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

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

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1 Introduction

Section 112028 of H.R. 1, also anecdotally known as the One Big Beautiful Bill Act was introduced in the 119th Congress. It outlines a framework to address and counteract the imposition of what the US considers to be "unfair" or "discriminatory" foreign taxes imposed by foreign jurisdictions. The measures aim to protect U.S. economic interests and ensure reciprocal treatment of tax obligations in international trade and investment.

Outside the US, financial institutions that act as brokers or custodians of US securities on behalf of their clients, may be resident (or their clients may be resident) in a jurisdiction that the US, at some point, determines to be discriminatory to its interests. This has already happened with the introduction of tariffs which has caused significant disruption to supply chains as well effects on prices of goods and services in the US. So, depending on political factors, if H.R.1 passes the Senate, it will then be signed into law by President Trump. At that point QIs and NQIs should have already considered the likely effects on their businesses. This will include an assessment of the potential capital flight risk from investors who no longer want to have any exposure to the US capital market and an assessment of the potential changes to their tax operational models for withholding and reporting.

Former President Obama already said in a speech he gave at the White House in 2009[1], that (and I paraphrase) any financial institution that did not sign a QI Agreement with the IRS would be deemed to be 'facilitating tax evasion'. The first risk assessment therefore should be whether NQIs should make more strenuous efforts to become QIs or at least to re-visit the reasons that they did not previously apply.

Technically, the proposed statute is codified as Section 899 of subpart D (miscellaneous provisions) of Part II (Non-resident Aliens and Foreign Corporations) of subchapter N (tax based on income from sources within or without the United States) of Title 26 of the US Internal Revenue Code (see Figure 1). It introduces punitive tax measures, definitions, exclusions, and guidance requirements to deter discriminatory foreign tax practices. Anyone doing research on "Section 899" can easily go down the wrong rabbit hole because Section 899 already existed but was repealed by the Tax Reform Act in 1986. It was then revived under the Tax Cuts and Jobs Act (TCJA) 2017.

The positioning of the Section 899 proposed by H.R.1 in the structure of the Internal Revenue Code is important for QIs and NQIs to understand. QIs are typically concerned with Chapter 3 and 4 of the Internal Revenue Code, whereas Section 899 is part of Chapter 1.

[1] https://obamawhitehouse.archives.gov/the-press-office/remarks-president-international-tax-policy-reform?utm_source=chatgpt.com

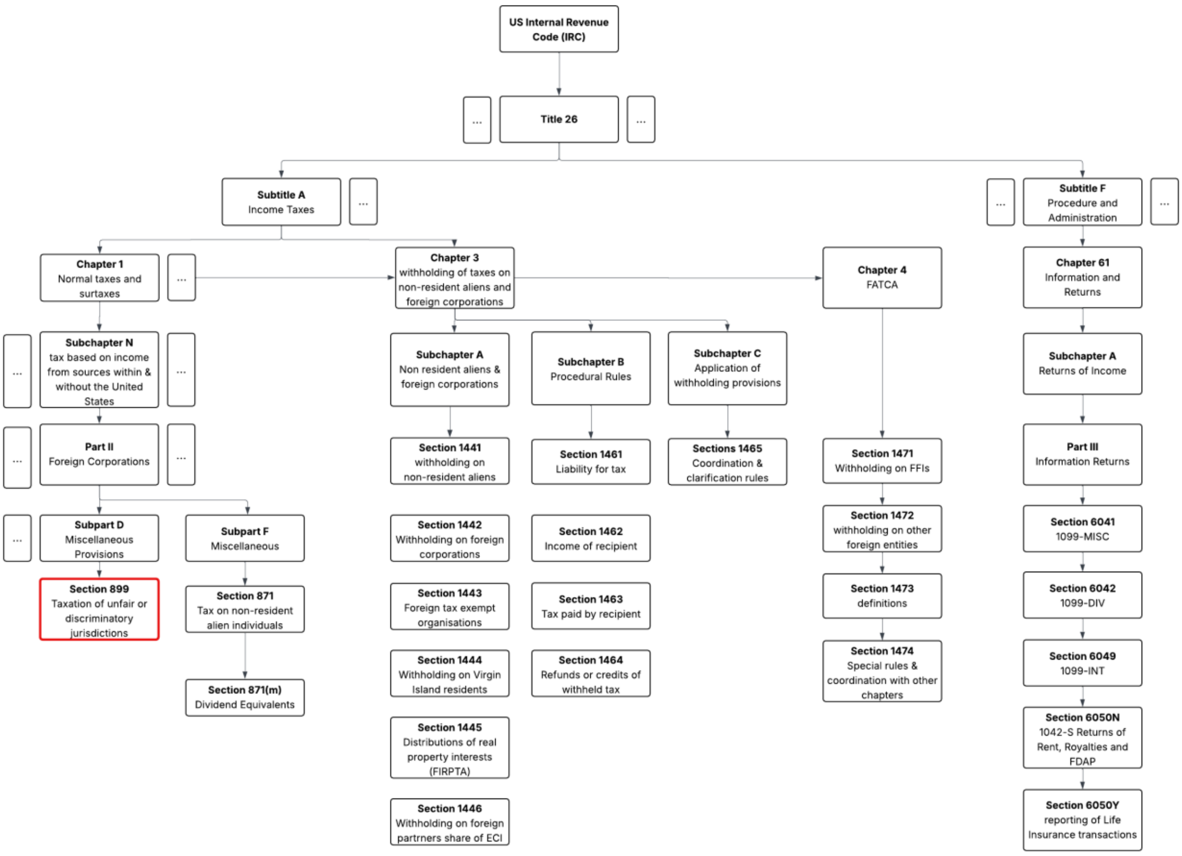

Figure 1. Structural location of Section 899 and relationship to Chapters 1, 3, 4 and 61.
Source: Author

The difficulty for jurisdictional authorities, governments, politicians and for financial institutions and investors is the level of uncertainty, volatility and unpredictability associated with the US at present. Some of the decisions being made by the current administration have seemed capricious at best (and malicious at worst), including for example, imposing a 10% tariff on good exported to the US from the Heard and McDonald Islands which are inhabited solely by penguins.

So, while this Bill has yet to pass into law, and even if it does, it is unlikely to come into practical effect before 2027, it is incumbent on the industry as a whole to consider the implications if it does and if the administration names any significant jurisdictions as “unfair” or “discriminatory”. The geopolitical landscape at the moment would certainly conclude that EU Member States may be at higher risk (or even the whole of the EU block) and, in a transactional environment, perhaps any other jurisdictions on which the administration wishes to create leverage.

2 Context

Over the past decade, various countries have introduced unilateral tax measures targeting the digital economy and multinational enterprises, many of which are perceived to disproportionately affect US-based firms. These include digital services taxes (DSTs), diverted profits taxes (DPTs), and undertaxed profits rules (UTPRs), often introduced outside multilateral frameworks like the OECD.

The United States has historically viewed such taxes as discriminatory, economically harmful, and inconsistent with international tax norms. Section 112028 is designed to serve as a statutory response, granting the US Treasury authority to increase tax burdens on countries that impose these taxes.

In Section 899, an "unfair foreign tax" includes:

- Undertaxed Profits Rules (UTPR)
- Digital Services Taxes (DST)
- Diverted Profits Taxes (DPT)
- Extraterritorial taxes and discriminatory taxes
- Any tax with a stated purpose to economically burden U.S. persons

Certain foreign taxes are explicitly **not** considered unfair:

- Standard income taxes
- VAT, sales, and consumption taxes
- Property, estate, and gift taxes
- Foreign withholding taxes on individuals
- Non-discriminatory, generally applicable transaction taxes

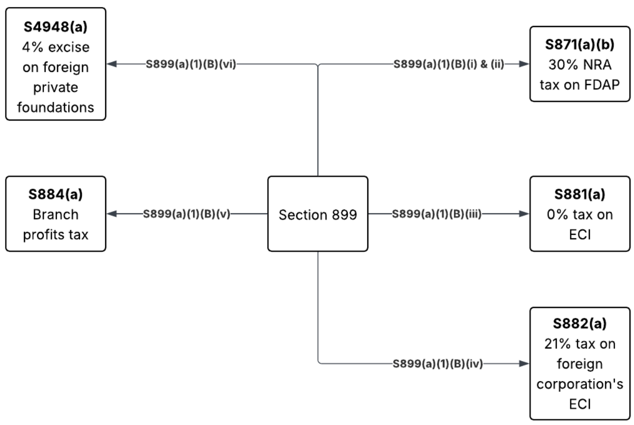

Figure 2. Specified rates of tax affected by Section 899. Source: Author

Subjects of these US countermeasures are "applicable persons". Applicable persons are:

- Foreign governments of discriminatory countries Section 899(b)(1)(A)
- Foreign residents and entities of discriminatory countries including:
    - individuals Section 899(b)(1)(B)

- corporations Section 899(b)(1)(C)
- foundations Section 899(b)(1)(D)
- Entities majority-owned by such persons Section 899(b)(1)(E)
- trusts Section 899(b)(1)(F)

Section 899(a)(3)(A) addresses withholding taxes by reference to Sections 1441[2] and 1442[3] by uplifting the statutory rate of tax by up to 20% in 5% annual increments. Sections 1441-1464 are generally referred to as "Chapter 3" of the US internal Revenue Code, particularly by financial institutions making payments and withholding taxes on distributions to non-resident aliens, so called NRA withholding or Chapter 3 withholding.

There are some safe harbor provisions and transitional relief in Section 899 including:

- No penalties for withholding failures before January 1, 2027, if good faith efforts are demonstrated
- Temporary relief provided to withholding agents during the transition

Unlike Section 871(m) where "good faith efforts" is a defined term, good faith efforts in Section 899 appears undefined. Similarly, "no penalties" does not appear to clarify the scope of this arrangement. "Penalties" applicable to QIs for example, for under-withholding, as would be the case if a QI failed to apply the Section 899 penalty, could rise to an Event of Default of the QI Agreement for systemic uncorrected under-withholding, to revocation of the QI Agreement in addition to the financial penalties associated with under-withholding and efforts involved in making a qualified certification of effective controls.

The big question is who will decide which countries are being discriminatory to the US and how will that information be communicated. Section 899(d)(3) sets out that the Secretary of the Treasury is required to:

- Publish a list of discriminatory foreign countries on a quarterly basis
- Notify Congress of any updates
- Issue regulations to prevent abuse and ensure consistent application

If recent history is anything to go by, these decisions may actually be made by the President.

While the main point of Section 899 references statutory tax rates, there is a specific expansion provided in Section 899(a)(3)(A): *"In the case of any payment to an applicable person, each rate of tax specified in section 1441(a) or 1442(a) (**or any rate of tax applicable in lieu of such statutory rate**) shall be increased by the applicable number of percentage points.". If "in lieu of" can be interpreted to refer to treaty rates,* this would seem to extend the applicability to treaty rates of Section 899 withholding as well as the statutory rate.

3 Affected jurisdictions

While the Bill requires the publication of a list by the Secretary of the Treasury on a quarterly basis going forward, we already know which countries are potentially in the crosshairs.

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[2] https://www.law.cornell.edu/uscode/text/26/1441

[3] https://www.law.cornell.edu/uscode/text/26/1442

- **United Kingdom**: Implemented a Digital Services Tax affecting large digital companies.
- **France**: Adopted a Digital Services Tax targeting revenues from digital activities.
- **India**: Introduced an Equalization Levy on digital transactions.
- **Canada**: Proposed a Digital Services Tax similar to those in Europe.
- **Australia**: Considered implementing measures targeting digital services.
- **Brazil**: Discussed tax reforms that may impact foreign digital service providers.

4 Timing

If enacted in its current form, Section 899 would become effective on the date of enactment of the bill. However, the application of its provisions is conditional:

- **Trigger Condition**: The provisions of Section 899 are activated only if a foreign country imposes an "unfair foreign tax" on U.S. persons or entities. See Section 7 of this article.
- **Escalating Tax Rates**: Once triggered, the U.S. would impose additional taxes on affected foreign persons, starting with a 5-percentage point increase in the first year. This increase would escalate by 5 percentage points each subsequent year, capping at a total increase of 20 percentage points above the standard rate. If the Bill is enacted in 2025, this would mean that there would be a 5% uplift in withholding rates in 2026 leading to a 50% withholding rate in 2029.
- **Scope of Application**: The increased tax rates would apply to various forms of US-source income, including interest, dividends, and other fixed or determinable annual or periodical gains, profits, and income (FDAP), as well as effectively connected income and branch profits.

5 Implications for Qualified Intermediaries

Financial institutions outside the US fall into two broad categories for Chapter 3 considerations – qualified intermediaries and non-qualified intermediaries. Qualified intermediaries (QIs) are given rights to withhold taxes on US sourced FDAP income paid to non-residents and to apply treaty rates to such income based on a contractual agreement with the IRS – Revenue Procedure 2022-43[4] – the QI Agreement. Non-qualified intermediaries (NQIs) cannot apply treaty rates to US sourced income directly unless they disclose their clients to a QI or to a US withholding agent. This is described in more detail in my books "Qualified Intermediary"[5] and "US Withholding Tax – Practical Implications of QI and FATCA"[6] both published by Palgrave Macmillan.

These types of financial institutions are usually in a chain of payment from US corporations as Issuers of financial instruments such as equities or bonds from which dividends and interest are received. Should Section 899 come into force and the US determines that a given jurisdiction is unfair to US interests, then for that jurisdiction, the statutory rate of tax for that jurisdiction would rise incrementally each year, starting at 30%

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[4] https://www.irs.gov/pub/irs-drop/rp-22-43.pdf

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

[6] https://link.springer.com/book/10.1007/978-3-030-23085-2

rising in increments of 5% to a maximum of 50%. This can be found in Section 899(a)(4)(A)(i) and (ii). Based on Section 899(a)(3)(A), the same logic would apply to treaty rates of tax. This is permitted because the US reserves the right to apply retaliatory withholding rates even if a tax treaty would normally reduce or eliminate withholding.

The most common tax treaty rate with the US is 15%. So, under Section 899, the treaty rate of tax could also increase by up to 20% in 5% percent increments up to 35%. This would be a best-case scenario. Section 899 (a)(4)(A)(ii) also provides for an additional 5% increase in subsequent years, in addition to the original 5%, capped at an additional 20% in Section 899 (4)(B). In a worst-case scenario, the first-year uplift in the statutory rate would be 5%, in the second year an additional 5%, the third year a 5% increase and in the fourth year a final 5% increase to meet the cap of 20%. This could make the statutory rate in "discriminatory jurisdictions" move from 30% to 35% in year 1 to 40% in year 2, 45% in year 3 and finally 50% in year 4.

In Figure 3, a non-withholding QI operating tax rate pool omnibus accounts can co-mingle US assets of both individuals and entities for both treaty and non-treaty purposes because the two applicable tax rates are generally 15% treaty rate and a 30% statutory rate. Under Section 899, as shown in Figure 4, this may no longer be possible because the treaty and statutory rates would potentially be different from those applying in the prior year (15% and 30%) for some of the beneficial owners in the original pool. The use of omnibus accounts is also typically controlled by the use of withholding statements issued by the downstream financial institution to the upstream payor. In the Figure 4 model, in the first and subsequent years no new accounts would be required only a new withholding statement unless some of the assets are beneficially owned by residents of discriminatory countries. In this case, there would need to be two new rate pools created to pool the assets of beneficial owners resident in deemed discriminatory countries and separate them from the assets of those who are not so affected This will require close coordination with the IRS to make sure that everyone in the payment chain has enough notice to issue new withholding statements and each payor, particularly primary withholding agents, can make arrangements to deduct increased tax from the discriminatory pools and pay the increased amount of tax.

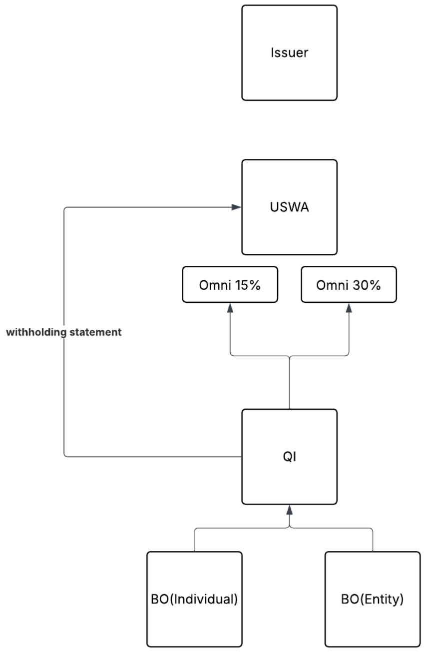

Figure 3. Current tax rate pool model for NWQIs. Source: Author

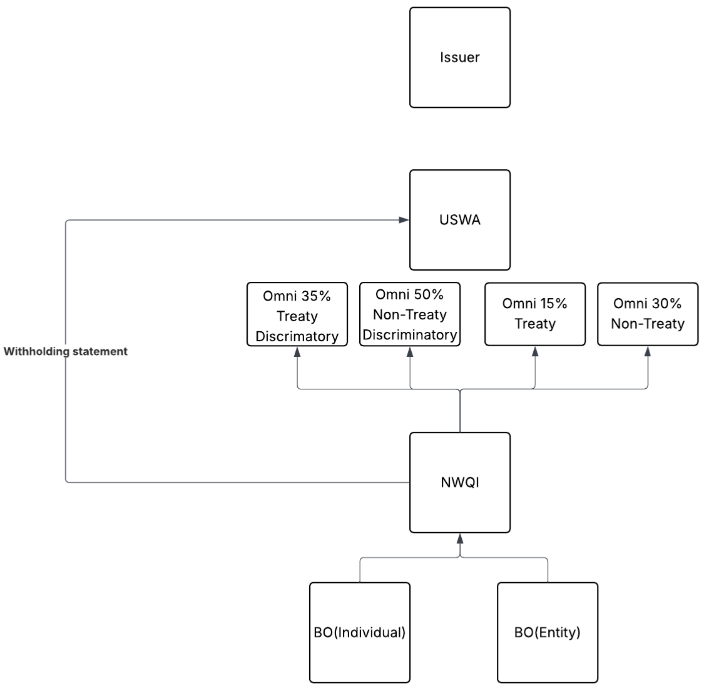

Figure 4. Projected Section 899 tax rate pool model for NWQIs. Source: Author

For QIs that opt to adopt primary withholding obligations in Chapter 3 and 4 (WQIs), there would be minimal operational impact. These types of QIs typically operate a single omnibus account into which all income is paid gross. It is then for the WQI to calculate and withhold the tax as well as paying it off to the US Treasury.

Reporting for both types of QI would be impacted. This is because reporting for QIs is generally pooled, by income type and tax rate. In the present mode, dividends paid to both individuals and entities taxed at the statutory rate would be co-mingled into one information return (1042-S) for a given rate. Under the Section 899 scenario, clients would be subject to a different uplifted rate. Assuming there is no cross-over between tax years i.e., the uplifted rate of tax only applied for a whole US tax year, then 1042-S reporting would only be impacted by the number of forms and the creation of two new 1042-S reporting pools per income type.

Finally, the US reporting work must take account of amended reporting when either errors have occurred or more frequently, the issuer, often a mutual fund or REIT[7], re-classifies income that was originally distributed as a dividend. If the QI has already submitted its 1042-S when the re-classification takes place, then the QI must submit amended 1042-S returns to the IRS. This means that, for every re-classification, the QI must figure out who was holding those instruments on the pay date, to figure out which withholding pools it needs to amend. More pools, more complexity, more opportunity for errors.

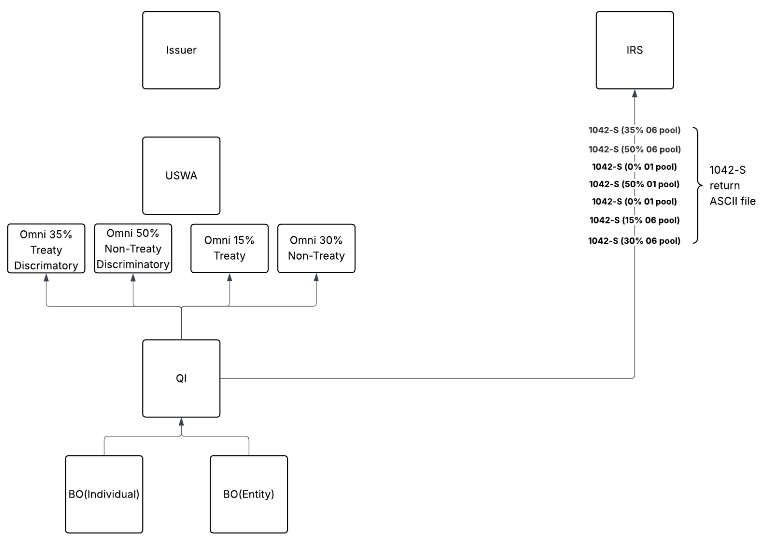

Figure 5. Effect of Section 899 on QI 1042-S reporting

[7] Real Estate Investment Trust

What is less clear is whether these punitive tax rates would affect the withholding rate under Chapter 4. Since Chapter 4 only has one withholding rate (30%), if Section 899 does apply to FATCA, then the penal withholding rate for non-participating FFIs in Chapter 4 could rise to 50%. Now, this might, ironically, encourage more financial institutions, particularly in non-IGFA markets, to engage in the US FFI Agreement[8] to avoid being classified as a non-participating FFI. The problem here is that FATCA withholding is not a tax, it's a penalty imposed by the US on financial firms that do not "step up to its plate" as far as anti-tax evasion is concerned. The problem is that, while it's not a tax per se, the penalty is levied through the tax system. So, here, the jury is out until further clarification in made.

Finally, timing may be an issue. Here we are referencing Section 899(a)(4)(C)(i)-(iii). The applicable date for these issues is recorded as the first day of the first calendar year beginning on or after the latest of (i) 90 days after enactment of Section 899 – which would apply if the "unfair" tax was already being applied by the jurisdiction when the act came into force or (ii) 180 days after the date of enactment of a tax that trigger the jurisdiction to be discriminatory.

Let's suppose the Bill gets passed on July 4th, 2025. In the case of a pre-existing discriminatory jurisdiction i.e., a jurisdiction that the US already deems discriminatory on the day the Bill passed. When the Bill gets passed Section 899 comes into force 90 days later i.e. October 4th, 2025. The first year after that starts is January 1st, 2026. Our interpretation of Section 899 when applied to a jurisdiction that is already deemed unfair, is that the first 5% increased tax rates would apply from January 1st, 2026, and be reported in 2027.

With respect to matters discussed in section 7.1, the FASTER Directive has already been passed but is not due to take effect until January 1st, 2030. Section 899(a)(4)(C)(iii) would apply and the increased tax rates would apply to EU investors from January 1st, 2030, being reported in 2031.

In both these cases, QIs may need to implement new omnibus rate pool accounts and will need withholding statements on December 31st each year with respect to their omnibus accounts, to reflect the changes in rates applicable to each account.

6 Implications for Non-Qualified Intermediaries

Non-qualified intermediaries are most common in jurisdictions that have no IRS-approved KYC rules. There are two types of NQI – disclosing (D-NQI) and non-disclosing (ND-NQI).

A disclosing NQI will be disclosing each recipient of US-sourced FDAP income to a QI or US withholding agent. They can do this either with segregated client accounts (uncommon) or by using omnibus accounts together with a withholding statement. Note that NQIs are permitted to pool for the purpose of withholding but not for the purpose of reporting. The withholding statement will identify each recipient and specify the tax rate to be applied to the specific income payment in the client base together with the applicable punitive tax rates for that year. To this extent, there would be little operational impact on a disclosing NQI although of course the recipient would be impacted financially in increased US taxes. The impact on the financial institution to whom that disclosure was made could be significant, not least because the 1042-Ss (IRS and recipient copies) are tax rate specific. This would not necessarily increase the number of 1042-Ss but it would make the reporting

[8] Revenue Procedure 2017-16

process more complicated and thus disclosing NQIs could face increased fees from their counterparties for the additional reporting work required.

A non-disclosing NQI, on the other hand, will typically have all the US-sourced FDAP income taxed at the statutory 30%. This would need to change under Section 899 only insofar as the withholding statement would need to reflect the increased rates. Again, the investor would be the one most affected. An NQI in a non-discriminatory jurisdiction would have to take account of clients that were resident in discriminatory jurisdictions. So, in principle a non-disclosing NQI might have to establish two omnibus accounts, one taxed at 30% for non-discriminatory client residencies and another whose statutory tax rate would change each year based on the Section 899 uplift. This raises the question of two scenarios (i) a payment being made to a financial institution that is itself resident in a discriminatory country while it has clients that are not and (ii) a payment made to a ND-NQI in a non-discriminatory country that has clients who are in a discriminatory country. Either of these two cases would cause problems for ND-NQIs who traditionally operate one simple omnibus account. The IRS has no control over them since they haven't signed a QI Agreement, so this matter would need to be handled at the regulatory level in Chapter 3.

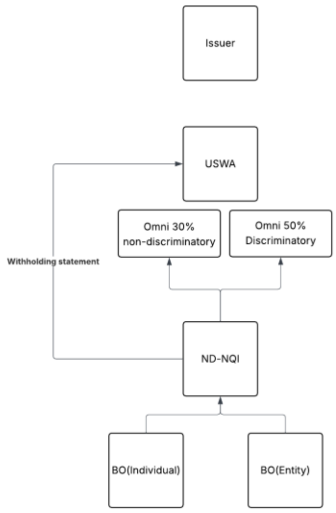

Figure 6. Operating model for a ND-NQI with clients in both types of jurisdiction.

7 Other geopolitical risks

I have written extensively about other risks that result from the unpredictability of the current administration. Some decisions of the US administration can be seen as capricious and related to the opinions and emotions of the individual officeholder rather than the result of well thought-out and structured policy decisions taken by the co-ordinated branches of the US government.

7.1 European Union

I would suggest that the impending FASTER Directive may well be viewed by the US as discriminatory towards American interests and directly trigger a Section 899 response in 2030. This is because of two foundational concepts in FASTER that are incompatible with the US tax framework.

The first foundation of the FASTER Directive is an electronic tax residency certificate (eTRC) issued by a Competent Authority (usually the tax administration). All EU Member States will be obligated from January 1st, 2030, onwards to have an eTRC in place for its residents under Chapter II of the FASTER Directive. This digital document will be the basis (along with a declaration) that an investor is eligible to obtain tax treaty benefits from another EU Member State.

Of course, Americans also invest heavily in EU markets, but they will be unable to obtain an eTRC because they are not a Member State of the EU. In 2024, US investors held approximately $239.3Bn in EU portfolio investments including equity and debt securities. The US does have a similar tax residency certificate, and the FASTER Directive does have a provision for substantial equivalence in Chapter I Article 3(1)(4)(e), but this is determined on a Member State by Member State basis because Chapter III Section I Article 8(1)(b) provides each Member State the authority to not grant CFI status if the financial institution does not have appropriate authority from its domestic competent authority. The equivalent US tax residency certificate is the Form 6166[9]. However, Form 6166 does not currently meet the proposed EU digital standard. This is because the Form 6166 is (i) paper-based, not digital as required by FASTER, (ii) is not guaranteed to be issued within 14 days and (iii) the content may not be to a sufficient standard. Therefore, US investors may lose their ability to get tax relief at source or quick refunds from passive income generated from an EU Member State. This would leave the standard refund process as the only available option of US investors.

The second foundational concept of the FASTER Directive is that of a Certified Financial Intermediary (CFI). CFIs must register with Member States through an EU portal, yet to be built. Chapter III Section 1 Article 8(1)(a) of FASTER does allow for a non-EU financial institution, such as a US financial institution, to register as a CFI in any or all of the 27 Member States, provided it is not itself in an EU non-cooperative jurisdiction. Article 8(3) does permit additional guarantees to be necessary from such non-EU CFIs. This could in essence end up looking very similar to the US QI Agreement in reverse. The larger US financial institutions have subsidiaries or business units in many EU markets so it's likely that, as with Finland's implementation of TRACE, many US firms will be eligible for voluntary CFI status.

[9] https://www.irs.gov/individuals/international-taxpayers/form-6166-certification-of-us-tax-residency

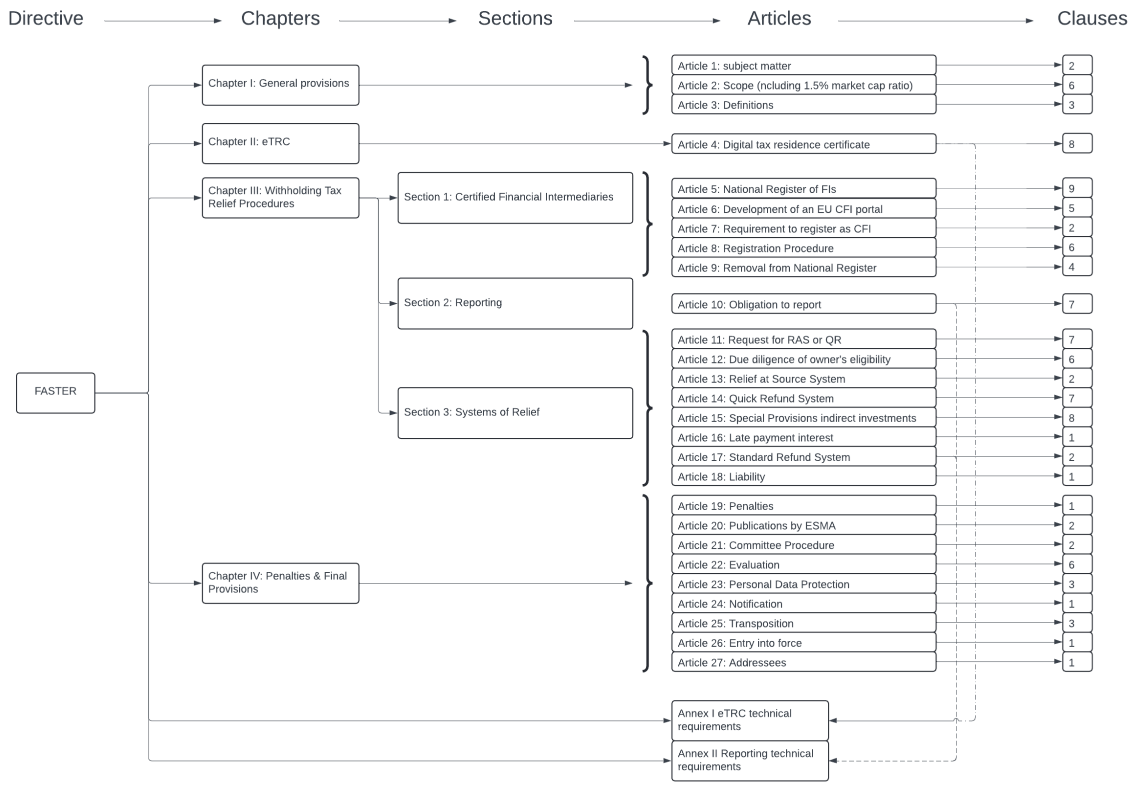

Figure 7. Structure of the FASTER Directive. Source: Author

However, it is not a great leap to presume that the FASTER Directive will be seen as a discriminatory treatment of US investors and thus become subject to Section 899. As discussed earlier, this would be a case where an unfair tax had been enacted (in 2024) but not implemented until 2030. While it has been enacted, it has not yet been transposed into EU Member State domestic legislation, thus Section 899(a)(5)(A)(i)(III) would apply.

7.2 Targeted action to China and Russia

On the geopolitical stage, China and Russia are the two big competitors to the US as the recent tariff war with China and sanctions on Russia demonstrate. China has a double tax treaty with the US and the treaty rate is just 10%. Russia has a double tax treaty with the US although parts of this were suspended in 2024, so the current treaty rate is 30%. However, until 2024, Russian investors also enjoyed a 10% treaty rate with the US.

Section 899 defines an **"unfair foreign tax"** broadly to include:

- Digital services taxes (DSTs)
- Undertaxed profits rules (UTPRs)
- Diverted profits taxes (DPTs)
- Any tax whose design or effect is to disproportionately burden US persons
- Taxes whose stated purpose includes generating revenue from foreign, especially. US businesses

7.2.1 China

China does not impose a formal DST or UTPR in the style of the OECD's Pillar Two model. However, it does maintain strict foreign tax administration policies and technology transfer rules, but those are not clearly categorised as discriminatory taxes under the terms of Section 899. Future tax policy changes, such as targeted taxation on digital platforms, cloud services, or non-resident technology firms, could be evaluated by the US Treasury under this standard and form part of a retaliatory package in addition to tariffs.

7.2.2 Russia

As of now, Russia is not automatically designated as having a "discriminatory tax regime" under Section 899, but it is more likely than China to be a candidate for such designation based on both policy behaviour and geopolitical context.

The suspension of tax treaties with the US and other Western countries increased the effective withholding rates and denies tax credits. This disproportionately affects US persons, which could be evidence of discriminatory tax policy under Section 899.

7.3 Generalised suspension of double tax treaties

One other alternative risk would, by extension, be the wholesale suspension of US double tax treaties rather than a targeted increase in the tax rate for discriminatory jurisdictions proposed in Section 899.

The US currently has sixty-six double tax treaties in effect with the most common treaty rate on dividends being 15% instead of the 30% statutory rate. There is a precedent for this risk. In 2023, Russia suspended portions of the US-Russia double tax treaty as a political retaliatory measure against US sanctions. The US Treasury confirmed the suspension in August 2024. This meant that the 10% rate on US dividends and 0% rate on portfolio interest paid to Russian investors was immediately changed to 30% and will remain so until the suspension is lifted. The Russian suspension was also applied to thirty-eight other jurisdictions because Vladimir Putin deemed those jurisdictions to be "unfriendly" towards Russia. There is a remarkable similarity to the language of H.R.1 with respect to Section 899 and the Russian explanation of the suspension of its US treaty.

8 Economic impacts

In 2021, US withholding agents reported over $945 billion in US-source income payments to foreign recipients on Form 1042-S. Of this amount, approximately 13.7% (about $129.5 billion) was subject to withholding tax, resulting in an average withholding rate of 16.9%[10].

The remaining 86.3% (approximately $815.6 billion) of US-source income paid to foreign persons was either exempt from withholding or subject to reduced withholding rates. These reductions are often due to

[10] These figures are derived from the IRS Statistics of Income (SOI) data for 2021.

provisions in US tax treaties, which can lower the standard 30% withholding rate on certain types of income, such as interest, dividends, and royalties.

If the United States were to suspend **all** its tax treaties, the default 30% withholding rate would apply to all US-source income paid to foreign persons. Assuming the previously exempt or reduced-rate income (approximately $815.6 billion) became fully subject to the 30% rate, this could theoretically generate up to $244.7 billion in additional gross withholding tax revenue annually.

If the US were to implement Section 899 double tax treaty surcharges fully and **only** with the countries already identified as potentially discriminatory (i.e., UK, France, India, Canada, Australia and Brazil), it would result in an estimated $47.5 billion in additional annual U.S. tax revenue in the third year when we include dividends, royalties, and portfolio interest income.

9 Conclusion

Section 899 represents a significant shift in the US response to foreign tax practices deemed unfair or discriminatory. By codifying retaliatory tax measures, it sends a signal that targeted taxes on US companies will be met with what the US deems to be proportional enforcement.

In the current climate, while it's possible to identify likely countries that will be deemed discriminatory, it's not yet possible to accurately predict the scale effect of Section 899. The way in which US tariffs have been handled should give concern to many countries that they may be affected by these provisions.

The definition of applicable persons means that, if your country is determined to be discriminatory to US interests, most of your investment community and investors are going to be impacted by (i) increasing treaty rates of tax on US FDAP income, if such are being received, (ii) increasing statutory rates of tax where there is no treaty rate or the beneficial owner has not claimed a treaty rate.

The application and timing of the increased tax rates means that, if the Bill is signed into force in 2025, if our interpretation is correct, tax rates will likely need to be adjusted from January 1st, 2026, and reported in 2027 for those countries that are announced to be discriminatory. This will mean that financial institutions in those countries will need to obtain new withholding statements from their financial institution clients in the payment chain. For those at or near the top of the payment chain, this will require constant monitoring on a quarterly basis to ensure that the correct tax rates are applied to financial institutions in the relevant countries and not applied elsewhere.

Inclusion of passive income in Section 899 brings the non-US financial community well within scope for retaliatory tax hikes that are, for the most part, unrelated to the causative issue. In short, it seems illogical that a tax on digital services imposed by a jurisdiction, which might impact a US technology firm, should then go on to create a 50% tax on dividends paid to all investors from that jurisdiction.

If H.R.1 Section 899 is enacted and if additional taxes are imposed on income paid to foreign investors from "unfriendly" or "discriminatory" jurisdictions and/or if treaty suspensions were expanded this could lead to significant behavioural responses, including capital flight, additional retaliatory measures and a substantial economic impact. We have already seen a very volatile reaction to tariffs imposed by the US, so it would not be unreasonable to conclude that if Section 899 were imposed along with up to 50% targeted withholding tax rates, this would create a very unstable position for the US and its partners.

The US has, historically been the bulwark of the global economy and thus almost impossible for foreign investors to avoid. This is also one of the reasons that US tax policy has been so extraterritorial in nature with very little successful sustained push-back because no-one could really afford the consequences of being excluded from the US securities markets. That era is quickly coming to an end.

Escalating tensions between the US and particularly the EU will likely see some difficult negotiations ahead as the administration pushes the European Commission to avoid effective discrimination against US investors through the FASTER Directive.

All of the above is moot unless and until H.R.1 is passed by the Senate and signed into law by the President. That said, it is important to consider risks and plan for consequences so that everyone is as prepared as they can be in these difficult times.

For a more detailed analysis or more information and guidance, contact us.