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The Big Beautiful Bill and the Effects on Bank Lending Into the US

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Every year, foreign lenders make thousands of loans to U.S. entities. The U.S. withholding tax on the related interest payments has been generally stable since 1984. The general rule is that interest paid under these loans from a U.S. borrower to a foreign lender is subject to a 30% U.S. withholding tax. However, for most of these loans, interest paid to the foreign lenders is not subject to U.S. withholding tax due to (1) the portfolio interest exemption,[1] (2) the application of an income tax treaty, or (3) the foreign lender being engaged in the business of lending in the U.S.[2] That stability may well be upended by "The One, Big, Beautiful Bill," with proposed Code Section 899.

Section 899, if enacted as proposed, can significantly impact not only new credit facilities, but existing ones. As described below, Section 899 can impose a withholding tax of 5-20% on the interest earned by a foreign bank even if a tax treaty would otherwise apply a zero rate of withholding. The main focus of this alert is to discuss the possible impact on loans by non-U.S. banks to U.S. borrowers and to suggest some proactive planning that the borrowers may want to consider now to ameliorate the possibility for a significant increase in the amounts payable under the loan.

Proposed Section 899 would impose a retaliatory withholding tax of 5% (that can grow to 20%) on interest paid to a foreign bank if the foreign bank is resident in a discriminatory foreign country. A country is a discriminatory foreign country if it imposes unfair taxes. Unfair taxes include digital services taxes (DST), diverted profits taxes (DPT), taxes that may be imposed under the undertaxed profits rules (UTPRs) of Pillar Two, or other identified taxes that have a disproportionately negative impact on U.S. taxpayers.[3]

The view of Congress is that the retaliatory withholding tax is to be imposed even if an applicable treaty provides that the interest is to be subject to a U.S. withholding tax at a zero rate.[4]

Assume that a foreign bank has lent money to a U.S. borrower, and it was expected that the interest would not be subject to a U.S. withholding tax under the terms of an applicable tax treaty. A standard LSTA-style loan agreement entered into prior to Section 899's enactment would provide that the borrower would be obligated to not only pay the withholding tax, but pay additional amounts so that the lender receives the same amount of cash it would have received if there was no withholding.[5]

Effective Date

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If the bill is enacted by September 30, 2025, the increase in the withholding tax would be applicable for payments made after January 1, 2026, for calendar year taxpayers.[6] There is, however, a possible stay. The goal of the stay provision is to get non-U.S. countries to drop the “unfair taxes.” To enable the negotiations for that, the bill provides that no withholding is to start until Treasury releases a list of countries that are discriminatory foreign countries. At the same time, the revenue estimates for the bill assume that the Section 899 withholding is effective from the date of enactment, so it may be that Treasury expects to release the list soon after enactment.

Impact on Existing Loans

As noted above, if Section 899 is enacted, the change in law could have a meaningful effect on loan agreements entered into prior to Section 899’s enactment, if the borrower is required to “gross up” the lender for taxes imposed on the lender, other than certain “excluded taxes.” The new Section 899 tax would not be expected to be one of the standard excluded taxes in the case of a pre-existing loan agreement. The borrower generally bears the risk that after a lender becomes party to the loan, withholding rules will change and subject interest payments made under the loan to withholding taxes. So, if withholding rules change after the lender becomes a party to a loan, the borrower is generally required to pay additional amounts to make the lender whole with respect to that withholding tax because those “new” withholding taxes are not excluded taxes.

Considerations for Existing Loans

If Section 899 is enacted, borrowers under pre-existing agreements that are typical LSTA-style loan agreements would have two options to mitigate the impact of Section 899. First, the borrower may request that the lender designate a different lending office if changing the lending office would reduce or eliminate the Section 899 withholding, not subject the lender to any unreimbursed (by the borrower) costs, and is not otherwise disadvantageous to the lender.[7] Second, if changing lending offices doesn’t fully eliminate the need for a borrower gross-up, the borrower generally can require the lender to assign its interest in the loan to a lender that will be able to receive payments not subject to withholding. The borrower must pay the costs associated with the assignment. Whether the borrower would have the right to prepay the loan would be a dependent on the terms of the loan.

Moving Forward

The bill is now being considered in the Senate, and we will be following any revisions. There are also a number of sub-sections of proposed Section 899 that will require interpretation. This alert is meant to prompt U.S. borrowers to assess their possible exposure and consider pro-active measures that may be needed to be implemented this fall.

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[1] A foreign bank that is earning interest from a U.S. borrower on a loan made in the ordinary course of business cannot earn portfolio interest.

[2] A foreign lender engaged in a U.S. trade or business either directly or through a disregarded subsidiary would not be subject to U.S. withholding tax by supplying an IRS Form W-8ECI. If the lender is a U.S. subsidiary of the foreign bank there is no withholding due, and proposed section 899 would not apply to impose one.

[3] All of the countries in EU have adopted UTPR, as have most of our significant trading partners, including Canada and the U.K. Thus, they would be discriminatory foreign countries.

[4] See, H.R. 119-106, Book 2 of 2, pg 1762 at n. 1533 (2025). Note that the same footnote advises that portfolio interest is not subject to Section 899.

[5] Query then if this retaliatory tax is really effective to penalize foreign lenders.

[6] If the bill is enacted after September 30, 2025, the section would first be effective on January 1, 2027. Rules for non-calendar-year taxpayers are beyond the scope of this alert.

[7] This may not be an easy task. If the foreign bank is headquartered in a discriminatory foreign country, moving the loan to a lending office in another jurisdiction is not expected to cleanse the Section 899 taint. Changing the lending office to a U.S. subsidiary office may be disadvantageous to the lender.

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