

Tax Legislation Could Significantly Harm Foreign Investors

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Last month, the U.S. House of Representatives passed the so-called “One Big Beautiful Bill Act,” which contains a host of tax and spending provisions supported by President Trump. Among many other potential changes to the tax law, the legislation would add new Section 899 to the Internal Revenue Code, which could drastically affect foreign investment in the U.S., including in the real estate market. The Senate is also considering a bill with a similar provision.

As background, foreign persons are taxed on various types of income in the United States at different tax rates. Under current law, if a foreign person receives U.S. source interest, dividends, or certain other types of passive investment income, that income is usually taxed in the U.S. at a 30% rate, which tax must be withheld by the payor. In addition, if a foreign person receives income that is effectively connected with the conduct of a trade or business in the United States (“ECI”), such income is generally taxed at the same rates that would be applicable to U.S. persons (generally, a top 37% ordinary income rate and 20% capital gain rate for individuals and a 21% rate for corporations). Foreign persons are taxed on gain from the sale of U.S. real property interests (so-called “FIRPTA” gain) as if such gain were ECI. Foreign corporations are also generally subject to a 30% branch profits tax on dividend equivalent amounts attributable to ECI, which is designed to place a foreign corporation in the same position as if it had owned a U.S. business through a domestic corporation. The United States has income tax treaties with many countries that may reduce or eliminate some of these taxes.

Under current law, foreign governments are largely exempt from U.S. tax, except with respect to income they derive from commercial activity in the U.S. or that relates to certain controlled entities that conduct commercial activity. As a result, foreign governments usually pay little to no U.S. tax on their U.S. investments.

Section 899 appears designed to punish “discriminatory” foreign countries, which are defined in the legislation to include countries that have enacted an undertaxed profits rule, such as the global corporate minimum tax negotiated by OECD countries. Many developed countries have enacted this tax, and therefore would be considered discriminatory foreign countries under this rule, including most European countries. Countries with a digital services tax or certain other taxes borne disproportionately by U.S. persons are also affected by Section 899, although the details differ between the House and Senate bills.

For individuals or corporations that are residents of a discriminatory foreign country, Section 899 would increase certain tax rates by 5 percentage points for each tax year in which the law is applicable to that country, up to a maximum of 20 percentage points in the House bill, or up to a maximum of 15 percentage points in the Senate bill. The increase would apply to the 30% tax on passive investment income, the branch profits tax, FIRPTA gain, and, for corporations, other types of ECI. However, some exceptions to these taxes, such as the exception for “portfolio interest,” would remain applicable, although the details vary between the two bills.

As a result, for residents of discriminatory foreign countries, the withholding tax on certain interest and dividends could rise to up to 50% under the House bill, and the FIRPTA tax rate for capital gain recognized by individuals

could rise to up to 40%. For foreign corporations, the combined effect of the increased tax on ECI and the increased branch profits tax could cause ECI to be taxed at an effective rate of over 70% under the House bill, not taking into account any state or local taxes.

The increase in tax also applies notwithstanding any income tax treaty the United States has with an affected country. For example, if a particular treaty normally would eliminate the 30% tax on interest received by a resident of the treaty country, Section 899 would increase the rate to up to 20% under the House bill (or 15% under the Senate bill).

Section 899 would also eliminate the U.S. tax exemption for governments of affected countries. When combined with the rate increase under Section 899, this could radically change the tax consequences of the U.S. investments of affected governments.

Given the drastic changes that Section 899 would make to the U.S. income tax treatment of a large number of foreign investors, its enactment could significantly disrupt markets. Foreign investors could seek to rapidly dispose of U.S. real estate before the higher tax rates take effect, causing property values to fall, and may be less likely to make investments in the U.S. going forward. This appears to be contrary to the Trump administration's goal of encouraging investment in the U.S.

Section 899 could also affect U.S. persons who have borrowed from foreign banks in affected countries. For example, many commercial real estate loan documents provide that the lender generally bears the burden of any withholding tax on interest income. However, if such withholding is due to a change in law after the loan was made, the borrower is typically responsible for the additional withholding. Thus, the legislation could increase the effective interest rates on many commercial real estate loans owed to foreign lenders.

The purpose of Section 899 seems to be to cause foreign countries to repeal taxes that discriminate against U.S. persons. Therefore, it is surprising that under the House bill, Section 899 would largely take effect at the beginning of 2026, giving countries little time to change their laws even if they had a desire to do so (the Senate version would be delayed until 2027). Regardless, the large number of countries involved means it is likely that Section 899 would have a significant effect on foreign investment in the U.S. for the foreseeable future.

It remains to be seen whether one of the two proposed versions of Section 899 is included in any final bill that passes Congress, or whether it gets eliminated or pared down. In any event, the potential consequences of Section 899 are so large that any foreign persons with investments in the U.S. and their U.S. counterparties should begin to consider its effects.

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