United States – President Open to Doubling Tax Rates on Citizens, Corporations of Certain Foreign Countries

The January 20, 2025 executive memorandum on President Trump's America First Trade Policy directs the U.S. Treasury Secretary, in consultation with the Secretary of Commerce and the United States Trade Representative, to investigate whether any foreign country imposes discriminatory or extraterritorial taxes on U.S. citizens or corporations. If such practices are found, the president can invoke Internal Revenue Code (I.R.C.) section 891 to double the tax rates on citizens and corporations of those foreign countries.[1]

WHY THIS MATTERS

If I.R.C. section 891 were invoked and applied, the increased tax rates would potentially apply to compensation from services provided by globally mobile employees in the United States, for example, services provided by a U.S.-nonresident employee sent to the United States on business travel, or trailing compensation related to a previous period working in the United States such as U.S.-source retirement distributions or an employee stock plan (if not otherwise exempt). Increased withholding tax rates on investment income of those foreign individuals could also result in increased tax-equalization cost to the employer.

I.R.C. Section 891

In accordance with the executive memorandum, if the Treasury Secretary's investigation determines that a foreign country is imposing discriminatory or extraterritorial taxes on U.S. citizens or corporations, section 891 provides for the president to double the tax rates on certain U.S.-source income received by that country's citizens and corporations. The increased tax rate applies to income effectively connected with a U.S. trade or business of such individuals (including compensation from personal services performed in the United States), and income from sources within the United States not effectively connected with a U.S. trade or business (such as dividends, interest, rents, royalties, and certain capital gains). The increased tax cannot exceed 80 percent of the taxpayer's income. If the foreign country removes the unfair taxes, the president can revoke the doubled tax rates.

I.R.C. section 891 was enacted in 1934 is to serve as a deterrent against foreign tax practices that unfairly target U.S. businesses and individuals. The statute does not define what constitutes an “extraterritorial” or “discriminatory” tax, does not address interaction with U.S. tax treaties, and is limited in scope as doubling the tax rates on foreign citizens and foreign corporations is the only remedy provided for. In addition, it lacks any provisions for diplomatic engagement with a country that has been identified as imposing an unfair tax.

KPMG INSIGHTS

Since section 891 has never been invoked, there is no established process or guidance for its application, resulting in uncertainty regarding how this section would be implemented. It is not clear how section 891 would interact with existing U.S. income tax treaties, and there are questions as to whether section 891 would affect dual citizens (U.S. citizens who are also citizens of another country).

Defending American Jobs and Investment Act

On January 22, 2025, the House of Representatives’ Ways and Means Committee Chairman Jason Smith (R-MO) introduced H.R. 591, the *Defending American Jobs and Investment Act*[2] which would enact additional measures to counter discriminatory or extraterritorial taxes. The bill would impose a 5-percent addition to the U.S. tax rate each year for four years on income taxable under U.S. law of individuals and entities located in a foreign jurisdiction that have been identified by the Treasury Department to impose a discriminatory or extraterritorial tax. After four years, the cumulative 20-percent additional tax would be imposed each year that the targeted tax remains in effect. The additional tax rate would apply to any individual (other than a citizen or resident of the United States) who is a citizen of such foreign jurisdiction and any corporation which is created or organized in such foreign jurisdiction. Those individuals and entities would also be denied the benefit of reduced withholding taxes under any treaty obligation of the United States. The additional tax rate would cease to apply after a foreign country repeals its extraterritorial and discriminatory taxes.

Chairman Smith issued a statement upon introduction of the bill, indicating that it aims to reinforce President Trump's executive order rejecting the OECD “Global Tax Deal.”[3] In December 2021, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS), which includes over 140 countries, released model rules for implementing a Pillar Two global minimum tax of 15 percent for multinational enterprises (MNEs) with annual revenue of at least €750 million. Adoption of these new rules follows a "common approach," meaning jurisdictions are not required to adopt the rules, but if they choose to do so, they must implement them consistently with the model. The rules encompass an income inclusion rule (IIR) and an under-taxed payment rule (UTPR), serving as a back-stop to the IIR. The UTPR, which could allow foreign jurisdictions to impose additional tax on U.S. multinationals with an effective rate below 15 percent, has been an area of concern previously cited by Chairman Smith and Senate Finance Committee Chairman Mike Crapo (R-ID).

In December 2022, the European Union approved a directive requiring EU member states to implement and apply the UTPR starting from 2025. Similarly, Australia, New Zealand, South Korea, and Thailand have adopted the UTPR from 2025, while Indonesia will do so from 2026. Several other major economies, including Canada, Mexico, and Japan, have also announced plans to implement the UTPR.

KPMG INSIGHTS

References to retaliatory measures may be designed principally to serve as a negotiation tool by the new administration. The threat of invoking section 891 (or section 899 if it were to become law) could be used by the U.S. government to pressure foreign countries to remove what the U.S. government deems are unfair tax practices without actually implementing the doubled tax rates.

FOOTNOTES:

1 America First Trade Policy, 90 Fed. Reg. 8471 (Jan. 30, 2025).

2 H.R. 591, 118th Cong. (2025).

3 See "Ways and Means Republicans Introduce Legislation to Reinforce Trump Administration's Rejection of Biden Global Tax Surrender – Ways and Means" (January 22, 2025) on the www.waysandmeans.house.gov website at: https://waysandmeans.house.gov/2025/01/22/ways-and-means-republicans-introduce-legislation-to-reinforce-trump-administrations-rejection-of-biden-global-tax-surrender/ .

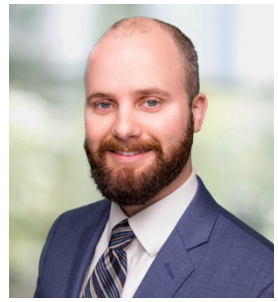
* * * *

Contact us

For additional information or assistance, please contact your local GMS or People Services professional or one of the following professionals with the KPMG International member firm in the United States:

Martha Klasing
Partner
Washington National Tax – Global Mobility Services
Tel. +1 202-533-4206
mklasing@kpmg.com

Christine Deveny
Director
Washington National Tax – Global Mobility Services
Tel. +1 407-563-2259
cdeveney@kpmg.com



John Seery
Managing Director
Washington National Tax – Global Mobility Services
Tel. +1 202-533-3313
jseery@kpmg.com

The above information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 as the content of this document is issued for general informational purposes only.

The information contained in this newsletter was submitted by the KPMG International member firm in the United States.

www.kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

Learn about us: **kpmg.com**