GUEST EDITORIAL

Retaliatory Taxation: What Should the EU Do?

On 20 January 2025, his first day in office, President Trump signed two executive orders related to international taxation. The first was directed at the OECD/Inclusive Forum GLoBE project, and announced that the US will not cooperate with it. The order stated that:

> The OECD Global Tax Deal supported under the prior administration not only allows extraterritorial jurisdiction over American income but also limits our Nation's ability to enact tax policies that serve the interests of American businesses and workers. Because of the Global Tax Deal and other discriminatory foreign tax practices, American companies may face retaliatory international tax regimes if the United States does not comply with foreign tax policy objectives. This memorandum recaptures our Nation's sovereignty and economic competitiveness by clarifying that the Global Tax Deal has no force or effect in the United States.[1]

The order also announced countermeasures, stating that:

> The Secretary of the Treasury in consultation with the United States Trade Representative shall investigate whether any foreign countries are not in compliance with any tax treaty with the United States 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 to the President, through the Assistant to the President for Economic Policy, a list of options for protective measures or other actions that the United States should adopt or take in response to such non-compliance or tax rules. The Secretary of the Treasury shall deliver findings and recommendations to the President, through the Assistant to the President for Economic Policy, within 60 days.[2] [Emphasis added.]

The second order was more specific in threatening to invoke existing legal authority to address 'discriminatory or extraterritorial' foreign taxes, stating that:

> The Secretary of the Treasury, in consultation with the Secretary of Commerce and the United States Trade Representative, shall investigate whether any foreign country subjects United States citizens or corporations to *discriminatory or extraterritorial* taxes pursuant to section 891 of title 26, United States Code.[3] [Emphasis added.]

What taxes are the target of these threats?

The reference to 'extraterritorial' taxes is primarily to the Undertaxed Profits Rule (UTPR) of GLoBE, while the reference to 'discriminatory' taxes is primarily to digital services taxes (DSTs). This can be seen from legislation introduced two days later by Rep. Jason Smith, the Republican chair of the House Ways and Means Committee. The rationale behind the 'Defending American Jobs and Investment Act' (DAJI) is described by Rep. Smith as follows:

> Congressional Republicans made it clear as soon as the Biden Administration initiated its negotiations with the OECD that the United States would never be party to a global tax surrender. Now with President Trump in the White House, we finally have a leader who will defend American workers and businesses against economic attacks by other nations. One of the Trump Administration's first actions was to reject the OECD framework that would have destroyed U.S. jobs, forfeited an estimated $120 billion in tax revenues, and enhanced China's competitive advantage. The *Defending American Jobs and Investment Act* will ensure that President Trump has every tool at his disposal to pushback against any foreign country that seeks to

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[1] The White House, *The Organization for Economic Cooperation and Development (OECD) Global Tax Deal (Global Tax Deal)* (20 Jan. 2025), https://www.whitehouse.gov/presidential-actions/2025/01/the-organization-for-economic-co-operation-and-development-oecd-global-tax-deal-global-tax-deal/. (accessed on 17 Apr. 2025)

[2] *Ibid.*

[3] The White House, *America First Trade Policy* (20 Jan. 2025), https://www.whitehouse.gov/presidential-actions/2025/01/america-first-trade-policy/.

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undermine America's economic vitality or unfairly target our workers and businesses.[4]

Rep. Smith explains that DAJI:

- Requires the Treasury Department to identify *extraterritorial taxes and discriminatory taxes* enacted by foreign countries that attack US businesses, such as the UTPR surtax.
- After the unfair foreign taxes have been identified, the tax rates on US income of wealthy investors and corporations in those foreign countries will increase by five percentage points each year for four years, after which the tax rates remain elevated by twenty percentage points while the unfair taxes are in effect.
- The reciprocal tax ceases to apply after a foreign country repeals its *extraterritorial and discriminatory taxes.*
- The reciprocal tax will remain dormant as long as countries avoid any unfair taxes on US businesses and workers. Several countries have already made the wise decision to exclude the UTPR surtax from their implementation of the OECD global minimum tax.[5] [Emphasis added.]

DAJI defines extraterritorial taxes as:

> any tax imposed by a foreign country on a corporation (including any trade or business of such corporation) which is determined by reference to any income or profits received by any person (including any trade or business of any person) by reason of such person being connected to such corporation through any chain of ownership, determined without regard to the ownership interests of any individual, and other than by reason of such corporation having a direct or indirect ownership interest in such person.[6]

This is clearly describing the UTPR, which applies a top up tax to a subsidiary or Permanent Establishment (PE) in a taxing jurisdiction based on the effective tax rate on the income of another part of the same multinational in another jurisdiction. The UTPR is distinguished from the Income Inclusion Rule (IIR), which like Controlled Foreign Corporation (CFC) rules only applies to subsidiaries and is therefore excluded by 'other than by reason of such corporation having a direct or indirect ownership interest in such person'.

DAJI defines discriminatory taxes as –

any tax imposed by a foreign country if:

(1) such tax applies to items of income that would not be considered to be from sources within the foreign country under the rules of part I of this subchapter if such part were applied by treating such foreign country as though it were the United States,
(2) such tax is imposed on a base other than net income and is not computed by permitting recovery of costs and expenses,
(3) such tax is exclusively or predominantly applicable, in practice or by its terms, to nonresident individuals and foreign corporations or partnerships (as determined under rules similar to paragraphs (4) and (5) of section 7701(a) by treating the foreign country as though it were the United States) because of the application of revenue thresholds, exemptions or exclusions for taxpayers subject to such foreign country's corporate income tax, or restrictions of scope that ensure that substantially all residents (other than foreign corporations and partnerships (as so determined)) supplying comparable goods or services are excluded from the application of such tax, **or**
(4) such tax is not treated as an income tax under the laws of such foreign country or is otherwise treated by such foreign country as outside the scope of any agreements that are in force between such foreign country and one or more other jurisdictions for the avoidance of double taxation with respect to taxes on income.[7]

This definition is clearly designed to capture DSTs and similar taxes which (1) apply to what the US considers foreign source income, (2) are gross-based, (3) frequently exclude domestic corporations because of revenue thresholds, and (4) are not covered by tax treaties. But because the definition is in the disjunctive ('or'), it can also capture other taxes, such as the UTPR, which is arguably covered by the first clause because it also applies to foreign source income. The definition does list several exceptions for withholding taxes, consumption taxes, excise taxes, property taxes, and 'any other similar tax identified by the Secretary for purposes of this subparagraph'. But that still leaves a lot of foreign taxes potentially covered. For example, a payroll tax would not be covered by any of the exceptions and would therefore be a 'discriminatory tax' because it is 'imposed on a base other than net income and is not computed by permitting recovery of costs and expenses'.

Before discussing DAJI, it is worth considering section 891, which is currently in the Internal Revenue Code and states that:

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4 US House Committee on Ways and Means, *Ways and Means Republicans Introduce Legislation to Reinforce Trump Administration's Rejection of Biden Global Tax Surrender* (22 Jan. 2025), https://waysandmeans.house.gov/2025/01/22/ways-and-means-republicans-introduce-legislation-to-reinforce-trump-administrations-rejection-of-biden-global-tax-surrender/.

5 *Ibid.*

6 House Bill: H.R. 591, 119th CONGRESS, §899(d)(1) (2025).

7 *Ibid.*, s. 899(d)(2) (emphasis added).

> Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to **discriminatory or extraterritorial taxes**, the President shall so proclaim and the rates of tax imposed by sections 1, 3, 11, 801, 831, 852, 871, and 881 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country; but the tax at such doubled rate shall be considered as imposed by such sections as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 percent of the taxable income of the taxpayer (computed without regard to the deductions allowable under section 151 and under part VIII of subchapter B). Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under the preceding provisions of this section have been modified so that discriminatory and extraterritorial taxes applicable to citizens and corporations of the United States have been removed, he shall so proclaim, and the provisions of this section providing for doubled rates of tax shall not apply to any citizen or corporation of such foreign country with respect to any taxable year beginning after such proclamation is made.[8]

It is useful to know a bit about the background for this section. In a previous *Intertax* article, I explained the origins of the first US tax treaty with France, which was ratified by the US in 1932 and by France in 1935.[9] Mitchell Carroll, who was the US negotiator, explained the origins of the treaty as follows—:

> A foreign corporation with a branch in France had been subjected to the tax that was withheld from dividends paid by French companies, but on the same proportion of dividends distributed at its head office abroad as its assets in France bore to total assets. In the 1920's the Boston Blacking Company of Massachusetts, in order to obviate the accounting adjustments necessitated by devaluations of the franc, had exchanged the assets of its branch in Paris for registered shares in a newly formed French company. This tax was presumably no longer due except when the French company distributed dividends. Nevertheless, the Bureau de l'Enregistrement, which administered the levy, served a 'summation' on the American corporation to pay the tax. The company contested the assessment but the fisc was upheld by the Tribunal de la Seine.
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> The United States company appealed to the Court of Cassation. Encouraged by the decision of the lower Court, the Bureau enquired into the relations between various French companies and their respective foreign parent corporations, which were for the most part in the United Kingdom, the Netherlands, Belgium, Germany, Switzerland or in the United States. Claims were made against a number of our largest corporations. The assessment against one of them was based on the assertion that the French subsidiary was 'its emanation pure and simple'. Another company objected strenuously, and in order to establish a basis for bargaining, the fisc obtained from Moody's the figures of its distributions over the previous 30 years and computed thereon the tax and penalties. The total of the claims was enormous. The American Embassy in Paris forwarded protests to the Department of State in Washington.
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> At initial conferences in the Palais du Louvre, in May 1930, the Minister of the Budget, Mr Germain Martin and French officials refused to settle the matter unilaterally. They insisted on negotiating a bilateral treaty with reciprocal concessions, which would set a precedent to invoke vis a vis other interested governments.
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> Negotiations were suspended in September 1930, because of the French request for a reduction of our custom duties on wines. After a change in the French Cabinet, the Treaty was signed on April 27, 1932. The United States Senate gave its advice and consent and the President promptly ratified on July 25, 1932; but France delayed, only ratifying the treaty in 1935.[10]

What Carroll omits from the last sentence was that section 891 was added to the Code in 1934 to pressure France to ratify the treaty. Clearly, using taxation to coerce other countries is not a new US tactic.

As is clear from the above, the French tax that was targeted by section 891 was neither extraterritorial nor discriminatory. It was not extraterritorial because it imposed tax on a French subsidiary or PE based on a comparison of the assets in France to total assets, which was a perfectly legitimate method of formulary apportionment, similar to what US states were doing at the same time. In fact, France was at the time a purely territorial

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8 26 USC, s. 891 (2024) (emphasis added).

9 Reuven S. Avi-Yonah, *The First US Tax Treaty and Its Influence*, 52(1) Intertax 5–7 (2024), doi: 10.54648/TAXI2024001.

10 Mitchell B. Carroll, *Evolution of U.S. Treaties to Avoid Double Taxation of Income – Part II*, 3 Int'l Law. 12 (1969). On Carroll's role *see* Matthieu Leimgruber, *Tax Lawyers of the World, Unite! Mitchell B. Carroll* (1898–1987)*, Transnational Tax Networks and International Capital* (unpublished manuscript on file with author (abbreviations expanded)) (2024) ('Carroll would rise to prominence by systematically defending corporate interests in multilateral arenas and by shaping the non-governmental expert networks that closely monitored multilateral tax diplomacy. By contributing to cooling down the potential political salience of multilateral debates on capital flight and tax evasion, corporate henchmen like Carroll facilitated the interwar emergence of a business-friendly structuring of the field of international tax law at the inter-governmental level'.).

jurisdiction and unlike the US did not tax foreign source income of its own residents. And the French tax was not discriminatory because it applied to subsidiaries or PEs of all foreign corporations, not just US ones.

What Carroll objected to was that France treated subsidiaries as equivalent to PEs, which is why the treaty introduced the arm`s length standard (ALS), which appears in this treaty for the first time.[11] From there it was introduced by Carroll into his study of attribution of income and into the League of Nations model, and thence to every contemporary tax treaty and most countries' tax legislation.[12]

Section 891 was never applied, in part because it preceded every US tax treaty and was therefore overridden by the non-discrimination article in all of them. However, Itai Grinberg, who later was the main US negotiator for Base Erosion and Profit Shifting (BEPS), suggested in 2016 that it should be applied to EU corporations as retaliation for the state aid cases.[13] Grinberg argued that this violation of the treaties is justified in response to potentially discriminatory actions by the treaty partner, but it is unclear whether a court would accept that argument, which is presumably why DAJI was considered necessary because it contains an explicit treaty override. DAJI is also broader than section 891, which does not define 'extraterritorial or discriminatory'.

DAJI has three interesting features.

First, it applies to countries that have 'extraterritorial or discriminatory' taxes regardless of whether they apply them to US multinationals. The legislation applies to any foreign country that **has** (as of the date the report is submitted) at least one extraterritorial tax or discriminatory tax, whether or not it is applied in practice.[14] It states that:

> a foreign country shall be treated as having an extraterritorial tax or discriminatory tax during the period –
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> (A) beginning on the earlier of the date on which such tax is enacted or takes effect, and
> (B) ending on the later of the date on which the permanent repeal or termination of such tax is enacted or takes effect.[15]

This provision means that DAJI acts as a 'police person to the world': It would apply to an EU Member State that has a UTPR or DST even if it never applies it to any US multinational. Thus, extending the current UTPR safe harbor (which excludes the US from the UTPR) to the end of the Trump administration in 2029 would not prevent the DAJI retaliatory taxes from applying to that Member State.

Second, like section 891, DAJI only applies to foreign corporations and citizens of the offending country. That means that a foreign multinational with a PE in the US can avoid DAJI by incorporating the PE as a US subsidiary, which is usually feasible, and then avoid making distributions (dividends, interest or royalties) to its foreign parent while DAJI is in effect because they would be subject to retaliatory taxes imposed on the parent regardless of any tax treaty. Selling the subsidiary, however, would not be subject to tax because any gain is not US source income. As for foreign citizens, they can avoid DAJI by earning interest income from the US (since that is not subject to any withholding taxes under the portfolio interest exemption) and by structuring any distribution as a redemption rather than a dividend (because capital gains of foreigners are exempt), which is easy to do.[16] Because of these features of DAJI and section 891, they are unlikely to raise a lot of revenue if implemented, and are also not a particularly effective deterrent.[17]

Third, unlike section 891, DAJI contains an explicit treaty override. It states that the increased withholding taxes it imposes will apply 'notwithstanding sections 894 and 7852(d), determined without regard to any treaty obligation of the United States'.[18]

This language raises an interesting issue. In recent years, US tax legislation has been enacted on a purely partisan basis. No Democrats voted for the Tax Cuts and Jobs Act in 2017, and no Republicans voted for the Inflation Reduction Act in 2022. Under US Senate rules, legislation can only be passed with a sixty-vote majority (which neither party is likely to have) unless it qualifies as 'budget reconciliation', which applied to both the TCJA and the IRA. But under Senate rules, every provision of a bill passed by reconciliation must relate to the budget, which is why the provision naming the law 'TCJA' was removed from the TCJA.

The problem is that it is likely that an explicit treaty override like the one contained in DAJI will not be

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11 *See* Avi-Yonah, *supra* n. 9.

12 On the history of the ALS, *see* Reuven S. Avi-Yonah, *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation*, 15 Va. Tax Rev. 89 (1995).

13 *See* Itai Grinberg, *A Constructive U.S. Counter to EU State Aid Cases*, Tax Notes Int'l 167 (11 Jan. 2016).

14 House Bill: H.R. 591, 119th CONGRESS, §899(a)(3) (2025).

15 *Ibid.*

16 *See* Reuven S. Avi-Yonah, *Does the US Have to Be a Tax Haven?*, Tax Notes Int`l 1009 (2024), doi: 10.2139/ssrn.5048106.

17 Note, however, that section 891 also applies to citizens of the offending country (including dual citizens of the offending countries and the US) that live and work in the US, as well as to branches of banks of the offending countries that cannot be incorporated for regulatory reasons. In these two cases section 891 imposes a real cost if it is not overridden by a tax treaty

18 House Bill: H.R. 591, 119th CONGRESS (2025). Strangely, the treaty override language in the bill only talks about the withholding provisions (ss 1441 and 1442) while the operative rate-increasing provision talks about the taxing provisions (ss 871, 881, etc.). This could mean that there is an override only if there is withholding but not for effectively connected income taxation even though this increased taxation of PEs violates the non-discrimination article of the treaties.

considered by the Senate parliamentarian as sufficiently related to the budget.[19] That is why the Base Erosion Anti-Abuse Tax (BEAT), which violates the non-discrimination provision of every US tax treaty, did not include an explicit override when it was enacted as part of the TCJA. But this opens the BEAT to a challenge if it is applied in a treaty context because there is Supreme Court authority that treaty overrides must be explicit to be effective.[20]

Thus, if DAJI is included in the tax legislation expected this year to extend the TCJA, then either it will not contain the treaty override language, in which case it can be challenged under the treaties, or the Republicans will have to overrule the parliamentarian, which rarely happens.

What should the EU and other countries do if President Trump threatens them with retaliatory taxes under section 891 or under DAJI if it is enacted?

In my opinion, nothing. Section 891 can be challenged in court because it is overridden by the tax treaties. DAJI may or may not be enacted as an explicit treaty override, but even if it is, as a practical matter it is easily avoided in most cases.

I have argued elsewhere that neither the DSTs nor the UTPR are extraterritorial or discriminatory, nor do they violate the tax treaties or customary international law.[21] Applying retaliatory taxes to them is therefore unjustified, and the EU should not abandon them because of such threats.[22] But it should also avoid counterretaliation, because that would just lead to another trade war, and the world has plenty of those already.

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19 *See* Adam Girts, *Yossarian's Treaty: A Proposal to Solve the Treaty Override v. Byrd Rule Catch-22 When Implementing Multilateral Treaties* (21 May 2022), available at SSRN https://ssrn.com/abstract=4203605 or, http://dx.doi.org/10.2139/ssrn.4203605.

20 Whether an explicit statement is required for a treaty override has been widely debated. *See* H. David Rosenbloom & Fadi Shaheen, *Treaty Override: The False Conflict Between Whitney and Cook*, 24(2) Fla. Tax Rev. 375 (2021), doi: 10.5744/ftr.2021.2001; H. David Rosenbloom & Fadi Shaheen, *The BEAT and the Treaties*, Tax Notes Int'l 53 (2018), Vol. 92, doi: 10.2139/ssrn.3229532; H. David Rosenbloom & Fadi Shaheen, *The TCJA and the Treaties*, Tax Notes Int'l 1057 (2019); but *see* Reuven S. Avi-Yonah & Bret Wells, *The BEAT and Treaty Overrides: A Brief Response to Rosenbloom and Shaheen*, Tax Notes Int'l 383 (2018); Reuven S. Avi-Yonah, *Pacta Sunt Servanda? The Problem of Tax Treaty Overrides*, Brit. Tax Rev. 15 (2022), doi: 10.2139/ssrn.4098235; Reuven S. Avi-Yonah, *The Dubious Constitutional Origins of Treaty Overrides: A Response to Rosenbloom and Shaheen*, 26(1) Fla. Tax Rev. 287 (2023), doi: 10.5744/ftr.2023.0287.

21 On the DSTs, *see* Reuven S. Avi-Yonah, *What's Everyone's Problem With DSTs?* Tax Notes Int'l 1285 (7 Dec. 2020); Reuven S. Avi-Yonah, *Much Ado: Why the United States Should Calm Down About DSTs*, Tax Notes Int'l 903 (13 Nov. 2023); Reuven S. Avi-Yonah, *Should Digital Services Taxes Be Creditable?*, Tax Notes Int'l 1469 (11 Mar. 2024), doi: 10.2139/ssrn.4963850; Reuven S. Avi-Yonah, *Once More: Digital Services Taxes Should Be Creditable*, Tax Notes Int'l 1357 (26 Aug. 2024), doi: 10.2139/ssrn.4963850. On the UTPR, *see* Reuven Avi-Yonah, *UTPR's Dynamic Connection to Customary International Tax Law*, Tax Notes Int'l 951 (21 Nov. 2022); Reuven S. Avi-Yonah, *The UTPR and the Treaties*, Tax Notes Int'l 45 (2 Jan. 2023); Reuven S. Avi-Yonah, *The UTPR Reconsidered: A Response to Fadi Shaheen*, Tax Notes Int'l 557 (23 Oct. 2023), doi: 10.2139/ssrn.4608138; Reuven S. Avi-Yonah, *Is the UTPR Extraterritorial or Discriminatory?*, Tax Notes Int'l (17 Mar. 2025).

22 *See* Josh White, *EU Will Keep Minimum Tax Despite US, Commissioner Says*, Law 360 (29 Jan. 2025).