Briefing

International review for May

Speed read

Uncertainty is a recurring theme in this month's international tax update. The US House of Representatives has passed its budget reconciliation Bill; however, it is unclear whether its tax provisions will survive Senate scrutiny. The recent German and Canadian federal elections have delivered new heads of government, but it is less clear whether these new leaders will be able to progress their tax policy agendas in the absence of majority rule. There is some welcome clarity this month with a CJEU case providing useful guidance on when tax exemptions are not to be considered as State Aid.

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US budget reconciliation: the One Big Beautiful Bill Act

On 22 May 2025 the House of Representatives passed its budget reconciliation Bill (the 'One Big Beautiful Bill Act') that would generally make permanent the expiring provision of the 2017 Tax Cuts and Jobs Act (TCJA). Notable, although not exhaustive, observations on the international tax provisions of the Bill include:

Extensions of current law

The legislation sets permanent rates for the Global Intangible Low-Taxed Income 'GILTI' of 10.668% (currently 10.5%), Foreign-Derived Intangible Income 'FDII' of 13.335% (currently 13.125%), and Base Erosion and Anti-abuse Tax 'BEAT' of 10.1% (currently 10%).

Notably, the legislation does not extend the Controlled Foreign Company (CFC) look-through rule of IRC s 954(c)(6). This section was first enacted as a temporary provision in 2005 and has been extended several times since, but is scheduled to expire for tax years of foreign corporations beginning on or after 1 January 2026. If the provision expires, taxpayers will have to consider various technical positions, for example the application of IRC s 245A to CFC to CFC dividends and the same country exceptions.

Restoring expired items

The legislation would also restore several expired business tax benefits from the TCJA, including restoring the deductibility of US research and experimental expenditure under IRC s 174 from 2025 through to 2029. This could impact some BEAT calculations. Foreign research would notably remain subject to the 15 year amortisation schedule under s 174. However, changes mean the deduction for foreign research under s 174 (a) would be ineligible for a s 59(e) election; only domestic research subject to s 174A would be eligible for the 'optional 10-year write-off' election under s 59(e).

The tax title also proposes to compute adjusted taxable income for purposes of the IRC s 163(j) business interest expense limitation without regard to any deduction allowable for depreciation, amortisation, or depletion for tax years beginning after 31 December 2024, and before 1 January 2030. This change would reinstate the prior law effective for tax years beginning before 1 January 2022, and generally have the effect of increasing the allowable interest expense deduction.

Revenue raising provisions: IRC s 899

The revenue cost of the taxpayer-favourable provisions of the Bill would be partially offset by a new s 899 'Enforcement of Remedies Against Unfair Taxes', which combines portions of the 'Defending American Jobs and Investment Act' (the 'Smith Bill') and the 'Unfair Tax Prevention Act' (the 'Estes Bill'). It is estimated this provision will raise approximately $116bn over the ten-year budget window.

Section 899 firstly increases the rates of tax imposed on non-US individuals, corporations, governments and private organisations with sufficient nexus to 'a discriminatory foreign country', and secondly modifies the application of the BEAT to corporations that are owned, directly, or indirectly by such persons.

The undertaxed profits rule (UTPR) of Pillar Two, digital services taxes (DSTs) and diverted profits taxes (DPTs) are *per se* 'unfair foreign taxes' under the Bill, but only if they apply to US persons or their CFCs. However, the proposals would also provide the US Treasury Secretary ('Secretary') with discretion to identify other taxes that are extraterritorial or discriminatory based on definitions included in the provision. It is unclear at this stage what other tax measures may be identified as 'unfair foreign taxes' by the Secretary.

At the time of writing, 30 countries have implemented the UTPR. Of those countries, seven (Austria, Canada, France, Italy, Spain, Turkey and the UK) were identified in a February 2025 Executive Order as having DSTs and two (Australia and the UK) also have DPTs. The proposed section 899 would be expected to treat each of these countries as having 'unfair foreign taxes'. Whilst the UK's DST survived recent UK-US trade negotiations, the looming spectre of s 899 may mean it is not so lucky in the upcoming UK-US negotiations on a digital businesses agreement.

The starting rate from which the tax rate would increase (i.e. 'the specified rate of tax') is, in the case of income subject to a tax treaty, the applicable treaty rate. This is generally increased by five percentage points for each year the unfair taxes are imposed. The total percentage point increase would be capped at 20 percentage points above the statutory rate, meaning that for the withholding and branch profits tax, the cap would be 50% and the tax rate for effectively connected income (ECI) would be capped at 41% for corporations and 57% for individuals.

Section 899(a)(2) would modify the application of the BEAT to US corporations that are more than 50% owned by foreign corporations resident in a discriminatory foreign country. The proposed provisions would significantly expand the number of taxpayers subject to the BEAT, including not only large multinational corporations but also many small multinational groups that have not been previously subject to the BEAT.

The Bill would also modify the calculation of the BEAT liability for those in scope, including by (amongst other things) increasing the BEAT rate from 10% to 12.5% and removing the services cost method exception, a provision that would fall heavily on foreign groups that depend on a global network for their performance of US customer contracts.

Revenue raisers not included

A number of revenue-raising proposals that were previously mooted are not included in the legislation. These excluded provisions include increasing the stock buyback excise tax rate; a new higher tax rate for wealthy individuals and limitation of capital gains treatment for carried interest.

What next?

The Bill will be transmitted to the Senate for consideration to begin in early June after the Congressional Memorial Day recess. The Senate is expected to make changes to the House-approved Bill, including the tax title, so it remains to be seen if the provisions above will survive intact.

German coalition government tax proposals

On 6 May 2025 Conservative leader Friedrich Mertz won a parliamentary vote to become Germany's next chancellor, governing in coalition with the Social Democrats. The coalition agreement, published on 9 April 2025 outlined several key tax and financial policies aimed at enhancing economic growth, competitiveness and social security. The proposals include, amongst other things:

- Investment incentives: The coalition intends to introduce reducing balance tax depreciation for expenditure on equipment. Businesses will benefit from a 30 percent depreciation rate for financial years 2025, 2026 and 2027.
- Reduction of corporate income tax rate: Starting on 1 January 2028, the corporate tax rate of 15 percent will be reduced incrementally by one percentage point annually over five years.
- Solidarity surcharge: The solidarity surcharge (an additional tax levied on individual and corporate tax liabilities, originally intended to finance the cost of German reunification) will remain unchanged at 5.5%.
- Pillar Two: The coalition has reaffirmed its commitment to the global minimum tax and will support international efforts to permanently simplify the minimum tax framework, whilst monitoring global developments to prevent competitive disadvantages for German companies.
- Financial transaction tax: The government backs the implementation of a financial transaction tax at EU level.

Although these proposals illustrate Chancellor Mertz's tax policy priorities, it remains to be seen if these can be translated into legislation in a coalition framework.

Tax policy and the Canadian election

Across the Atlantic, following the results of the federal election on 28 April 2025, Mark Carney's Liberal Party won enough seats in the House of Commons to form a government.

Some of the key business tax promises the Liberal Party made during the election campaign were to:

- conduct a review of the corporate tax system;
- cancel the proposed increase in the capital gains inclusion rate, keeping it at [1/2];
- implement a Canada Patent Box to bring intellectual property back to Canada: the party said this would reduce the corporate income tax rate by half for both large corporations and small businesses;
- extend immediate expensing for manufacturing and processing machinery and other clean energy equipment and vehicles, as well as the Accelerated Investment Incentive; and
- lead international efforts to develop international tax rules proposed by the OECD.

However, the Liberals are two seats short of the 172 needed to form a majority, meaning that once again an uncertain political landscape makes it difficult to predict whether or not Carney can successfully strike deals in Parliament to implement his tax policy priorities.

CJEU rules on tax exemptions permissible under EU law

On 29 April 2025, the CJEU rendered its decision in Case C453/23 (a Polish State Aid case), addressing the conditions under which tax exemptions may be considered permissible under EU State Aid rules.

The plaintiff was a Polish company that owned land on which a railway siding infrastructure was located. In 2021, the company indicated its intention to make this siding available to a rail carrier to carry out transport operations on its behalf. Under Polish tax rules, a property tax exemption is available for land, buildings, and structures forming part of railway infrastructure when made available to rail carriers. The purpose of this exemption is to promote rail transport, which is generally considered as more environmentally friendly and safer than road transport.

Although the company met all the conditions set out under national law, the exemption was denied on the grounds that, under EU law, it would constitute unlawful State Aid. The plaintiff challenged the refusal in the national courts and the matter was referred to the CJEU for a preliminary ruling.

The CJEU recalled its settled case law under which a measure can be classified as State aid only if all of the following four conditions are met:

- there must be an intervention by the State or through State resources;
- the intervention must be liable to affect trade;
- the intervention must confer a selective advantage on the beneficiary; and
- it must distort or threaten to distort competition.

The CJEU noted that it is for the referring court to determine whether the exemption distorted or threatened to distort competition. The CJEU emphasised that, in principle, the act of releasing an undertaking from the costs which it would normally have had to pay distorts competition.

The CJEU stated that when considering whether a selective advantage has been granted, the EC is tasked with (a) identifying the reference system and (b) demonstrating that the disputed tax measure is a derogation from that 'normal' system, and therefore represents a form of discrimination.

Quoting its settled case law, the CJEU noted that the determination of the reference system must follow from an objective examination of the content, the structure and the specific effects of the applicable rules under national law. In this case, the Court identified the Polish property tax regime, including the exemption, as the normal tax framework.

The CJEU ruled a general and neutral exemption (as was the case here) would not constitute State Aid as long as (i) the reference system itself was not manifestly discriminatory and (ii) provided the exemption is not subject to a condition linked to the nature of the beneficiaries or the nature of their activities, which would enable all of those beneficiaries to be grouped together within a single consistent category. The CJEU also gave several examples of tax measures that would not be classified as State Aid, as long as the criteria above are met; for example, a tax exemption that is dependent on the undertakings' results, or tax exemptions the application of which are subject to a certain recruitment policy or certain environmental measures. ■

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