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Tax Group

House Tax Bill Provision Could Substantially Increase Taxes on Non-US Lenders – A Dilemma for Financing Transactions

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The "One Big Beautiful Bill Act" approved by the House of Representatives on May 22, 2025, proposes to add a new Section 899 to the Internal Revenue Code. If enacted in its current form, the provision would significantly increase US taxes, including withholding taxes, on investors and lenders from certain countries viewed as having imposed "discriminatory taxes" aimed at US persons.

Key Points

- **Targeted Countries**: The bill could apply to Canada, France, Germany, Italy, Ireland, Luxembourg, the Netherlands, Spain and the United Kingdom, among others deemed to impose "unfair foreign taxes."
- **Tax Increases**: Affected individuals and entities would see US tax rates rise by 5% annually, up to 20% above the statutory rate.
- **Scope**: The increased tax rates would apply to:
    - US source interest, dividends and portfolio income.
    - Income connected to a US trade or business.
    - Branch profits.
- **Impact on Banks**: Non-US banks in affected countries would face higher withholding rates, potentially reaching 50% over time.
- **Uncertainty**: The final form of the legislation remains unclear, creating challenges for ongoing financing transactions.

Impact

While it is uncertain whether Section 899 will be enacted in its current form and, as currently proposed, certain details are not entirely clear, the proposal raises significant issues for financing transactions that are currently under way.

The proposed regime would apply to "applicable persons," generally tax residents of any "discriminatory foreign country" and entities in other countries owned more than 50% by such persons. A "discriminatory foreign country" is any foreign country that has one or more "unfair foreign taxes." Based on the current definition, countries with taxes that may be covered currently include Canada, France, Germany, Italy, Ireland, Luxembourg, the Netherlands, Spain and the United Kingdom, among others.

Proposed Section 899 would increase otherwise applicable tax rates on "applicable persons," including withholding tax rates, on: 1) US source interest, dividends and other kinds of portfolio income, 2) income that is effectively connected with such person's US trade or business, and 3) branch profits. The tax rates would increase by 5% each year, with a cap of 20% above the statutory rate. Proposed Section 899 would similarly increase tax rates applied in lieu of the statutory rate, for example, reduced rates provided for in a tax treaty. Importantly, it appears proposed Section 899 is not intended to apply to interest that is exempt under the "portfolio interest exemption." However, in other cases, an applicable person otherwise subject to the full statutory withholding rate of 30% over time could see their applicable withholding tax rate rise to 50%.

Because non-US banks generally are not entitled to the “portfolio interest exemption,” banks resident in countries like those above (or other countries designated as having discriminatory taxes in the future), including potentially their branches and affiliates in other countries, would see substantial increases in applicable withholding rates on US income, among other consequences.

Because it is not possible to predict what final legislation adopting this regime will look like, or how targeted countries will react, this proposal poses a dilemma for parties seeking to finalize financing transactions in the interim. There is no evidently “appropriate” allocation of this risk of increased withholding tax, given that neither borrowers nor lenders have any way practically to control whether the increased tax rates would apply.

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