation, amortization, or depletion. For purposes of this exclusion, the provision does not define the term “sale,” but expressly does not use the broad definition of “sale” otherwise used in FDII, which includes “any lease, license, exchange, or other disposition.” This provision is retroactive from enactment, applying to sales or other dispositions occurring after June 16, 2025.

KPMG observation

This rule prevents the income from a U.S. corporation’s transfer of IP to foreign persons, including its CFCs or a foreign parent, from qualifying for FDII (or FDDEI, as renamed under the Senate bill). Because the rule does not adopt the broad definition of “sale” that applies for the rest of FDII, this provision only excludes from FDII income arising from an actual or deemed transfer of IP, the “sale of the tree,” and not income from the license of such IP, the “sale of the fruit.” This rule is consistent with one of the primary objectives of FDII (and GILTI), which was to incentivize the retention of IP in the United States.

The Senate bill also amends section 250(b)(3)(A)(ii), which provided that, in determining DEI, relevant gross income is reduced by all deductions properly allocable thereto. The Senate bill modifies this rule such that gross DEI is reduced by expenses and deductions properly allocable to such gross income *other than* interest expense and research or experimental expenditures. This modification applies to tax years beginning after December 31, 2025.

KPMG observation

Eliminating interest and research expenditures from the deductions allocable to DEI will generally result in an overall increase in DEI and FDDEI for taxpayers. Similarly, the elimination of the DTIR exclusion could significantly increase the amount of their income eligible for the FDII deduction, particularly for companies with significant fixed assets. Taken together, these changes could make the FDII deduction more favorable for some companies notwithstanding the reduction in the FDII rate. However, the FDII deduction (along with the GILTI deduction) is still subject to the taxable income limitation of section 250(a)(2).

Rules related to deemed intangible income (sec. 70323)

Similar to the elimination of NDTIR for GILTI, the Senate bill removes the exclusion for QBAI (DTIR in FDII) from the FDII calculation. As a result, a taxpayer's FDII deduction is simply its FDDEI multiplied by the FDII rate (33.34% under the Senate bill). The Senate bill eliminates the terms "DII" and "FDII" from the Code (replacing the latter with "FDDEI").

This change to FDII applies to tax years beginning after December 31, 2025.

KPMG observation

While provisions such as FDII and GILTI general favor U.S. parented groups, as noted above, foreign parented groups with U.S. subsidiaries are also able to benefit from FDII and should consider evaluating income streams (perhaps previously ignored) for application of the updated incentive. As with all these new provisions, modeling any potential benefits is critical.

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