Enforcement of remedies against unfair foreign taxes: Section 112028 of H.R. 1 (119th Congress) Updated

Implications for qualified and non-qualified intermediaries under the QI Agreement and certified financial intermediaries under the FASTER Directive

Date	20th June 2025
Author	Ross McGill
Role	Chairman Emeritus, TConsult
Affiliations	Member of the Advisory Board, RAQUEST GmbH

Contents

1 Introduction

Earlier in June 2025, I published a White Paper[1] analysing the terms of a proposed US Internal Revenue Code Section 899 and its potential impact on non-US financial institutions and non-US investors.

This article provides updates to the original White Paper following discussions in the Senate Finance Committee (Title VII). New material, including Figure 1 is designed to help readers understand the structure of the new section in order to be able navigate to the most appropriate part of the material as well as commentary on the changes between the two documents.

2 About the Author

Ross K. McGill is the founder and Chairman Emeritus of TConsult and a member of the Advisory Board of withholding tax software company RAQUEST GmbH. He sits on three subcommittees of the International Standards Evaluation Group (SEG) for ISO20022. He gave expert witness testimony to the European Commission FISCO Group and edited the final report of the European Commission Tax Barriers Business Advisory Group. He has written numerous books on cross-border withholding tax[2].

3 Summary

3.1 Structure

Figure 1 provides an overview of Section 899 including its sub-clauses and particular terms.

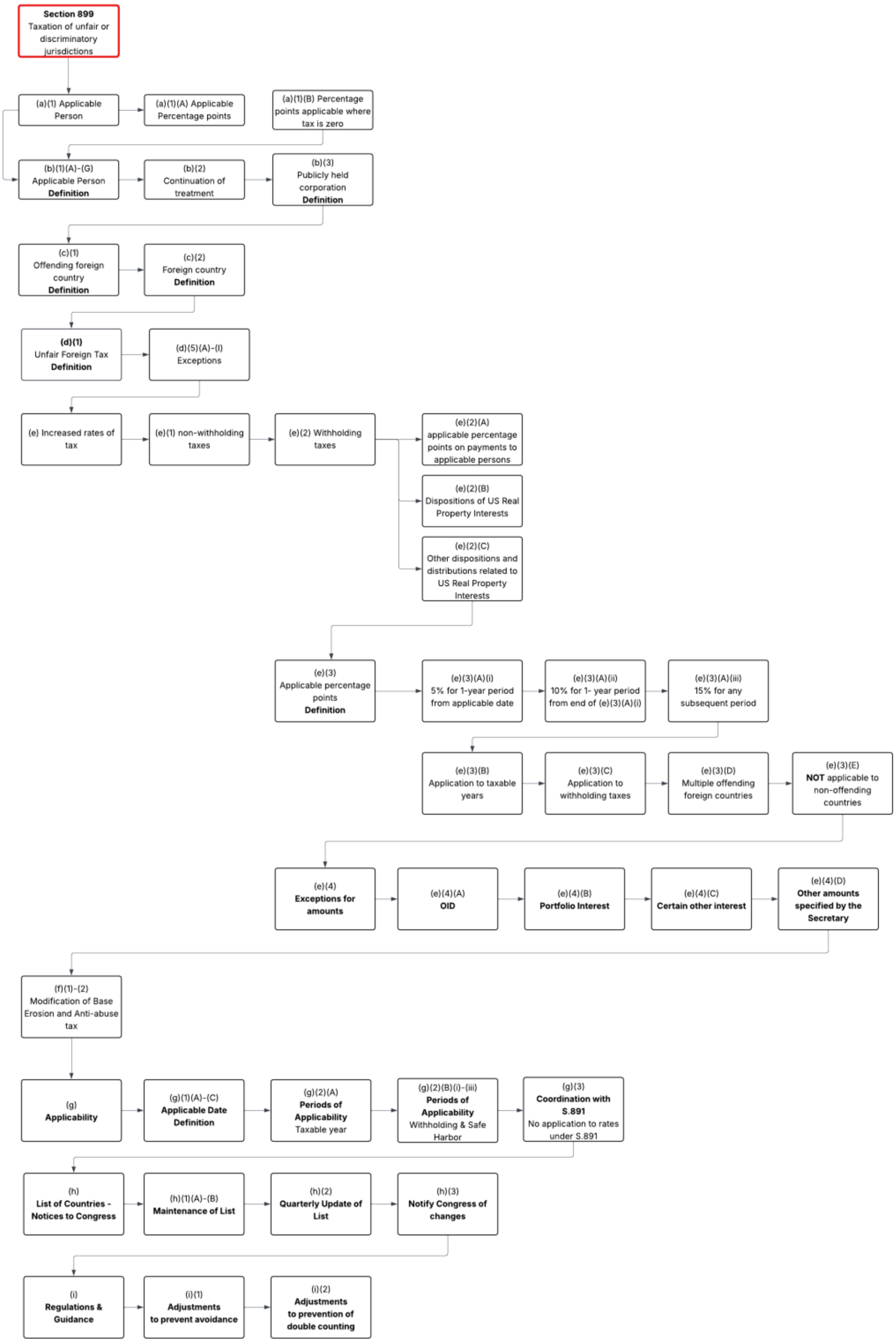

Figure 1. Structure of Section 899

3.2 Terminology

In H.R.1 the terms used are "discriminatory" foreign taxes and "discriminatory" foreign countries. In the updated text, these terms are replaced with "unfair foreign taxes" and "offending foreign countries". While this may seem, at first glance, to be a difference without a difference, it's likely that the change was negotiated to give some extra leeway to the Treasury to be able to include certain jurisdictions that might not otherwise rise to the level of objective discrimination. The new text also includes the term "extraterritorial tax" and connects this to the terms offending foreign country and unfair tax. In the new text, the definition of an offending country is derived from the fact that it is imposing an extraterritorial tax. This is rather ironic given the extraterritorial nature of Section 1471-1474 (FATCA) which imposes a 30% tax on all US FDAP income paid to non-participating FFIs[3].

The drafting of Section 899 was clearly done by those who may not understand the difference between a country (as often expressed by the President) and a tax jurisdiction (which is the more normal term when discussing these technical matters). A country is a sovereign state that is a political and legal entity. A tax jurisdiction on the other hand is a region or authority that has the legal power to impose taxes (which can be a subdivision of a country). For example, the United Kingdom and the Crown dependencies (Jersey, Isle of Man and Guernsey) are all separate tax jurisdictions, Hong Kong is a special administrative region (SAR) of the People's Republic of China. Mr. Trump has also frequently referred to the European Union as if it were a single country, but it is actually made up of 27 member states each of which are also tax jurisdictions. So, the question arises whether a strict reading of Section 899 could see a conflict of interpretation. The most obvious in the EU would be Spain. Spain is one country but has multiple tax jurisdictions (Pais Vasco – Basque country, Navarra). So, when considering whether a "country" is being unfair, the US Treasury would potentially need to account for different tax jurisdictions within that country. We prefer to consider that the framers of Section 899 were more concerned with the political appearance of the Bill than the technical details associated with implementation.

3.3 Implementation

The Senate version of the Bill has a clause that gives a temporary safe harbor to withholding agents, such as QIs and NQIs that penalties or interest will not apply due to failures to withhold prior to January 1st 2027. Many have taken this to mean that imposition won't start until that date. We disagree. Our interpretation is that implementation can begin from January 1st, 2026 if the Bill is passed at any time up to October 2025.

3.4 Monitoring

From the perspective of a non-US financial institution, Qualified Intermediary (QI) or non-qualified (NQI), there are two key issues that will need to be tracked:

1. Is my country deemed unfair? For most financial institutions, their client base is usually heavily weighted to their home jurisdiction[4]. So, a Maltese bank will likely have a very large percentage of its customers as Maltese residents. It's important to note that Section 899 is not directly targeting investors, it is targeting countries. So, if Malta is deemed to be an unfair country, by inference, all

Maltese investors in US securities will be impacted. The second question also needs to be tracked in parallel.

2. Are my clients resident in unfair jurisdictions – even if I am not? There are two possible scenarios here:
    a. I am a larger bank with operating units in multiple countries
    b. I am a larger domestic bank that has clients, some of whom are not necessarily tax resident in my home jurisdiction.

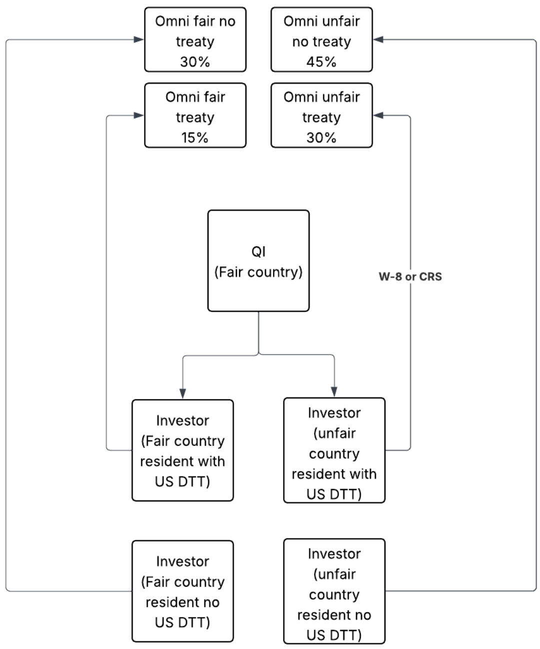

Figure 2. Monitoring tax in rate pools

Figure 2 shows how a QI organised in a country deemed "fair" under Section 899, would still have to assess the tax rates for clients who are tax residents of "unfair" countries. This could be achievable by using data collected by financial institutions under the OECD Common Reporting Standard (CRS). As noted under the section on reporting, this gives rise to the potential for the same tax rate to be applied for different reasons e.g., a 30% tax rate by reason of a section 899 uplift of a 15% rate in an unfair country or a 30% tax rate by reason of the normal Chapter 3 withholding rules where a client is in a fair country but does not claim the benefit of the treaty or is not entitled. As these rates can change each year and by country, if passed, this will present some formidable challenges to QIs and NQIs.

What is clear from the way Section 899 is worded, is that it provides a wide scope for the Treasury to assess impact. By targeting countries, the issue is whether they mean just the financial institutions in that country or whether they mean the investors resident in that country (who might have accounts outside that country). This highlights the asymmetric nature of Section 899. The punitive tax rates being discussed will financially impact investors in those countries who may choose to divest from the US entirely precisely because of these measures. However, the countries that will be predominantly concerned with this Section will be those that are imposing what the US calls an unfair extraterritorial tax that effectively creates an unfair playing field for US companies. It can be argued that the most common tax that fits this description will be a digital services tax

(DST). In today's world, dominated by US technology giants, it's not surprising that a DST imposed by any country (or bloc) would be deemed to be unfair by the US. It does seem illogical however, asymmetrical, that a tax that affects only US corporations should be met with a tax on all foreign passive investment from that country.

It will become clearer if the Bill is passed, as the Secretary to the Treasury is required under Section 899(h)(1)(A)-(B), 899(h)(2) and 899(h)(3) to maintain a list of unfair jurisdictions, to update that list quarterly and notify Congress of any changes. QIs will need to develop policies and procedures to be able to monitor this, via their Compliance Program obligation[5]. NQIs don't have a compliance program obligation to the US, but they will still need to have policy and procedure to make sure that the correct amount of tax is collected and reported.

3.5 Documentation

The impact of Section 899 will be felt most at the documentation phase of a QI or NQI's US tax cycle. Documentation, or lack thereof, predominantly decides the tax rate to be applied. A W-8 with a treaty claim could reduce the starting rate of tax from 30% to 10%, 15% or 25% (the most common treaty rates). This model will have to be adjusted to take account of not only the financial institution's residency but also the residency of the investor. For example, an investor resident in country A (determined to be unfair) holding an account at a financial institution in country B (deemed fair) would likely be subject to Section 899 both at the statutory level and at the treaty level. This will significantly impact those financial institutions that have clients from multiple residencies.

The IRS recently confirmed to us that a QI can grant treaty benefits to a direct client based solely on KYC i.e., no W-8 required. However, not using the W-8 (which contains a penalty of perjury statement) exposes the financial institution to liability for under-withholding if it gets this wrong. Happily, almost all financial institutions have taken the decision not to accept this liability and opt for the W-8 form instead. For those financial institutions that continue to rely on KYC for treaty benefits, Section 899 poses an additional risk because the under-withholding would be even greater if, for example, they failed to react to a change in the unfair countries list and failed to apply a higher rate when required.

Another big outstanding question is going to be an indirect reference to CRS. Under CRS, a financial institution will be documenting all the tax residencies associated with its clients, so that it can report them indirectly to the appropriate authority. This raises the question of what should happen to an investor with two tax residencies one of which is deemed unfair and the other not so. Without further guidance, the financial services industry would most likely take the risk averse approach and tax based on the worst-case scenario. Section 899(e)(D) does clarify that if a taxpayer is tax resident in multiple (i.e., more than one) unfriendly jurisdictions, the highest applicable rate applies. However, the general difficulty is, under residency-based tax systems i.e., everyone in the world except the US and Eritrea), the criteria for tax residence is usually 180 days present in the country, so the maximum number of tax residencies usually possible in one year is just two.

That of course raises the edge case in which a client has two tax residencies, both of which are deemed unfair – but listed as unfair in different quarters of the year. These sections do however, give some clarity given that they mention "taxpayers" rather than countries. This supports our current view that financial institutions will have to take into account the tax residencies of their clients (taxpayers) as well as their own residency.

3.6. Exemptions

One of the most important exemptions provided in Section 899(e)(4)(B) is for portfolio interest. Original Issue Discount (OID) is also exempted from the uplift in tax rates on unfair jurisdictions in Section 899(e)(4)(D).

3.7 Withholding

There is no practical substantive change in the implementation of increased rates employed under Section 899. The need for QIs and NQIs to assess their withholding methodology based on the uplifted and non-uplifted rates that apply for that year to those clients affected. It is likely that the number of withholding rate pools being used would increase and the methodology by which assets would be transferred between omnibus accounts would need to be more robust given that the unfair country list could change quarterly.

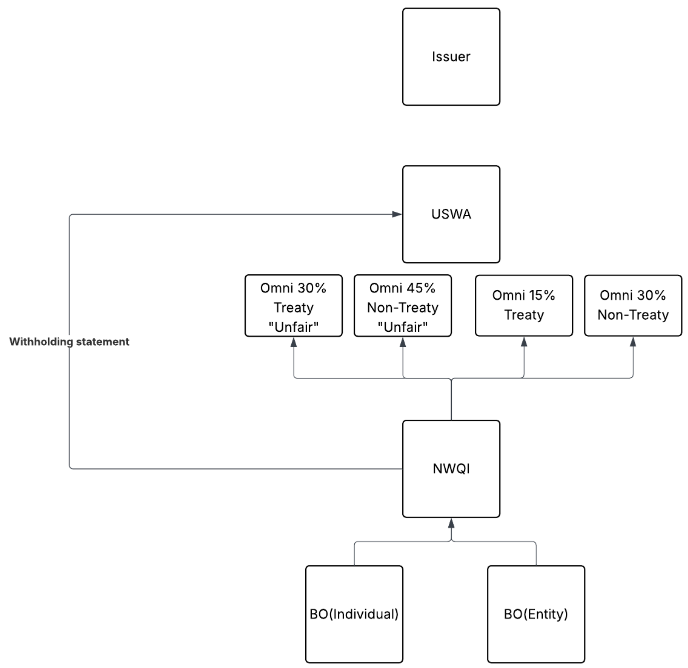

Figure 3. Revised withholding model for QIs under Section 899

The cap introduced in the original Bill of 20% has been replaced in the Senate Finance Committee version by a lower 15% uplift of the applicable rates given in 899(e)(3)(A)(iii). The maximum impact of this is shown in Figure 3. Over 3 years, the treaty rate of say 15% would rise to 30% and the statutory rate would increase to 45%. For China, the current treaty rate of 10% would rise (if China were deemed unfair) to 25%. It is unlikely that China would not react to such a change.

The overall model of withholding statements and omnibus (rate pool) accounts would not need to change. Each omnibus account would be populated with US assets of domestic investors (in the case of the country of the financial institution's organisation being deemed unfair) co-mingled with the US assets of any investor with a tax residency in an unfair jurisdiction. Provided there is no change to the "unfair" list, all that would change over time would be the withholding rate to be applied to assets in those accounts. However, financial institutions should take care, if a country reacts and is removed from the unfair list, the financial institutions will need to move those assets out of one omnibus account into the more favourable one. Larger institutions will need to assess how many rates are affected. For example, financial institutions with Chinese, Philippine and Indian clients may need additional omnibus accounts because the treaty rates are currently at 10%, and 25%. The unfair uplift there would be to 25% and 40% respectively.

3.7 Reporting

1042-S reporting, in essence, would remain unchanged, except that the number of applicable tax rates being pooled would increase (and change year on year) to reflect the uplifted tax rates applied.

While the Senate reviewed Section 899 provides some answers to more detailed questions, it leaves other unanswered. For example, a pooled 1042-S representing income code 06 (dividends) taxed at 30% on the basis of a third-year uplift in an unfriendly country could not be distinguished from a 30% pool for income code 06 applied rate for a friendly country – because 1042-S returns do not currently record the jurisdiction to which the pooled rate applies. This represents a potential change to 1042-S reporting where the Secretary to the Treasury may want to be able, not unreasonably, to demonstrate the financial effects of Section 899 in terms of increased tax receipts. The minimum requirement to achieve this would be to require 1042-S returns to be further separated by status of jurisdiction. Given that the IRS would know the year in which a given jurisdiction had uplifted tax rates, the impact could be calculated. None of this is mentioned in the current Section 899 text, but would probably, if implemented, be achieved with an IRS Notice, Announcement or Revenue Procedure.

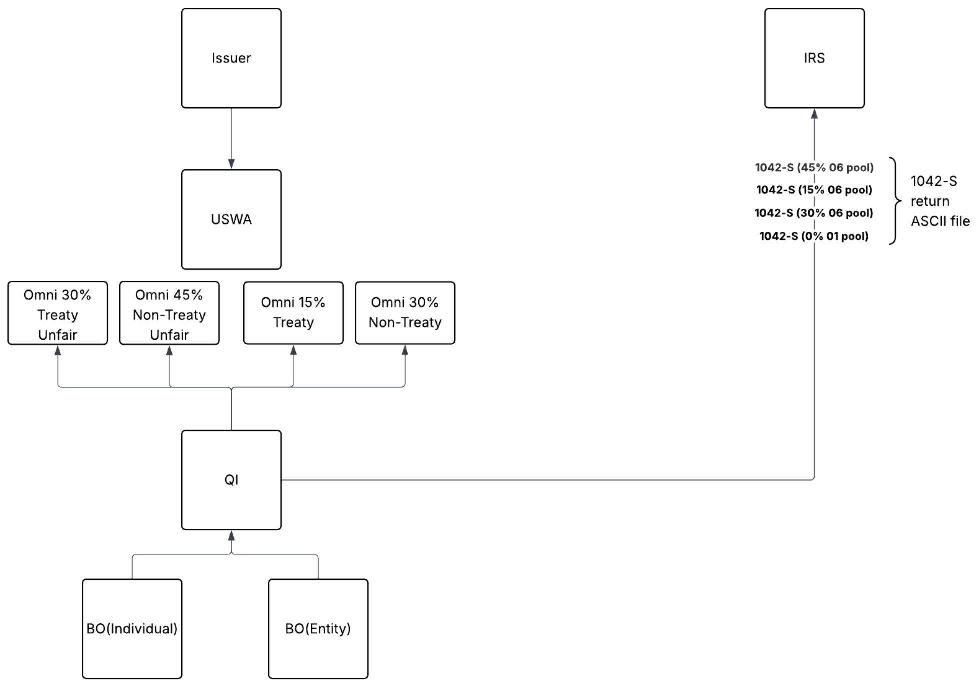

Figure 4. Section 899 effect on information returns

Figure 4 shows the conundrum. Under standard 1042-S reporting, the QI has a 30% treaty pool for clients resident in unfair countries being, in the third year, a 15% rate on dividends uplifted by 15%. However, it also has a 30% statutory rate pool account for clients resident in "fair" countries that have not claimed a tax treaty or are not entitled. Under current reporting rules, there would be no way to differentiate these two scenarios.

3.8 Transposition

We remain of the opinion that, if passed into law on July 4th, 2025, or at any time before October 2025, the terms of these uplifted rates could start to apply as soon as January 1st, 2026, as a result of a third-quarter unfair jurisdictions list published by the Treasury. As noted earlier, the Senate version provides a safe harbor for withholding agents until January 1st, 2027. This does not mean that implementation is delayed until then only that withholding agents won't be penalised for under-withholding. Any under0-withholding in that period due to Section 899, would still have to be corrected.

3.9 Impact on FASTER

We had already noted in our original White Paper that the EU as a whole would potentially be deemed to be an unfair country. Mr. Trump has already publicly confused the EU with a country[6]. In 2018 in a Face the Nation interview he said, "The European Union was formed in order to take advantage of the United States." Which demonstrates an antipathy to this supranational group.

There is an argument that wholesale application to the EU would not be advantageous to the US since at least two EU markets (Malta and Cyprus) do not have a withholding tax on dividends paid to non-residents, thus technically leaving 25 countries that could be deemed to have unfair extraterritorial taxes, one of which could be France who have adopted a digital services tax (DST) that would unfavourably target revenues from digital activities from US technology companies.

Whether a wholesale or more targeted approach is taken, it is clear from recent rhetoric that the US administration views the EU as an unfair area and thus would likely be targeted if the Bill is passed. However, the EU is going one step further with its FASTER Directive due to come into force on January 1st, 2030. Given our original commentary on the lack of equivalence of the US Form 6166 to the FASTER eTRC and the additional hoops that US financial firms would face in registering as CFIs compared to EU firms, we remain of the opinion that the US will likely deem the FASTER Directive to be an unfair extraterritorial tax and fall within the listing scope of Section 899.

4 Unintended consequences – the impact on Americans

It is also worthy of note that Rep. Darin LaHood is the sponsor of H.R 10468 the "Residence-based taxation for Americans Abroad Act". The implications of Section 899 would seem to be that any American resident outside the US that opts-in to the RBT[7] model would be treated as a non-resident alien for the purpose of US taxation. This would raise the obvious question of whether the US would or could join the OECD AEoI[8] and Common Reporting Standard.

That aside, the question is then what happens for an American resident in a "fair" country and an "unfair" country. As a presumed non-resident alien opted in under H.R.10468, these US persons would be taxed at the usual Chapter 3 statutory and treaty rates by QIs and NQIs. So, instead of taxing US persons at 0% on US-sourced FDAP income, the treaty and 30% statutory rate, including the Section 899 uplifts would take effect. So, in a worst-case scenario, we could see US citizens resident outside the US subject to an uplifted treaty rate or up to 45% statutory rate on US-sourced FDAP income.

5 Conclusion

The biggest issues of Section 899 in its revised form are:

1. the terminology has changed from objectively discriminatory to subjectively unfair,
2. the cap on increases for unfair countries has been reduced to 15% over three years and
3. that financial institutions will have more work to do to assess their own jurisdiction's ongoing status as well as that of their clients to determine the correct tax rate and avoid under-withholding after the transitionary reliefs expire.
4. Americans opting-in to RBT under H.R.10468 could end up being harmed financially if their jurisdiction of residency imposes an extraterritorial tax that affects US corporations

It is still far from clear that H.R.1 (or H.R.10468) will pass or that the proposed Section 899 will ever come into force. Recent geopolitical unrest, notably the US attack on Iran, have put more pressure on Republicans to publicly disagree with the President which may in turn create a back-pressure on his Big Beautiful Bill Act.

All the above said, it's important for non-US financial institutions and investors to consider possible scenarios and their operational effects so that they can make informed decisions and, if necessary, adapt their business models.

6 References

[1] https://tconsult-ltd.com/wp-content/uploads/2025/06/Section-899-White-Paper.pdf

[2] https://link.springer.com/book/10.1007/978-3-031-81410-5

[3] Foreign Financial Institutions that have not signed an FFI Agreement or who are not compliant with IRC Sections 1471-1474

[4] For this purpose we are using the term "jurisdiction" and "country" interchangeably

[5] Section 10.01(A) of the QI Agreement

[6] https://www.latintimes.com/trump-mocked-calling-european-union-country-tariff-threat-no-geographical-skills-all-579386?utm_source=chatgpt.com

[7] Residence-Based Taxation

[8] Automatic Exchange Of Information