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# The Knight Watch

## A Look at President Trump's America First Trade Policy Executive Order and International Tax; Proposals of Retaliatory Taxes to Counter "Discriminatory" Tax Practices

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"Two types of people laugh at the law: those that break it and those that make it."

***— Terry Pratchett, Night Watch***

To state the obvious, the Trump Administration plans to take the country in a new direction as it relates to international trade. Even before recent news on tariffs, the new direction of the Trump Administration was evident on day one, and the use of tax policy was identified as a favored mechanism.

On January 20, 2025, President Donald Trump announced his America First Trade Policy in an Executive Memorandum (EM)[1] aimed at prioritizing American interests in international trade. The new policy also addresses tax policy matters and the concern that certain global tax policies have placed American companies at a disadvantage. In the America First Trade Policy, the President directed the U.S. Department of the Treasury Secretary, in consultation with the U.S. Commerce Department Secretary and U.S. Trade Representative (USTR), to investigate whether any foreign country subjected U.S. citizens or foreign corporations to discriminatory or extraterritorial taxes pursuant to Code Sec. 891,[2] discussed below, and deliver to the President the results of that investigation in a report by April 1, 2025.[3]

Also on Jan. 20, 2025, President Trump announced in yet another EM[4] that the Organization for Economic Co-operation and Development (OECD) Global Tax Deal (*i.e.*, Pillar 1 and Pillar 2), which had been supported by the prior administration and the first Trump Administration, "has no force or effect in the U.S." The President directed the Treasury Secretary and permanent representative of the United States to the OECD to "notify the OECD that any commitments made by the prior administration on behalf of the U.S. with respect to the Global

Tax Deal have no force or effect within the U.S. absent an act by the Congress adopting the relevant provisions of the Global Tax Deal." The President also directed the Treasury Secretary, in consultation with the USTR, to investigate "whether any foreign countries are not in compliance with any tax treaty with the U.S. or have any tax rules in place, or are likely to put tax rules in place, that are extraterritorial or disproportionately affect American companies" and develop and present a list of options to the President through the Assistant to the President for Economic Policy for protective measures or other actions that the United States should adopt or take within 60 days (March 21, 2025).[5]

Days after these actions, President Trump, in addressing the Davos World Economic Forum by video, detailed other components of his America First Trade Policy to incentivize activity in the United States, with the goal of boosting domestic manufacturing and protecting American jobs—*e.g.*, through (1) lowering the corporate tax rate (currently at 21 percent) to 15 percent for corporations that make products in the United States and (2) the imposition of disincentives (through tariffs) for those that choose not to do so. In that regard, President Trump said:

> *"If you don't make your product in America, which is your prerogative, then very simply you will have to pay a tariff—differing amounts but a tariff—which will direct hundreds of billions of dollars and even trillion of dollars into our Treasury to strengthen our economy and pay down our debt."*[6]

## Tax Discrimination Against U.S. Taxpayers

The American First Trade Policy and the actions identified above is driven by the perception that foreign countries are enacting tax legislation that is extraterritorial and discriminates against U.S. businesses.

Examples of such discriminatory and extraterritorial taxes include:

- **Digital Services Taxes (DSTs).** DSTs are taxes on gross revenues derived from a variety of digital services—*e.g.*, the sale of advertising space, provision of digital intermediary services (such as the operation of online marketplaces), and sale of data collected from users. These taxes disregard where a company is headquartered or operates physically, focusing instead on where the users of its digital services are located – effectively singling out the dominant players in the global digital economy, most of which are based in the United States. For this reason, DSTs are perceived as unfairly targeting U.S. tech giants.
- **Global Minimum Corporate Tax, also referred to as Pillar Two.** Pillar Two seeks to reduce profit shifting to low-tax jurisdictions and provide a more coordinated approach to ensure that large multinational enterprises (MNEs) pay a 15-percent minimum tax irrespective of where headquartered or the jurisdictions in which they operate. Specifically, U.S. policymakers raised concerns regarding the undertaxed profits rule (UTPR), which allows other jurisdictions to tax the parent jurisdiction if that jurisdiction is below the 15-percent rate (often referred to as a "top-up" tax).
- Section 49 of the German tax code, which imposes a withholding tax on royalty payments for patents and trademarks registered in Germany.
- The United Kingdom's Diverted Profits Tax, which is designed to counteract contrived arrangements used by MNEs that result in the erosion of the U.K. tax base by (1) counteracting arrangements by which foreign companies exploit the permanent establishment rules and (2) to prevent companies from creating tax advantages by using transactions that result in the erosion of the U.K. tax base.
- The Australian Multinational Anti-Avoidance Law, which is designed to prevent the diversion of profits offshore through contrived arrangements, and the change to withholding taxes on royalties paid to a foreign resident.

## Potential U.S. Responses to Tax Discrimination

In response to perceived tax discrimination, and in addition to the tariffs, the Trump Administration and congressional Republicans are considering various retaliatory measures.

- **Triggering Existing Code Sec. 891**.[7] Code Sec. 891 generally doubles the rates of tax on citizens and corporations of certain foreign countries (subject to certain limitations)[8] whenever the President finds that, under the laws of a foreign country, citizens or corporations of the United States are subjected to discriminatory or extraterritorial taxes. If triggered, Code Sec. 891(1) doubles the tax rate on income effectively connected with a U.S. trade or business of individuals, corporations, insurance companies, and regulated investment companies, and (2) imposes a 30-percent rate of tax on foreign individuals and

foreign corporations for income not effectively connected with a U.S. trade or business. Historically, Code Sec. 891 has been viewed principally as a negotiating tool,[9] the aim of which is to pressure foreign countries to reconsider their tax policies or face economic consequences. Although enacted in 1934, it has never been triggered. An interesting aspect of the potential application of Code Sec. 891 is its interaction with bilateral income tax treaties, particularly in certain instances (such as with respect to dividends, interest, or royalties) where the treaty reduces the rate of the U.S. withholding tax to a rate less than 30 percent or, in certain cases, zero.

- **Defending American Jobs and Investment Act.** Introduced by Chairman Smith and co-sponsored by all Republicans on the House Ways and Means Committee, this bill was introduced days after the President's EMs. The bill (H.R. 591) would create a new section of the Code (Section 899) that penalizes certain taxpayers for the conduct of foreign countries. The contours of the bill are discussed in greater detail below.
- **Unfair Tax Prevention Act.** Introduced more recently by House Representative Ron Estes (R-KS), the Unfair Tax Prevention Act (H.R. 2423) takes a different approach than Defending American Jobs and Investment Act but, like that bill, has support from all Republicans on the House Ways and Means Committee. In summary, the bill would (1) expand the currently existing Base Erosion and Anti-Abuse Tax (BEAT) under Code Sec. 59A such that it would treat "foreign-owned extraterritorial tax regime entities" as "applicable taxpayers" under BEAT, regardless of their size, and (2) modify how such taxpayers determine their base erosion minimum tax amounts. The contours of the bill are discussed in greater detail below.

## Defending American Jobs and Investment Act

Specifically, under the Defending American Jobs and Investment Act:

- The Treasury Department would be required to deliver a report every 180 days to Congress identifying extraterritorial taxes and discriminatory taxes enacted by foreign countries against U.S. businesses.[10]
- After the identification of discriminatory or extraterritorial taxes, U.S. income of investors and corporations in those foreign countries (defined as an "Applicable Person") would be subject to (1) full statutory tax rates and (2) an increase by five percentage points each year for four years, after which the full statutory tax rates would remain elevated by 20 percentage points while the unfair taxes are in effect.
- The mechanism for increasing tax rates described above would cease to apply after a foreign country repeals its extraterritorial and discriminatory taxes (or the application of such taxes to U.S. businesses otherwise terminates).
- This mechanism for increasing tax rates is a tool of the U.S. government that would remain dormant as long as foreign countries avoid any unfair taxes on U.S. businesses and workers.

## Key Aspects of the Defending American Jobs and Investment Act

The bill uses the following definitions.

**An "Applicable Person" is:**

- any individual (other than a citizen or resident of the United States) who is a citizen of a foreign country listed in a report, any foreign corporation (other than a foreign corporation with respect to which any domestic corporation is a U.S. 10 percent or more shareholder), any foreign partnership, except to the extent provided by the Treasury Secretary and taking into account if the foreign partnership is engaged in a U.S. trade or business.

**An "extraterritorial tax" means:**

- Any tax imposed by a foreign country on a corporation, determined by reference to any income or profits received by any person by reason of such person being connected to such corporation through any chain of ownership and other than by reason of such corporation having a direct or indirect ownership interest in such person.
- The term "tax" includes any increase in tax whether effectuated by an increase in the rate or base of a tax by a denial of deductions or credits or otherwise.

**A "discriminatory tax" is defined as meeting one of the following four definitions:**

- The tax applies to items of income that would not be considered to be from sources within the foreign country under U.S. income tax rules if the sourcing rule were applied by treating the foreign country as though it was the United States.
  - — *E.g.*, the Australian royalty resourcing rule (deeming intellectual property (IP) arising in Australia from licensing U.S. IP) would be discriminatory under this definition.

- The tax is imposed on a base other than net income and does not permit a recovery of costs and expenses.
  - A DST could meet this definition.
- The tax is exclusively or predominantly applicable in practice or by its terms to nonresident individuals or foreign corporations or partnerships by treating the foreign country as though it were the United States due to specified factors or restrictions, and similarly situated foreign corporations and partnerships that supply comparable goods are services excluded from the tax.
  - A DST could meet this definition, as could Pillar 1 Amount A.
- The tax is not treated as an income tax under the laws of the foreign country or is viewed as outside the scope of a double tax treaty.
  - *E.g.*, the U.K. diverted profits tax or the German Section 49 tax on IP could meet this definition.

**Under the bill, the following taxes are not extraterritorial or discriminatory:**

- withholding taxes;
- value-added tax (VAT), goods and services tax, sales tax, or similar tax on consumption;
- a tax imposed on a per-unit or per-transaction basis rather than on an *ad valorem* basis;
- a tax on real or personal property; or
- any other similar tax identified by the Treasury Secretary.

**Once identified as discriminatory or extraterritorial, the bill triggers the following response actions to such taxes:**

For non-Foreign Investment in Real Property Tax Act (FIRPTA) withholding taxes: First, reduced treaty-based withholding tax rates would be eliminated, so the starting point would be the 30-percent rate. Second, the 30-percent statutory withholding tax rate would increase by five percentage points per year up to 20 percent during the period the offending tax is in place for a maximum withholding rate of 50 percent. The increased withholding tax rate would not apply to cross-border payments to a foreign corporation where a U.S. corporation owns 10 percent or more of such foreign corporation (*i.e.*, an exception to an Applicable Person).

The rate of FIRPTA withholding tax, currently 15 percent, would increase five percentage points per year up to 20 percent during the period the offending tax is in place. The rates of tax described in Code Sec. 1445(e) relating to dispositions or distributions described in Code Sec. 1445(e) would increase five percentage points per year up to an additional 20 percent during the period the offending tax is in place. For purposes of Code Sec. 1445, treaty-based withholding rates would be eliminated.

Tax on income of a foreign corporation effectively connected with a U.S. trade or business, currently imposed at the statutory rate of 21 percent, would increase five percentage points per year up to an additional 20 percent during the period the offending tax is in place.

Tax on income of a foreign corporation from U.S. sources not connected with a U.S. trade or business, currently taxable at a 30-percent rate, would increase five percentage points per year up to an additional 20 percent during the period the offending tax is in place.

*The America First Trade Policy and the issue of tax discrimination against the United States highlight the complexities and challenges of navigating international trade and tax in a globalized economy.*



The 30-percent branch profits tax would increase five percentage points per year up to an additional 20 percent during the period the offending tax is in place.

The tax on nonresident aliens,[11] both for income not connected with a U.S. trade or business (currently imposed at a 30 percent rate) and for income effectively connected with a U.S. trade or business, would increase five percentage points per year up to an additional 20 percent during the period the offending tax is in place.[12] The proposed bill would also require the Treasury Secretary to take any extraterritorial or discriminatory taxes into account when assessing whether to enter into or update a bilateral tax treaty with any country that has adopted such taxes.

**The bill would not increase the tax for:**

- a U.S. corporation owned by a foreign-parented group (since such person is not an Applicable Person);
- an individual who is a resident alien for U.S. income tax purposes (since such person is not an Applicable Person);
- various types of income that currently are not subject to U.S. federal income taxation under the Code seemingly would not be impacted under the bill, to include (1) capital or other gain arising from

non-effectively connected, non-real estate related transactions derived by a foreign corporation or a nonresident individual (who is not physically present in the United States for 183 days or more in the taxable year), (2) various types of non-effectively connected interest and original issue discount,[13] (3) international transportation income exempt from taxation under Code Sec. 883, and (4) income described in Code Secs. 892 and 893.

### Illustrative Example of the Defending American Jobs and Investment Act

Assume the United States has a bilateral income tax treaty with Country X (a foreign country) that *inter alia* eliminates the income tax on interest payments made from the United States to Country X down to zero percent. Further, assume Congress passes the Defending American Jobs and Investment Act, and President Trump signs H.R. 591 into law on Jan. 31, 2025. Prior to the three-month deadline under H.R. 591, the Treasury Secretary submits a report to Congress on Feb. 15, 2025 that identifies certain discriminatory tax laws in Country X.

*The U.S. international tax system will be significantly different if the President uses his authority to implement Code Sec. 891 or Congress passes H.R. 591, H.R. 2423, or another similar provision as part of the extension of the Tax Cuts and Jobs Act.*

Parent Corp. is a Country X corporation that has a U.S. subsidiary (U.S. Sub). U.S. Sub enters into a cross-border intercompany loan facility with Parent Corp. and borrows capital needed to fund its operations. Pursuant to the loan facility, U.S. Sub is required to make periodic payments of principal and interest to Parent Corp. The first interest payment is made by U.S. Sub on Aug. 31, 2025 (*i.e.*, more than 180 days from the time the Treasury Secretary submitted its report to Congress identifying Country X as having discriminatory taxes). As of Aug. 31, 2025, Country X has neither repealed its discriminatory taxes nor terminated its application to U.S. companies or U.S. individuals.

Assume that under the U.S. tax treaty with Country X such interest payments made by U.S. Sub to Parent Corp. would be reduced from the U.S. statutory 30-percent withholding tax rate down to zero percent. Here, because Country X has been identified as a country that has discriminatory taxes, the subject tax treaty would be inapplicable, and the interest payments (as described) in the first year would be subject to:

- a 30-percent tax rate (under Code Sec. 881) plus
- the applicable number of percentage points—*e.g.*, five percent (under Sections 899(c)(1)(A)(i) and (c)(1)(A)(ii)(II)).

In other words, the U.S. withholding tax rate on the subject interest payment would go from zero percent to 35 percent.[14]

## Unfair Tax Prevention Act

Under current law, an applicable taxpayer under the BEAT is a U.S. corporation with $500 million or more in annual gross revenue (measured over three years) and a base erosion percentage of at least three percent. The base erosion percentage is a ratio of base eroding tax benefits (*e.g.*, payments made to a foreign-related party that give rise to a deduction in the United States) over total allowable deductions (with certain exclusions). Under U.S. tax principles, the cost of goods sold is not a deduction and therefore is not a base eroding payment. Further, the payment for certain routine services that are not marked up (services cost method) is not a base eroding payment. The BEAT operates as an alternative minimum tax with a tax rate of 10 percent on modified taxable income. The tax rate is scheduled to increase to 12.5 percent after December 31, 2025.

The changes to the BEAT under H.R. 2423 would be significant.

- For in-scope U.S. corporations, the bill would remove the $500 million test and the base erosion percentage. Thus, a U.S. corporation owned by a foreign corporation headquartered in a jurisdiction that applies the UTPR on U.S. entities would be in scope of the BEAT regardless of the amount of revenue or base erosion percentage.
- The BEAT rate would increase to 12.5 percent upon enactment.
- Payments currently excluded under the services cost method exception would be treated as base eroding payments.
- Finally, 50 percent of the cost of goods sold purchased by a U.S. corporation from a foreign affiliate would be treated as a base eroding payment subject to the BEAT.

The bill would apply to a U.S. corporation controlled by a foreign corporation if any of the following entities are subject to an extraterritorial tax: (1) any foreign entity that

controls the U.S. corporation; (2) any foreign entity that is controlled by the U.S. corporation or the foreign entity that controls the U.S. corporation; or (3) any trade or business (branch) of any foreign entity described in (1) or (2).

For these purposes, an "extraterritorial tax" effectively refers to the UTPR or any tax that is determined by reference to any income or profits received by any person by reason of such person being connected to such corporation through any chain ownership. A "tax" includes increases in taxes due to higher rates or denied deductions, credits, or otherwise.

## Conclusion

The America First Trade Policy and the issue of tax discrimination against the United States highlight the complexities and challenges of navigating international trade and tax in a globalized economy.

The U.S. international tax system will be significantly different if Code Sec. 891 is enacted, or Congress passes H.R. 591, H.R. 2423, or another similar provision to advance this current Administration's international trade policies.

## Second Conclusion

Since we prepared this column, Ways and Means released its modified mark of the One Big, Beautiful Bill (OBBB), held a hearing on the bill, and voted it out of committee. The OBBB includes proposed section 899, which is an amalgamation of the H.R. 591 and H.R. 2423. The following is a summary of the major changes.

First, a discriminatory or extraterritorial tax includes by statute a UTPR, a DST, and a diverted profits tax. Proposed section 899 does not require the Secretary to prepare and submit a report to committees.

The treaty override is no longer explicit. In the case of withholding taxes, additional taxes apply in addition to the rate specified in Code Secs. 1441 and 1442 or otherwise in a treaty. For example, if a treaty has a withholding rate of five percent on dividends, then the rate would increase by five percentage points to 10 percent.

The changes to the BEAT are painful. While the payment for the purchase price of depreciable or amortizable is treated as COGS and not subject to the BEAT, an expense capitalized into COGS is treated as a base eroding payment. Also, any cross-border payments subject to withholding taxes are treated in full as base eroding payments, creating double taxation.

The definition of applicable taxpayer is broader and applies to any foreign corporation that is resident in a discriminatory foreign country, other than a foreign corporation owned by greater than 50 percent U.S. persons as defined under Code Sec. 904(h)(6). Also, any foreign corporation owned by more than 50 percent by a foreign corporation that is tax resident in a discriminatory foreign country is treated as an applicable person. For example, Corporation X is tax resident in a country that applies the UTPR on U.S. corporations. Corporation X owns 100 percent of Corporation Y, which is tax resident in a country that does not have a discriminatory or extraterritorial tax. Because Corporation Y is owned by greater than 50 percent of a foreign corporation tax resident in a discriminatory foreign country, Corporation Y is also treated as discriminatory foreign corporation.[15]

It is unclear whether the Senate will adopt proposed Section 899.



### ENDNOTES

1 The White House: America First Trade Policy.

2 If the President finds that discriminatory taxation exits, Code Sec. 891 permits the President to double certain U.S. tax rates by citizens and corporations of such foreign countries, subject to certain limitations.

3 As of the date of this column, the report has not been made public.

4 The White House: The Organization for Economic Cooperation and Development (OECD) Global Tax Deal (Global Tax Deal).

5 As of the date of this column, the report has not been made public.

6 Remarks by President Trump at the World Economic Forum (Jan. 23, 2025).

7 Code Sec. 891 applies both to extraterritorial taxes and discriminatory taxes, can be initiated solely by the President (without the need for congressional approval), and has never been invoked. *See* Joseph J. Thorndike, *Tax History: Threats, Leverage, and the early Success of Reprisal Taxes*, Tax Notes, March 21, 2016. Code Sec. 891 has not been subject to extensive regulatory consideration except for a regulation issued in 1962 that merely restates the statute. *See* T.D. 6610, 27 FR 8723 (Aug. 31, 1962).

8 Taxes imposed under the doubled rate are not permitted to exceed 80 percent of the taxable income of the taxpayer, determined without regard to certain deductions.

9 *Id.*

10 The first report would be due three months after the date of enactment.

11 An individual is a nonresident alien is he or she is not (1) a lawful permanent resident—a "green card holder" or (2) has not satisfied or come within the "substantial presence test."

12 The same increases would also apply to withholding tax rates on nonresident aliens who realize income from the disposition of U.S. real property interest (as defined in Code Sec. 897(c)).

13 To include bank deposit interest, portfolio interest, original issue discount on certain short-term obligations, amounts paid as part of the purchase price of an obligation sold between interest payment dates, original issue discount paid on the sale of an obligation other than a redemption.

14 And to the extent Country X were not to repeal or terminate the application of the discriminatory taxes to U.S. companies and/or individuals, the withholding tax rate would increase by five percentage points per year until it reaches 20 percent, for a total withholding rate of 50 percent (*i.e.*, 30-percent statutory rate plus 20-percent rate increase under H.R. 591).

15 Proposed sections 899(b)(1)(C) and (E).

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