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# Enforcement of Remedies Against Unfair Foreign Taxes

Lawmakers have proposed increasing taxes on income from U.S. sources by nonresident aliens from countries that impose taxes considered to be discriminatory (Section 899 of the Internal Revenue Code). For example, the version of H.R. 1 (also known as the One Big Beautiful Bill Act), passed by the House on May 22, 2025, included such provisions, and the Senate Finance Committee also proposed legislation during the reconciliation process. On June 27, the Treasury Secretary requested that the provision be dropped after an agreement with the G-7 on this issue. The bill as enacted on July 4 (P.L. 119-21) did not include these provisions. On January 5, 2026, Organisation for Economic Co-operation and Development (OECD) announced a side-by-side package that would exempt U.S. multinationals from Pillar 2.

## What Taxes Are Considered Discriminatory?

Two foreign tax provisions that have been labeled by some U.S. policymakers as unfair taxes are the undertaxed profits rule (UTPR), an element of the OECD's Pillar 2 global minimum tax; and digital services taxes (DSTs) imposed by several countries. Diverted profits taxes, currently imposed by the UK and Australia, are also listed as discriminatory.

### Pillar 2 Undertaxed Profits Rule (UTPR)

In response to concerns that multinational corporations shift profits to low-tax countries, the OECD and the G20, through an inclusive framework of 141 countries, developed a proposed global minimum tax (known as Pillar 2) of 15% on financial income after allowing certain deductions. (See CRS Report R47174, *The Pillar 2 Global Minimum Tax: Implications for U.S. Tax Policy*, by Jane G. Gravelle and Mark P. Keightley.) This tax plan has three methods of ensuring a minimum tax: a domestic top-up tax, a top-up tax imposed by the country of the parent of a subsidiary, and a UTPR. If the first two taxes still do not produce an effective 15% rate, countries with other related corporations can impose a tax under the UTPR. The United States has not adopted any element of Pillar 2.

Many countries have adopted the UTPR, including members of the European Union (EU), Australia, South Korea, and the United Kingdom (UK). The Canadian UTPR has been proposed in draft legislation, but not enacted. Japan is scheduled to adopt the UTPR in 2026.

The UTPR allows foreign countries to effectively tax corporations residing in other countries, including U.S. corporations operating in the United States as well as in other countries. This has been seen by some as violating the United States' international sovereignty.

### Digital Services Taxes (DSTs)

The OECD also proposed Pillar 1, which would allocate some taxing rights to countries in which consumers are located rather than based upon the location of a business. During consideration of this issue, many countries enacted digital services taxes, which taxed revenues (not profits). In some cases these taxes were scheduled to be repealed if Pillar 1 were adopted. Countries retaining digital services taxes would not be allowed Pillar 1 taxing rights. (See CRS Report R47988, *The OECD/G20 Pillar 1 and Digital Services Taxes: A Comparison*, by Jane G. Gravelle.) Pillar 1 will not likely take effect without U.S. agreement.

The Office of the United States Trade Representative (USTR) determined that digital services taxes in a number of countries discriminated against U.S. firms. Part of this large share of taxes paid by U.S. firms is due to their domination of the digital services sector, but some practices appear to target U.S. firms, according to the report.

### Proposed Tax Revision

The provision in the House-passed version of H.R. 1 would have imposed an additional tax on foreign individuals and corporations whose governments impose "discriminatory" taxes on U.S. firms. The tax would start at 5% and increase in 5-percentage-point increments per year, up to a maximum of 20% or up to a total of 50%.

Discriminatory taxes would include taxes imposed on U.S. firms under the UTPR, digital services taxes, diverted profits taxes, and certain other foreign taxes deemed discriminatory.

The increased taxes would be imposed on the following categories of income:

- Certain passive income (that which is fixed, determinable, annual, or periodical; or FDAP) such as some interest, dividends, rents, royalties, notational principal contracts, certain personal services, and Social Security and Railroad Retirement benefits. This rate is currently applied at 30% but is frequently reduced by treaties to a lower rate. Payments to foreign governments, currently exempt from the tax, would also be subject to this additional tax. If the rate is reduced by treaty, for example to 15%, the additional tax continues to apply until it is 20 percentage points higher than the nontreaty rate, for a maximum of 50% together. Portfolio interest (such as bank deposits, registered securities) is not subject to current withholding. This exclusion does not apply to interest between related parties including corporations, lending for certain business activities, and interest contingent of profits or

some other performance measure. The tax does not appear to apply to portfolio interest.

- Effectively connected income (ECI) derived from operating a trade or business in the United States. ECI includes gains from the disposition of real property under the Foreign Investors in Real Property Act (FIRPTA). This gain is also included for individuals.
- The withholding tax imposed on branch profits of foreign firms designed to impose an equivalent tax to dividends paid by U.S. subsidiaries of foreign corporations.
- The excise tax imposed on private foundations' investment income.

Additional taxes would also be collected on U.S.-incorporated subsidiaries of foreign parents by expanding the scope of the base erosion and antiabuse tax (BEAT) for these firms, expanding the base, increasing the rate to 12.5%, and disallowing credits. The base erosion tax is an alternative tax which is paid if larger than the regular corporate tax. It has a broader base, as it disallows certain deductions for payments to foreign related parties, and is not eligible for all credits. It is currently allowed at a 10% rate with some credits. The tax rate is scheduled to increase to 12.5% and credits to be eliminated after 2025, but the bill allows the credits and increases the rate slightly, to 10.1%.

### Effects of the Proposed Tax Revision

According to the Joint Committee on Taxation, the provision in the House bill was projected to raise \$116 billion over FY2025 through FY2034.

The tax would apply to countries with the UTPR: thus far, the EU, the UK, Australia, and South Korea. Many of these countries also have DSTs.

The withholding tax on FDAP would not apply to certain income, including portfolio interest and capital gains. Foreign partners of partnerships operating in the United States have effectively connected income subject to the normal U.S. income tax.

Tax rates are often reduced by tax treaties, in some cases to 0% for interest, and typically to 15% for dividends. Based on the most recent data for 2019, dividends accounted for 81% of income subject to withholding taxes, although they accounted for 22% of total passive income. Interest payments account for 51% of U.S.-source passive income, but only 5% of income subject to withholding. This significant reduction reflects both the exemption for portfolio interest and the 0% treaty rates. Rents and royalties account for 5% of income subject to withholding and a similar share of total passive income.

According to IRS data for 2022, the largest share of passive income goes to corporations, about 62%, with interest comprising about half the total of all passive income. Most income (87%) is not subject to withholding because of treaties or the nature of the income. (Interest payments to portfolios and for deposits in banks are exempt from the

withholding tax.) Revenue collections were \$28 billion in 2022, accounting for 18% of taxable passive income and 2% of total passive income. Recipients of larger shares include countries that are major trading partners (such as the UK and Canada) or the locations of subsidiaries of U.S. corporations (such as the Cayman Islands).

Foreign governments in the countries subject to the tax could be affected through their holdings of U.S. equities by targeted countries, although they are small relative to private holdings.

In 2021, IRS data indicate that foreign recipients of partnership income had a withholding tax of \$6 billion, an effective rate of 26%. Sales of real property were subject to a withholding tax of \$3 billion.

The countries with the largest foreign direct investment (that is, investment in a controlling interest, including effectively connected income, branch profits, and U.S. subsidiaries) are Japan, Canada, the UK, and Germany (for 2022). Canada and the UK are also currently the source of most new foreign direct investment. Data from the National Income and Product accounts indicate that about 90% of existing direct investment is from Europe, Canada, Japan, and Australia. These countries, except Canada, have one or more of the targeted taxes.

The JCT revenue estimates showed larger gains in the short run, which decline and become negative toward the end of the budget horizon. Over 85% of the revenue would be collected in the first five years.

Several responses to these additional taxes could be expected that would reduce the revenue yield. Some countries may respond by eliminating the taxes that trigger the increased U.S. tax rates. Investors in countries that are subject to the tax could reduce their investments or not make new ones, causing an outflow of capital and revenue. Finally, foreign investment from nonaffected countries could offset this capital outflow, but would not be subject to the taxes. In addition, asset values could decline, reducing revenues.

The provision could, on net, reduce the capital stock in the economy, which would in turn reduce output, although this effect would be offset to some extent by investments from other countries.

### Senate Finance Committee Proposal

The provisions considered in the Senate would have had a smaller scope and the projected revenue gain was \$52 billion. The withholding tax would not be triggered by the digital services tax so that Canada would not be subject to the withholding taxes absent subsequent legislation, although Canadian subsidiaries would be subject to the enhanced BEAT. The withholding tax would top out at 15% and would be in addition to actual taxes paid and not the nontreaty rate. The BEAT provisions in the House bill would be expanded to cover branch operations.

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