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Section 899 has been struck out of the US One Big Beautiful Bill legislation

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Meandering its way through the labyrinthine US legislative process is President Trump's "One Big, Beautiful Bill", a cornerstone of the executive's fiscal policy agenda. In truth, while certainly big, the legislation is far from beautiful. The sheer scale and scope of the proposed plan makes it unwieldy and vulnerable to relentless tinkering by lawmakers in a deeply divided Congress. The Bill, approved by the House of Representatives by a single vote, passed to the upper house Senate where, following much debate, the Finance Committee handed back its amended draft legislation. Sweeping proposals covering taxation policy, Medicaid and energy-related provisions are now the subject of intense negotiations prior to a final vote. Arguably, the element of the legislation of greatest concern to investors, notably those outside the US, would have been the treatment of a highly controversial provision known as Section 899. To much relief, Treasury Secretary Mr Scott Bessent has ordered its removal from the final draft.

WHAT WAS SECTION 899 AND WHY DID IT MATTER?

The provision outlined how the US government might seek to impose taxes on individuals, businesses and other entities located in countries deemed by the administration to have a tax regime that discriminates against US interests. The proposal, regarded as an augmentation to ongoing trade (tariff) – related negotiations was dubbed a potential "revenge tax" designed to provide US negotiators with additional leverage in ongoing discussions. Included under the provision would have been those countries that levy a so-called digital services tax on the US, thus potentially affecting the UK, France, Germany, Canada, Australia and India.

The originally planned legislation did not lack precedent. In fact, Section 891 of the US tax code has sat on the statute book since the Great Depression era of the 1930s, when US protectionism was last at its peak. Although never utilised, the law authorises the doubling of tax on citizens and businesses from countries that operate tax policies thought discriminatory to US interests. Just because this and the proposed legislation surfaced, in an already febrile environment for the dollar (discussed elsewhere in this publication) and other US assets, the proposal was described in some quarters as a "ticking time bomb", an extension of trade conflict into the world of capital controls.

Capital controls are, by definition, designed to limit the flow of capital into and out of a country. In fact, Section 899 didn't seek to do that, limiting its scope to act only against those countries operating, in the eyes of the administration, against US interests. Although not now part of the legislative package, it is far from inconceivable that some form of capital control might be envisaged in the future in an effort to rein back large and growing trade and current account deficits. Indeed, earlier this year American Compass, a think tank with links to Vice President Mr JD Vance argued for capital control in the form of a market access charge which, if implemented, could raise as much as $2 trillion in revenue over the next decade.

WHY WERE FINANCIAL MARKETS ON EDGE?

The key point relates to what might have fallen out from initiatives aimed at reducing the US current account and trade deficits. In theory, a country's balance of payments must balance. Were capital inflows to the US to be reduced by the threat of an additional tax imposition (i.e. overseas investors to become less willing to finance these deficits) the deficits themselves must be reduced. If this is what President Trump wants (wanted) then restricting inflows of foreign capital, hand-in-hand with making American manufacturing great again. might be a way to do it.

The problem is, and remains, that this is not a cost-free adjustment. The mere threat of imposition could wreak havoc across US financial markets. One of the key planks behind the evolution of US exceptionalism is the relatively frictionless access to US financial assets for overseas investors. The mere whiff of a threat could cause international investors, key holders not just of US stocks but more importantly, its bonds, to take flight. This would, all things being equal, drive-up US borrowing costs, in turn squeezing domestic demand in the US, causing imports to fall. Whilst certainly one way to reduce the current account deficit, the reduction in domestic demand would likely result in higher unemployment. The Federal Reserve could act to mitigate the impact by lowering interest rates (a live issue), in which case the main channel through which capital controls would work would be through a weaker dollar, a tried and tested means of achieving a balance of payment adjustment even if, for it to work, US firms would be required to produce more goods domestically rather than abroad.

THE SENATE (PARTIALLY) DEFUSED THE TIME BOMB, TREASURY SECRETARY BESSENT DID THE REST

Contained amongst numerous adjustments to the proposed House legislation, the Senate handed back a number of important changes to the lower house version of Section 899 including, in particular, that the original plans had been softened in scope and delayed in implementation. The key points contained in the Senate document include a capping of new taxes at 15% after three years, a notable dilution from a possible maximum 50% (and confirmation that interest payments to central banks would fall outside the legislation's scope), while the entire plan would not be implemented until at least the start of 2027, one year later than originally envisaged. Critically, for investors, the watered-down version reflected very obvious upper house unease regarding the potential ramifications were the provision to have been implemented. Sensing this discomfort and very much desirous of getting the fiscal package past the legislature to avoid yet another debt ceiling, possible default crisis, Treasury Secretary Bessent has, at least for now, killed off this most controversial element: "I have asked the Senate and House to remove the Section 899 protective measure from consideration in the One Big, Beautiful Bill".

We now move into the final stages of the Bill's enactment process and will be sure to keep readers informed of important developments should they arise.

KEY TAKEAWAYS

- Section 899 outlined how the US government might seek to impose taxes on individuals, businesses and other entities deemed to have a tax regime that discriminates against US interests, including the UK and Europe.
- Possible capital controls, although never enforced so far, might be one way of reducing the US trade and current account deficits but are far from cost-free. Overseas investor flight would potentially drive-up US borrowing costs.
- The Senate partially defused the original legislative time bomb, both softening and delaying implementation and Treasury Secretary Bessent has delivered the coup de grace.
- A vote on the sprawling legislative package, shorn of Section 899, is expected soon.