INTERNAL REVENUE
BULLETIN

IRS

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2026–3
January 12, 2026

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

ADMINISTRATIVE

REG-110519-25, page 353.

The proposed regulations would update points of contact within the Department of Justice and the IRS. The proposed regulations are necessary to reflect a reorganization within the Department of Justice to identify new points of contact for matters involving the internal revenue laws. The proposed regulations would also update points of contact at the IRS for administrative claim submissions from taxpayers seeking civil damages for certain unauthorized collection actions or awards of administrative costs with respect to certain administrative proceedings.

REG-134219-08; REG-132251-11, page 358.

This document withdraws two notices of proposed rulemaking regarding innocent spouse relief.

INCOME TAX

REG-101952-24, page 349.

These proposed regulations relate to the taxation of the income of foreign governments from investments in the United States. In particular, these proposed regulations provide guidance for determining when an acquisition of debt by a foreign government is considered to be commercial activity, and when a foreign government has effective control of an entity engaged in commercial activity. These proposed regulations will affect foreign governments that derive income from sources within the United States.

Rev. Rul. 2026-2, page 342.

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term tax exempt rate. For purposes of sections 382, 1274, 1288, 7872 and other sections of the Code, tables set forth the rates for January 2026.

T.D. 10042, page 320.

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Finding Lists begin on page ii.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part I

26 CFR 1.892-3 through 5.

T.D. 10042

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Income of Foreign Governments and of International Organizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations relating to the taxation of the income of foreign governments from investments in the United States. In particular, these final regulations provide guidance for determining when a foreign government is engaged in commercial activity and when an entity is a controlled commercial entity. The final regulations will affect foreign governments that derive income from sources within the United States.

DATES: *Effective date*: These regulations are effective on December 15, 2025.

Applicability dates: For dates of applicability, *see* §§ 1.892-3(c), 1.892-4(d), and 1.892-5(e).

FOR FURTHER INFORMATION CONTACT: Jack Zhou at (202) 317-6938 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Authority

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 892 of the Internal Revenue Code (Code). These regulations are issued under the express delegations of authority under sections 892(c) and 7805(a) of the Code.

Background

On June 27, 1988, the Department of the Treasury (Treasury Department) and the IRS published in the **Federal Register** a notice of proposed rulemaking (53 FR 24100) (1988 proposed regulations) with a cross-reference to temporary regulations under section 892 (TD 8211, 53 FR 24060) (1988 temporary regulations) to provide guidance concerning the taxation of income of foreign governments and international organizations from investments in the United States following changes made to section 892 of the Code by section 1247 of the Tax Reform Act of 1986 (1986 Act) (Public Law 99-514, 100 Stat. 2085, 2583). After the 1988 temporary regulations and 1988 proposed regulations were published, section 892(a)(2)(A) was amended by section 1012(t) of the Technical and Miscellaneous Revenue Act of 1988 (1988 Act or TAMRA) (Public Law 100–647, 102 Stat. 3342, 3527-28) to provide that income derived from the disposition of any interest in a controlled commercial entity (CCE) does not qualify for the exemption under section 892. Section 1019(a) of TAMRA states that, except as otherwise provided, any amendments made by TAMRA are effective as if included in the provision of the 1986 Act to which such amendment relates.

On August 1, 2002, the Treasury Department and the IRS published § 1.892-5(a)(3) in the **Federal Register** (TD 9012, 67 FR 49864) to provide that the term "entity" for purposes of section 892(a)(2)(B) (defining "controlled commercial entity") includes partnerships (2002 final regulations).

On November 3, 2011, the Treasury Department and the IRS published in the **Federal Register** a notice of proposed rulemaking (76 FR 68119) that would provide additional guidance for determining when a foreign government is engaged in commercial activity (2011 proposed regulations). On December 29, 2022, the Treasury Department and the IRS published in the **Federal Register** a notice (87 FR 80108) to reopen the comment period for the 2011 proposed regulations.

Also on December 29, 2022, the Treasury Department and the IRS published in the **Federal Register** a notice of proposed rulemaking (87 FR 80097) that would make changes to § 1.892-5T(b)(1) to provide exceptions to the general rule that a United States real property holding corporation (USRPHC), as defined in section 897(c)(2), which may include a foreign corporation, is treated as engaged in commercial activity and, therefore, is a CCE if the requirements of § 1.892-5T(a)(1) or (2) are satisfied (2022 proposed regulations).

The Treasury Department and the IRS received comments on the 2011 proposed regulations and the 2022 proposed regulations, all of which are available at *https://www.regulations.gov* or upon request. A public hearing was not requested and none was held. After taking into account and addressing those comments, this Treasury decision finalizes, with modifications, the 2022 proposed regulations and the 2011 proposed regulations. In addition, this Treasury decision finalizes proposed § 1.892-3(a)(4) of the 1988 proposed regulations in accordance with the modifications recommended by the comments to the 2011 proposed regulations, which were reiterated by a comment to the 2022 proposed regulations. Since reopening the comment period of the 2011 proposed regulations has not resulted in any new or different comments, § 1.892-3(a)(4) is finalized without reproposing the provision (as discussed in part II.B.2 of the Summary of Comments and Explanation of Revisions). Terms used but not defined in this preamble have the meaning provided in the final regulations.

Summary of Comments and Explanation of Revisions.

The final regulations retain the general approach and structure of the 2011 proposed regulations and the 2022 proposed regulations, with certain revisions. This section of the preamble discusses the comments received in response to the 2011 proposed regulations and the 2022 proposed regulations, and explains the revisions reflected in the final regulations.

I. *Overview*

Section 892 exempts a foreign government from U.S. income taxation under

subtitle A of the Code on certain qualified income received from investments in the United States in stocks, bonds, or other domestic securities, or financial instruments held in the execution of governmental financial or monetary policy. Section 892(a)(1)(A). This exemption does not apply to income that is (1) derived from the conduct of any commercial activity (whether within or outside the United States), (2) received by a CCE or received (directly or indirectly) from a CCE, or (3) derived from the disposition of any interest in a CCE. Section 892(a)(2)(A).

Section 892 does not define the term "foreign government." The 1988 temporary regulations generally define a foreign government to consist only of integral parts and controlled entities of a foreign sovereign, and define an "integral part" of a foreign sovereign to include any body, however designated, that constitutes a governing authority of a foreign country. *See* § 1.892-2T(a)(2). The 1988 temporary regulations generally define a "controlled entity" of a foreign sovereign to mean an entity that is separate in form from a foreign sovereign or otherwise constitutes a separate juridical entity if it satisfies certain requirements, including that it is wholly owned and controlled by the foreign sovereign directly or indirectly through one or more controlled entities. *See* § 1.892-2T(a)(3). The 1988 temporary regulations provide that a controlled entity does not include partnerships or any other entity owned and controlled by more than one foreign sovereign. Thus, a foreign financial organization organized and wholly owned and controlled by several foreign sovereigns to foster economic, financial, and technical cooperation between various foreign nations is not a controlled entity for purposes of section 892. *See* § 1.892-2T(a)(3).

Section 892(a)(2)(B) provides that, for purposes of section 892(a)(2)(A), a CCE is any entity engaged in commercial activities (whether within or outside the United States) and in which a foreign government holds (directly or indirectly) interests that meet specified thresholds. The 2002 final regulations provide that the term "entity" in section 892(a)(2)(B) means a corporation, a partnership, a trust (including a pension trust described in § 1.892-2T(c)), and an estate. *See* § 1.892-5(a)(3).

Section 892(c) authorizes the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 892.

II. *Defining Commercial Activities*

A. *General rule*

The 1988 temporary regulations define commercial activities to include all activities (whether conducted within or outside the United States) which are ordinarily conducted by the taxpayer or by other persons with a view towards the current or future production of income or gain. *See* § 1.892-4T(b). Furthermore, those regulations provide that an activity may be considered commercial activity even if that activity does not constitute the conduct of a trade or business in the United States under section 864(b). *Id.*

The 2011 proposed regulations would continue to define commercial activities to include all activities (whether conducted within or outside the United States) which are ordinarily conducted for the current or future production of income or gain, and provide that only the nature of the activity, not the purpose or motivation for conducting it, is determinative of whether the activity is commercial in character.[1] *See* proposed § 1.892-4(d) (which corresponds to the rule in § 1.892-4T(b)). Moreover, the 2011 proposed regulations would provide that an activity may be considered commercial activity even if that activity does not constitute a trade or business for purposes of section 162 or does not constitute (or would not constitute if undertaken in the United States) the conduct of a trade or business in the United States for purposes of section 864(b). *Id.*

Several comments generally recommended that the final regulations should not distinguish between commercial activity under section 892 and a trade or business under section 864(b), or should provide that an activity will not be treated as commercial activity if it would not constitute a trade or business under section 864(b) if it were carried on in the United States. The comments recommended that the final regulations provide additional guidance by making the existing Treasury regulations under section 864(b) applicable to foreign governments under section 892.

The Treasury Department and the IRS agree that, subject to express exceptions, an activity that constitutes a trade or business for purposes of section 162 or constitutes (or would constitute if undertaken in the United States) a trade or business in the United States for purposes of section 864(b) is commercial activity; however, the best reading of the term "commercial activities" as used in section 892 is that it has a different and broader meaning than "trade or business" under sections 162 and 864. In drafting section 892, Congress opted for a different term, "commercial activities," instead of the familiar term "trade or business." The word "activities" denotes a standard more easily satisfied than the term "trade or business." Congress's decision to use a different term should be given effect.

The final regulations therefore employ a broad definition, and provide that commercial activities potentially include activities that may not (or would not, if undertaken in the United States) constitute the conduct of a trade of business in the United States under section 864(b). Accordingly, the final regulations do not adopt the comments to limit the definition of commercial activities to activities that are a trade or business under section 864(b). In addition, the final regulations clarify that activities that constitute a trade or business for purposes of section 162 or constitute (or would constitute if undertaken in the United States) a trade or business in the United States for purposes of section 864(b) are commercial activities for purposes of section 892, except as expressly provided otherwise.

Another comment suggested that the position taken in proposed § 1.892-4(d) (that an activity may be considered commercial activity even if it does not constitute a trade or business) appears contrary to the rules of proposed § 1.892-4(e)(1)(ii), which would provide that effecting transactions in securities, commodities, or financial instruments for a foreign gov-

[1] The 2011 proposed regulations provided rules in proposed § 1.892-4(d) and (e) that correspond to the same rules stated in § 1.892-4T(b) and (c). These final regulations revise the structure of the provisions of the 2011 proposed regulations to be consistent with the structure of the 1988 temporary regulations.

ernment's own account does not constitute commercial activity regardless of whether the activity constitutes a trade or business. The Treasury Department and the IRS do not agree with this comment, and are of the view that the 2011 proposed regulations are internally consistent. Proposed § 1.892-4(d) would define the term commercial activities generally to include activities beyond those that would constitute a trade or business, while proposed § 1.892-4(e)(1)(ii) would provide a specific exception to that general rule for trading activities. The final regulations remove the reference to trade or business activity to clarify the trading exception under § 1.892-4(c)(2) (formerly proposed § 1.892-4(e)(1)(ii)).

B. *Investment exception*

Section 892 does not identify specific activities that do or do not constitute commercial activities. However, the regulations under section 892 provide that commercial activities do not include investment activities, cultural events, governmental functions, purchasing of goods for use of the foreign sovereign, and non-profit activities. *See*, for example, § 1.892-4T(c).

The 2011 proposed regulations would provide an exclusive list of investments that are not treated as commercial activities. This list includes investments in stocks, bonds, and other securities (as defined in § 1.892-3T(a)(3)); loans; investments in financial instruments (as defined in § 1.892-3T(a)(4)); the holding of net leases on real property; the holding of real property which is not producing income (other than on its sale or from an investment in net leases on real property); and the holding of bank deposits in banks. *See* proposed § 1.892-4(e)(1)(i) (which corresponds to § 1.892-4T(c)(1)(i)). The 2011 proposed regulations' investment exception also would provide that transferring securities under a loan agreement which meets the requirements of section 1058 is an investment and not commercial activity, and that an activity will not cease to be an investment solely because of the volume of transactions of that activity or because of other unrelated activities.

The 2011 proposed regulations also would provide that investments (including loans) made by a banking, financing, or similar business constitute commercial activities, even if the income derived from such investments is not considered to be income effectively connected with the active conduct of a banking, financing, or similar business in the United States by reason of the application of § 1.864-4(c)(5). *See* proposed § 1.892-4(e)(1)(iii) (which corresponds to § 1.892-4T(c)(1)(iii)).

1. Investment in Loans

The exclusive list of investments that are not treated as commercial activities under the 2011 proposed regulations includes the term "loans." *See* proposed § 1.892-4(e)(1)(i) (which corresponds to § 1.892-4T(c)(1)(i)). A comment stated that there is uncertainty as to the circumstances in which loan origination is commercial activity. The comment recommended that lending (and charging of associated fees) should not be treated as commercial activity unless an entity offers to make loans to the general public or makes more than five loans in a single year.

The recommendation of the comment is not adopted in the final regulations because the Treasury Department and the IRS do not agree that making loans to the general public or making a particular minimum number of loans constitute necessary conditions for loan (or other debt) acquisitions to be commercial in character, or that a lack of those characteristics necessarily indicates absence of commercial activities. The Treasury Department and the IRS are separately proposing rules in this issue of the **Federal Register** as to when acquiring a loan or other debt, including in connection with original issuance, is treated as an investment for purposes of section 892.

2. Investment and Trading in Financial Instruments

The 1988 temporary regulations provide an exception from commercial activities for investments in financial instruments held in the execution of governmental financial or monetary policy. *See* § 1.892-4T(c)(1). The 2011 proposed regulations would have modified this exception by providing that investments in financial instruments (as defined in § 1.892-3T(a)(4)) are not treated as commercial activities, without regard to whether the financial instruments are held in the execution of governmental financial or monetary policy. *See* proposed § 1.892-4(e)(1)(i) (which corresponds to § 1.892-4T(c)(1)(i)). The 2011 proposed regulations also would have added financial instruments (as defined in § 1.892-3T(a)(4)) to the trading exception under § 1.892-4T(c)(1)(ii), without regard to whether the financial instruments are held in the execution of governmental financial or monetary policy. *See* proposed § 1.892-4(e)(1)(ii). Section 1.892-3T(a)(4) defines financial instrument to include any forward, futures, options contract, swap agreement or similar instrument in a functional or nonfunctional currency (as defined in section 985(b)) or in precious metals when held by a foreign government or central bank of issue (as defined in § 1.895-1(b)).

Numerous comments to the 2011 proposed regulations recommended clarifying that all transactions in financial instruments that are within the scope of the trading safe harbors under section 864(b), including derivative transactions within the scope of the 1998 proposed regulations (63 FR 32164, June 12, 1998) under proposed § 1.864(b)-1, be treated as within the investment and trading exceptions of proposed § 1.892-4(e)(1)(i) and (ii) (which correspond to § 1.892-4T(c)(1)(i) and (ii)). Certain of these comments asserted that investing in these financial instruments is no less passive than a direct investment in stocks or securities and, therefore, the recommended clarification would be consistent with the purposes of section 892. Comments also recommended expanding the definition of the term "financial instrument" in § 1.892-3T(a)(4) to include all types of market standard derivatives. The recommendation was reiterated by a comment to the 2022 proposed regulations.

The Treasury Department and the IRS generally agree that investing and trading by a foreign government investor in financial instruments that are derivatives within the scope of the proposed regulations under section 864(b) are not commercial activities. *See* Prop. Reg. § 1.864(b)-1(b)(2), 63 FR 32164, June 12, 1998. Investing and trading in such financial instruments generally involve only putting capital at risk and do not involve activity such as structuring the instrument, in contrast to structuring of bespoke, non-market standard derivatives; thus, the expected return

is generally a return exclusively on capital rather than on the activities conducted. Accordingly, the final regulations adopt these comments by revising the definition of the term "financial instrument" under § 1.892-3(a)(4) to include financial instruments that are derivatives, which the final regulations define in a manner that is substantially similar to the definition in proposed § 1.864(b)-1(b)(2). As a result, a foreign government may invest and effect transactions (as a nondealer) for its own account with respect to these expanded types of financial instruments without being treated as engaged in commercial activities. *See* § 1.892-3(a)(4)(i). If, however, a contract or other financial instrument would be characterized under general Federal income tax principles as resulting in beneficial ownership of a reference asset, the determination of whether the foreign government investor is conducting commercial activity is made based on ownership of that asset and not with regard to the financial instrument. Moreover, if a contract or similar arrangement is not a derivative described in § 1.892-3(a)(4)(i), and does not otherwise qualify as an investment within the meaning of § 1.892-4(c)(1), effecting a transaction for one's own account in that contract or similar arrangement may be commercial activity unless it is within the scope of an exception to commercial activities under §§ 1.892-4(c) and 1.892-4T(c). The final regulations also make changes to the structure of § 1.892-3T(a)(4) by separating the provision into separate paragraphs for ease of reference. *See* § 1.892-3(a)(4)(i) and (ii). The final regulations finalize proposed § 1.892-3(a)(4) of the 1988 proposed regulations with modifications in accordance with the comments discussed above, together with the changes described herein, and remove the provision from the temporary regulations that were published on the same date.

3. Holding of Non-functional Currency

A comment recommended adding the holding of non-functional currency in a capacity other than a dealer or financial institution to the exclusive list of investments that are not treated as commercial activities. The Treasury Department and the IRS agree with this comment because solely holding one's own cash, whether or not in functional currency, is not an activity ordinarily conducted for the current or future production of income or gain. Although currency deposited in a bank may produce income or gain, merely depositing currency does not rise to the level of commercial activity. Since a foreign government entity generally would hold currency (whether functional or non-functional) in a bank deposit, the Treasury Department and the IRS are revising the rule for holding of bank deposits to clarify that the exception includes the holding of bank deposits in any currency. *See* § 1.892-4(c)(1)(i). The comment also recommended excluding currency gains from commercial activity income, but this recommendation is beyond the scope of the final regulations. Therefore, the final regulations do not adopt this recommendation.

4. Receipt of Certain Fee Income

A comment recommended an exception from commercial activity for the receipt of certain fee income as a passive investor in a private equity or private credit fund. The comment noted that foreign governments and their controlled investment vehicles that invest in private equity or similar funds may negotiate for the right to share in fees for services provided to portfolio companies by the sponsor of the fund. The comment thus recommended that a foreign government investor should not be treated as conducting commercial activity solely by reason of receiving a share of the fees for services performed by the sponsor if the foreign government holds (directly or indirectly) an equity interest in the underlying fund, subject to certain conditions. The comment also asserted that a foreign government investor should not be treated as conducting commercial activity if it receives fees incidental to providing capital for an investment in debt or equity of an underlying issuer. The comment contended that the receipt of these types of fees is not commercial activity because the fees are payable for making, continuing to make, or having made capital available to the underlying issuer for an investment otherwise described in § 1.892-4T(c)(1).

The final regulations do not adopt this comment. The Treasury Department and the IRS are of the view that, for purposes of determining whether a foreign government is engaged in commercial activities, the best reading of the term "commercial activities" is that it is concerned with the nature of the activity performed by, or attributable to, the foreign government. To the extent the commercial activities of a fund sponsor are attributable to a foreign government investor in a privately managed fund under § 1.892-5(d)(5)(i) (attribution from an entity classified as a partnership), or on the basis of agency, the foreign government investor is considered to conduct commercial activity unless one or more exceptions under § 1.892-5 (for example, the qualified partnership interest exception under § 1.892-5(d)(5)(iii)(B)) applies. This analysis applies without regard to whether the foreign government actually or constructively receives or otherwise shares in income labelled as a fee. The final regulations do not treat the receipt of any particular type of fee as alone determinative of whether a foreign government conducts commercial activities. This approach is consistent with Federal tax principles which analyze the substance of a transaction, rather than its label or form.

5. Partnership Equity Interests

The 2011 proposed regulations would provide, in relevant part, that investments in other securities (as defined in § 1.892-3T(a)(3)) or generally effecting transactions in other securities (as defined in § 1.892-3T(a)(3)) for a foreign government's own account as a nondealer do not constitute commercial activities. *See* proposed § 1.892-4(e)(1)(i) and (ii) (which correspond to § 1.892-4T(c)(1)(i) and (ii)). Section 1.892-3T(a)(3) provides that the term "other securities" does not include partnership interests (with the exception of publicly traded partnerships within the meaning of section 7704). As a result of the cross-reference to § 1.892-3T(a)(3) in proposed § 1.892-4(e)(1)(i) and (ii), comments have requested clarification as to whether a disposition of a partnership interest would be treated as commercial activity for purposes of section 892.

The Treasury Department and the IRS have determined that holding or trading partnership equity interests for one's own account and other than as a dealer is not by itself commercial activity. Rather, holding

equity interests in a partnership (including holding by an entity incident to trading partnership equity interests for one's own account and other than as a dealer) results in commercial activity if the partnership conducts commercial activity that is attributed to the holder. If this were not the case, there would be no need for a rule attributing the commercial activities of a partnership to its partners or for the exception to that rule for qualified partnership interests as defined in § 1.892-5(d)(5)(iii)(B). The exclusion of partnership equity interests from the definition of "other securities" for purposes of the investment and trading exceptions should not be read as implying that holding or trading such interests for one's own account and other than as a dealer are commercial activities. Accordingly, although a partner may be attributed commercial activities conducted by a partnership, the final regulations provide that the mere act of holding a partnership equity interest or effecting transactions in a partnership equity interest (for a foreign government's own account and other than as a dealer) are not in themselves treated as commercial activities. *See* § 1.892-4(c)(1)(i) and (c)(2). Further, pursuant to section 892(a)(2)(A), a foreign government's distributive share of partnership income attributable to commercial activities is not exempt from taxation under section 892. Moreover, pursuant to § 1.892-3T(a)(2) and (3), gain from the disposition of a partnership equity interest is not exempt from taxation under section 892 (though, depending on the partnership's assets and activities, it may be under the generally applicable Code provisions).

Comments also recommended that any income earned through a partnership and any gain arising from the disposition of a partnership interest be exempt under section 892 to the extent such income or gain would be exempt if realized directly by a foreign government. These recommendations pertaining to the types of income that are exempt under § 1.892-3T(a), however, are beyond the scope of the final regulations. Therefore, the final regulations do not adopt these recommendations.

6. Banking, Financing, or Similar Business

With respect to the 2011 proposed regulations' provision that otherwise qualifying investments made by a banking, financing, or similar business would constitute commercial activities, comments recommended that the final regulations define banking, financing, or similar business by reference to § 1.864-4(c)(5)(i) without regard to the limitation that the activities be undertaken in the United States.

The Treasury Department and the IRS address this comment by proposing new rules included in this issue of the **Federal Register** for determining the circumstances in which acquisitions of loans (and other debt) are investments or commercial activities for purposes of section 892, and, in doing so, propose to withdraw § 1.892-4T(c)(1)(iii) (the rule that treats investments and loans made by a banking, financing, or similar business as commercial activities). Therefore, the final regulations do not adopt the comment or finalize proposed § 1.892-4(e)(1)(iii) in the 2011 proposed regulations because it repeats the text of § 1.892-4T(c)(1)(iii).

III. *Controlled Commercial Entities*

Consistent with section 892(a)(2)(B), proposed § 1.892-5(a)(1) would define CCE to mean any entity (including a controlled entity as defined in § 1.892-2T(a)(3)) that is engaged in commercial activities (whether conducted within or outside the United States) if the foreign government holds (directly or indirectly) any interest in such entity which (by value or voting power) is 50 percent or more of the total of such interests in such entity, or holds (directly or indirectly) any other interest in such entity which provides the foreign government with effective practical control of such entity. The 2011 proposed regulations would define entity for purposes of section 892 and the regulations thereunder to include a corporation, a partnership, a trust (including a pension trust described in § 1.892-2T(c)), and an estate. The 2002 final regulations, however, define entity only for purposes of section 892(a)(2)(B). Consistent with the 2002 final regulations, the final regulations provide that the definition of "entity" in § 1.892-5(a) is for purposes of section 892(a)(2)(B) only.

Several comments requested further detail on the definition of effective practical control, including additional examples of arrangements and rules to illustrate the definition. Other comments made specific recommendations for what should not be treated as effective practical control, such as normal creditor interests and holding solely a minority equity interest (by vote and value) without more.

The Treasury Department and the IRS generally agree with the comments that the definition of effective practical control under § 1.892-5T(c)(2) would be made clearer by inclusion of additional details and examples. The final regulations replace the term "effective practical control" with the term "effective control" to be consistent with section 892(a)(2)(B)(ii). *See* § 1.892-5(a)(1)(iii)(B) and (c)(2). No inference is intended that the term "effective control" has any meaning different from that of "effective practical control." In a separate notice of proposed rulemaking published in this issue of the **Federal Register**, the Treasury Department and the IRS propose rules for defining effective control. *See* proposed § 1.892-5(c)(2).

One comment recommended clarifying that control with respect to entities held through a partnership be determined based on a foreign government's indirect interest through the partnership rather than based on the direct interest held by the partnership. The recommendation requires modifying § 1.892-5T(c), which is outside the scope of these final regulations. Therefore, the final regulations do not adopt this recommendation.

A. *U.S. real property holding corporations and U.S. real property interests*

The 1988 temporary regulations provide that a USRPHC, as defined in section 897(c)(2), or a foreign corporation that would be a USRPHC if it were a domestic corporation, is treated as engaged in commercial activity and, therefore, is a CCE, if a foreign government meets certain ownership or control thresholds with respect to that USRPHC or foreign corporation (the USRPHC per se rule). *See* § 1.892-5T(b)(1).

Proposed § 1.892-4(e)(1)(iv) of the 2011 proposed regulations would provide that a disposition, including a deemed disposition under section 897(h)(1), of a U.S. real property interest (as defined in section 897(c)) (USRPI), by itself, does not con-

stitute the conduct of commercial activity. However, as provided in § 1.892-3T(a), the income derived from the disposition of a USRPI described in section 897(c)(1)(A)(i) (generally an interest in real property located in the United States or the Virgin Islands) shall in no event qualify for the exemption from tax under section 892.

The 2022 proposed regulations would revise § 1.892-5T(b)(1) by providing two exclusions from the USRPHC per se rule for: (i) a foreign corporation that is a qualified holder under § 1.897(l)-1(d) (referring to qualified foreign pension funds or certain qualified controlled entities), or (ii) a corporation that is a USRPHC solely by reason of its direct or indirect ownership interest in one or more other corporations that are not controlled by the foreign government (as determined under § 1.892-5T(a)). As a result of the latter exclusion in the 2022 proposed regulations, a foreign government could use a domestic holding company for those minority interests without that holding company being treated as a CCE (the minority interest exception).[2] The 2022 proposed regulations would apply to taxable years ending on or after December 28, 2022, when finalized. The preamble provided that taxpayers may rely on the 2022 proposed regulations, including the minority interest exception, until the date the regulations are published as final regulations in the Federal Register.

Comments recommended that the final regulations withdraw the USRPHC per se rule. They asserted that there is no policy rationale under section 897 for the USRPHC per se rule in the context of section 892 and that it is merely a "trap for the unwary" that causes section 892 investors to devise ways to plan around the rule. One comment asserted that the 1988 Act's legislative history (discussed below) addressed only a foreign government's disposition of an investment in a domestic USRPHC, rather than demonstrating an intent to treat a foreign USRPHC as a per se CCE. Another comment recommended that the rule should apply solely to an entity that would be a USRPHC if the reference to USRPI in section 897(c)(2) were replaced with a cross reference to the definition of a USRPI in section 897(c)(1)(A)(i). Another comment recommended replacing the USRPHC per se rule with a rule that treats the gain or loss on the sale of a controlled USRPHC as if it were derived from commercial activity, similar to the rule under section 897(a) which treats gain or loss realized from the disposition of a USRPI as effectively connected with a U.S. trade or business. This comment explained that this recommendation is better aligned with the 1988 Act's legislative history.

Several comments recommended that the final regulations clarify or expand the application of the minority interest exception. Two comments made recommendations that would modify the assets to be taken into account for the minority interest exception, such as by disregarding USRPIs that do not collectively exceed ten percent of an entity's assets after excluding USRPIs that qualify for the minority interest exception. Other comments recommended other ways of expanding the minority interest exception, including by taking into account noncontrolling interests in noncorporate entities and investments in debt instruments or other financial instruments that could be treated as USRPIs.

The 1988 Act's legislative history includes a statement that "a commercial entity is to include any U.S. real property holding corporation (sec. 897(c)(2))." S. Rep. No. 100-445, 306 (1988). Although the legislative history does not expressly distinguish between domestic and foreign USRPHCs, the Treasury Department and the IRS have determined that limiting the USRPHC per se rule to domestic corporations is appropriate to preserve U.S. taxation of gain on the sale of shares of a controlled domestic USRPHC, consistent with the legislative history, while at the same time addressing the concerns of commenters as to application of the rule to foreign USRPHCs. The Treasury Department and the IRS also have determined that applying the USRPHC per se rule only to domestic corporations more directly addresses the concerns raised by comments that controlled entities, which are necessarily foreign and otherwise eligible for the section 892 exemption, must continuously monitor their investments to ensure that they do not become subject to the USRPHC per se rule. Thus, the final regulations limit the USRPHC per se rule to domestic corporations and do not deem a foreign corporation to be engaged in commercial activity solely by reason of its status as a USRPHC. *See* § 1.892-5(b)(1)(ii)(A). Due to this change in the USRPHC per se rule in the final regulations, the proposed exception for foreign corporations that are qualified holders under § 1.897(l)-1(d) is not necessary and so is not finalized. Therefore, foreign government investors as defined in § 1.892-2T(a) and foreign government pension funds that are qualified holders under § 1.897(l)-1(d) do not need to monitor their own USRPHC status for purposes of the USRPHC per se rule.

Similarly, the change in the USRPHC per se rule in the final regulations renders the proposed minority interest exception unnecessary because, under the final regulations, foreign governments have the alternative of investing directly or through foreign holding companies. However, the Treasury Department and the IRS understand that foreign government investors have relied on the minority interest exception for taxable years ending on or after December 28, 2022, as permitted by the preamble to the 2022 proposed regulations, and have entered into long-term minority interest investments in USRPHCs using domestic holding companies. If the minority interest exception were not finalized, the Treasury Department and the IRS understand, these investors could incur substantial costs to restructure these investments. Accordingly, the final regulations retain the minority interest exception (with certain clarifying modifications). *See* § 1.892-5(b)(1)(ii)(B). The Treasury Department and the IRS are of the view that adopting the minority interest exception does not present policy concerns under section 897 in the context of section 892 because the exception allows foreign government investors to use domestic holding companies for investments that could otherwise be entered into directly or by using foreign holding companies and therefore does not present an opportunity to facilitate the inappropriate avoidance of section 897.

With respect to the minority interest exception, a comment asserted that there

[2] The 2022 proposed regulations would also clarify § 1.892-5T(b)(1) by replacing the phrase "or a foreign corporation that would be a United States real property holding corporation if it was a domestic corporation" with "which may include a foreign corporation" when referencing section 897(c)(2) to define a USRPHC. See proposed § 1.892-5(b)(1)(i).

are two possible interpretations of the phrase "solely by reason of its direct or indirect ownership interest in one or more other corporations": (1) any ownership interests in noncontrolled corporations are removed from an entity's balance sheet before performing the asset test under section 897 to determine whether USRPIs constitute 50 percent or more of the value of the entity's assets (the Balance Sheet Method); and (2) noncontrolling interests in USRPHCs are treated as "good" assets for purposes of the asset test under section 897 and thereby are included in the denominator but not the numerator (the Good Asset Method).

The Treasury Department and the IRS have determined that the correct interpretation of the minority interest exception in § 1.892-5(b)(1)(ii)(B) requires use of the Balance Sheet Method, and thus it (and not the Good Asset Method) is the only method permitted to be used when applying this exception. That is because a corporation applying the Good Asset Method could satisfy § 1.892-5(b)(1)(ii)(B) even if it held a controlling interest in a USRPHC or a direct interest in U.S. real estate. In that case, the corporation would not be a USRPHC "solely by reason of its direct or indirect ownership interest in one or more other corporations that are not controlled by the foreign government," as required for the exception to apply. Thus, the final regulations provide that the phrase "solely by reason of its direct or indirect ownership interest in one or more other corporations that are not controlled by the foreign government" means disregarding any ownership interests, held directly or indirectly, in noncontrolled corporations determined under § 1.892-5(a)(1), after applying the asset test under section 897(c)(2) and § 1.897-2. For example, if a controlled entity (CE) within the meaning of § 1.892-2T(a)(3) does not own any assets other than 100 percent of the interests in a USRPHC whose only asset is a minority interest in a real estate investment trust (REIT), neither the USRPHC directly owned by CE nor CE itself (which does not hold any other assets) would be treated as a CCE pursuant to § 1.892-5(b)(1)(ii)(B). The asset test under § 1.897-2(e)(3) provides that CE, which holds a controlling interest in the USRPHC within the meaning of § 1.897-2(e)(3)(iii) (flush language), holds a proportionate share of each asset held by the USRPHC. Thus, because CE holds a controlling interest in the USRPHC, the USRPHC's minority interest in the REIT is treated as held by CE. That ownership interest in the REIT, which is a noncontrolled corporation (within the meaning of § 1.892-5(a)(1)), however, is disregarded when determining whether the USRPHC and CE are USRPHCs for purposes of § 1.892-5(b)(1)(ii)(B). Therefore, after having applied the asset test under § 1.897-2, including the look-through rules of § 1.897-2(e)(3), and then removing such minority interests from the balance sheets of the USRPHC and CE, neither the USRPHC nor CE are USRPHCs and therefore are not CCEs pursuant to § 1.892-5(b)(1)(ii)(B).

Additionally, the final regulations do not adopt the comments previously discussed relating to expanding the scope of the minority interest exception. The Treasury Department and the IRS have determined that expanding the scope of the minority interest exception may result in foreign governments holding (through a controlled U.S. corporation) active rather than passive, noncontrolling investments in U.S. real property, which would be contrary to the purpose of the CCE rules.

A comment recommended that the parent-to-subsidiary attribution rule of § 1.892-5T(d)(2)(ii) not apply where the parent corporation is treated as engaged in commercial activity under § 1.892-5T(b)(1) because it is a USRPHC. This recommendation is beyond the scope of the final regulations. Therefore, the final regulations do not adopt this recommendation.

B. *Inadvertent commercial activity exception*

The 2011 proposed regulations would treat an entity that conducts only inadvertent commercial activities in a particular tax year as not engaged in commercial activities if (1) failure to avoid conducting the commercial activity is reasonable as described in proposed § 1.892-5(a)(2)(ii); (2) the commercial activity is promptly cured as described in proposed § 1.892-5(a)(2)(iii); and (3) the record maintenance requirements described in proposed § 1.892-5(a)(2)(iv) are met (the inadvertent commercial activity exception). However, any income derived from any foreign government's inadvertent commercial activity, including activity attributed from a partnership, would not qualify for exemption from tax under section 892. *See* proposed § 1.892-5(a)(2)(i).

Comments recommended that the final regulations provide for a new rule permitting a specified percentage of an entity's assets or income during a tested year to be derived from the conduct of commercial activities regardless of whether the commercial activities were inadvertent and regardless of whether the requirements for the inadvertent commercial activity exception were satisfied. The comment asserted that section 892 allows for such a de minimis rule.

The final regulations do not adopt these comments. Section 892(a)(2)(B) provides that any entity engaged in commercial activities is a CCE if either clause (i) or (ii) of section 892(a)(2)(B) is satisfied. The provision notably does not provide for a quantitative threshold for determining whether an entity is engaged in commercial activities. Therefore, the Treasury Department and the IRS have determined that a quantitative threshold for determining whether an entity is engaged in commercial activities is inconsistent with section 892. However, the Treasury Department and the IRS have also determined that the best reading of section 892(a)(2)(B) is that an entity is not "engaged" in commercial activities where reasonable precautions were taken to avoid the commercial activities, but the entity nevertheless conducted such activities inadvertently. Accordingly, the exception in § 1.892-5(a)(2) finalizes providing targeted relief in the case of an entity that inadvertently conducts commercial activity, provided that the activity is discontinued in a timely manner.

A comment requested that the Treasury Department and the IRS prescribe procedures to simplify the tax payment and return filing obligations arising from inadvertent commercial activity. This comment is beyond the scope of the final regulations and, therefore, it is not adopted.

1. Whether Failure to Avoid Conducting Commercial Activities is Reasonable

Subject to the continuing due diligence requirement under proposed § 1.892-5(a)

(2)(ii)(B) and a safe harbor under proposed § 1.892-5(a)(2)(ii)(C), the 2011 proposed regulations would provide that whether an entity's failure to avoid engaging in commercial activity is reasonable is determined in light of all the facts and circumstances. Due regard will be given to the number of commercial activities conducted during the taxable year, and the amount of income earned from, and assets used in, the conduct of the commercial activities in relationship to the entity's total income and assets. The 2011 proposed regulations would also provide that for purposes of § 1.892-5(a)(2)(ii)(A) and (C), where commercial activity conducted by a partnership is attributed under § 1.892-5(d)(5)(i) to an entity owning an interest in the partnership, assets used in the conduct of the commercial activity by the partnership are treated as assets used in the conduct of commercial activity by the entity in proportion to the entity's interest in the partnership, and the entity's distributive share of the partnership's income from the conduct of the commercial activity is treated as income earned by the entity from the conduct of commercial activities.

Comments recommended that the final regulations provide that the continuing due diligence and other requirements to satisfy the inadvertent commercial activity exception do not apply where an entity reasonably concludes that it holds an interest as a limited partner in a limited partnership described in proposed § 1.892-5(d)(5)(iii)(B). The final regulations do not adopt this comment because the inadvertent commercial activity exception and qualified partnership interest exception are provided for different reasons and apply in different situations. *See*, for example, § 1.892-5(a)(2)(ii)(A), which acknowledges the separate exception for qualified partnership interests by citing to § 1.892-5(d)(5)(i) (attribution from an entity classified as a partnership that is subject to the qualified partnership interest exception under § 1.892-5(d)(5)(iii)). The inadvertent commercial activity exception may be available when it is not reasonably expected for an entity's investment to result in the attribution of commercial activities. In contrast, the qualified partnership interest exception may be available even when an entity invests in a partnership that it expects will deliberately conduct activities that may be treated as commercial activities. Therefore, whether an entity reasonably concludes that it qualifies for the qualified partnership interest exception is not a factor in determining whether the inadvertent commercial activity exception is available for activities conducted by the partnership in which the entity invests.

Proposed § 1.892-5(a)(2)(ii)(B) provides that a failure to avoid commercial activity will not be considered reasonable unless there is continuing due diligence to prevent the entity from engaging in commercial activities within or outside the United States as evidenced by having adequate written policies and operational procedures in place to monitor the entity's worldwide activities.

Comments requested additional details and illustrations with respect to "adequate written policies and operational procedures." One comment recommended a safe harbor in which an entity will be treated as having adequate written policies and operational procedures if the entity satisfies certain specified requirements, including that the entity (1) establish a written policy that prohibits the entity from engaging in commercial activities both directly and through investments in entities whose activities could be attributed to it for purposes of section 892, (2) communicate that written policy and its operational procedures to employees of the entity and other persons who have a relationship with the entity, and (3) periodically review a representative sample of the entity's investments. Another comment recommended replacing the word "adequate" with "reasonably suitable" because an entity that fails the inadvertent commercial activity exception did not, by definition, have "adequate" written policies and operational procedures.

The final regulations do not adopt the comment requesting a change to the description of written policies and operational procedures to "reasonably suitable," but instead provide examples of facts and circumstances that may be used to determine whether a written policy or operational procedure is considered adequate. *See* § 1.892-5(a)(2)(ii)(B). The description of written policies and operational procedures as being "adequate" does not mean that the policies and procedures, viewed with hindsight, had the effect of completely preventing commercial activities, but instead means that there is a reasonable expectation that the policies and procedures will be adequate for that purpose, considering all facts and circumstances. In determining whether written policies and operational procedures are considered adequate, the final regulations adopt, with modifications, the factors recommended by the comment but without providing a safe harbor. *See* § 1.892-5(a)(2)(ii)(B)(*1*) through (*5*).

Another comment recommended adopting a standard of review for determining reasonableness by taking into account whether commercial activity is de minimis. The final regulations do not adopt this comment because, as described above, the Treasury Department and the IRS have determined that a quantitative threshold for determining whether an entity is engaged in commercial activity is inconsistent with section 892.

Proposed § 1.892-5(a)(2)(ii)(B) also provides that a failure to avoid commercial activity will not be considered reasonable if the management-level employees of the entity have not undertaken reasonable efforts to establish, follow, and enforce the written policies and operational procedures. Comments recommended that the final regulations include within the scope of this rule the management-level personnel of an entity that is affiliated with the foreign government investor or that is responsible for the management of its investments. Comments similarly recommended that an entity should be able to rely on the establishment and enforcement of policies and procedures of the investment manager of (or those of another third-party controlling investments by) funds or managed accounts in which the entity invests.

In response to these comments, the final regulations provide that either employees of the entity claiming the inadvertent commercial activity exception or employees of any of its controlling entities (such control determined within the meaning of § 1.892-5(a)(1)) may be designated to establish, follow, and enforce the adequate written policies and operational procedures to appropriately monitor the worldwide activities of the entity claiming the inadvertent commercial activity exception. *See*

§ 1.892-5(a)(2)(v)(B). Moreover, the final regulations concentrate on any employees who have these oversight responsibilities, rather than solely on management-level employees, because management-level employees are not always the only employees undertaking efforts with respect to the written policies and operational procedures. However, regardless of where the responsible employees are located, the written policies and operational procedures must be adequate within the meaning of the final regulations. *See* § 1.892-5(a)(2)(ii)(B). Further, the responsible employees must in all cases undertake reasonable efforts (meaning exercising ordinary business care and prudence) in light of all facts and circumstances to establish, follow, and enforce the written policies and operational procedures.

Comments also requested with respect to the "reasonable efforts" requirement that reasonable reliance on competent tax advisors should constitute a reasonable effort to avoid conducting commercial activity, even if the advice is incorrect in hindsight. Other comments recommended creating a safe harbor under which an entity would be treated as having undertaken reasonable efforts if it had relied on tax advice that is a reasoned opinion rendered based on pertinent information and before the undertaking of the commercial activity.

The Treasury Department and the IRS have determined that an entity's failure to avoid commercial activity will not be treated as reasonable solely on the basis of obtaining a tax opinion or legal advice. Obtaining a tax opinion or legal advice alone does not supersede the need for employees of the entity claiming the inadvertent commercial activity exception (or employees of a controlling entity within the meaning of § 1.892-5(a)(1)) to take reasonable efforts to establish, follow, and enforce the applicable written policies and operational procedures to prevent the applicable entity from engaging in commercial activity. Accordingly, the final regulations do not adopt this comment with respect to proposed § 1.892-5(a)(2)(ii)(B).

2. Inadvertent Commercial Activity Safe Harbor

The 2011 proposed regulations would provide a safe harbor under which, if there are adequate written policies and operational procedures in place, the entity's failure to avoid the conduct of commercial activity during a taxable year will be considered reasonable if it satisfies the following two conditions: (1) the value of the assets used in, or held for use in, all commercial activity does not exceed five percent of the total value of the assets reflected on the entity's balance sheet for the taxable year as prepared for financial accounting purposes, and (2) the income earned by the entity from commercial activity does not exceed five percent of the entity's gross income as reflected on its income statement for the taxable year as prepared for financial accounting purposes. Proposed § 1.892-5(a)(2)(ii)(C).

Numerous comments recommended that the final regulations provide additional information about the meaning of "prepared for financial accounting purposes." Because foreign government entities are not publicly traded and are not domestic entities, they are not required to prepare financial statements under U.S. GAAP. Therefore, comments recommended that the final regulations provide that financial statements maintained under IFRS or an entity's local accounting rules or, if the entity does not prepare separate financial statements, books and records maintained in the ordinary course of its operations or for purposes of monitoring its investments will qualify for use under this safe harbor. A comment observed that many entities that own financial assets are required to use, or do use, mark-to-market accounting which, in the case of the income test, may distort an entity's eligibility for the safe harbor. The same comment also requested guidance regarding when both the income and assets limits are to be calculated and using what convention (for example, average of the quarter-end or month-end).

The Treasury Department and the IRS have determined that the safe harbor must be applied using an applicable financial statement as defined in section 451(b)(3) and § 1.451-3(a), which may include a financial statement prepared in U.S. GAAP, IFRS, or another method required under applicable regulatory accounting rules. The final regulations provide that if the entity does not prepare financial statements for financial accounting or regulatory reporting purposes, the entity may use books of account or records that are adequate and sufficient to establish the respective amount. The final regulations also provide that the determination of asset values for purposes of the safe harbor is made using the average of amounts as of the close of each quarter of the taxable year and the determination of income is made as of the end of the taxable year. Whether mark-to-market accounting is required with respect to financial assets will depend upon the method used by the applicable financial statement. The quarterly averaging method is unnecessary for the income portion of the safe harbor because income (in contrast to assets) is measured over a period rather than as of specific dates.

A comment recommended that the final regulations increase the safe harbor thresholds to ten percent (from five percent) to alleviate challenges with obtaining necessary information about Federal entity classification status of foreign investments. Another comment recommended that only asset values be used for the safe harbor. The comment also recommended that where an entity holds an interest as a limited partner under proposed § 1.892-5(d)(5)(iii), the value of that interest be included in the entity's calculation of its total assets, but not included in the value of its commercial activity assets.

The Treasury Department and the IRS have determined that an analysis of both the entity's income and assets and a five percent threshold are reasonable and appropriate for a safe harbor that relates to inadvertent commercial activity. The five percent threshold for this purpose is used to substantiate that the commercial activity is inadvertent, rather than permitting a de minimis rule that ignores any evidence of the commercial activity being inadvertent, such as, for example, having in place adequate written policies and operational procedures. Therefore, the final regulations do not adopt the comment to increase the safe harbor thresholds or to limit the safe harbor measurements to assets only. The Treasury Department and the IRS do agree with the comment on the treatment of qualified partnership interests in the safe harbor asset test. The final regulations provide that the commercial activity asset of a qualified partnership interest that is described in § 1.892-5(d)(5)(iii) is not

included as an asset used in commercial activity of the tested entity for purposes of this safe harbor, but the value of the qualified partnership interest is included in the entity's calculation of its total assets for that purpose. *See* § 1.892-5(a)(2)(ii)(A) and (a)(2)(ii)(C)*(2)*. Furthermore, the final regulations provide that a tested entity's distributive share of commercial activity income from a qualified partnership interest that is described in § 1.892-5(d)(5)(iii) is not included as income earned by the entity from commercial activity for purposes of this safe harbor, but is included in the entity's gross income for that purpose and treated as commercial activity income for all other purposes of section 892. *Id*.

3. Cure Requirement

The second requirement to qualify for the inadvertent commercial activity exception is that the commercial activity must be promptly cured as described in proposed § 1.892-5(a)(2)(iii). A cure is considered prompt under proposed § 1.892-5(a)(2)(i)(B) if the entity engaging in inadvertent commercial activity discontinues the activity within 120 days of discovering it. *See* proposed § 1.892-5(a)(2)(iii). The third requirement is that adequate records of each discovered commercial activity and the remedial action taken to cure that activity must be maintained. The records must be retained so long as the contents thereof may become material in the administration of section 892. *See* proposed § 1.892-5(a)(2)(iv).

The proposed rule would provide, as an example, that if an entity holding an interest as a general partner in a partnership discovers that the partnership is conducting commercial activity, the entity will satisfy the cure requirement if, within 120 days of the discovery of the commercial activity, the entity discontinues the activity by divesting itself of its partnership interest (including by transferring its interest in the partnership to a related entity) or the partnership itself discontinues its conduct of commercial activity.

Comments recommended that the final regulations provide a period that is greater than 120 days from the date of discovery for an entity to cure the inadvertent commercial activity. One comment recommended a six-month (or 180 days) cure period, and another comment requested that the cure period be the greater of 120 days or the length of the notice and exit terms to which the entity is contractually bound under the relevant governing document of the investment, plus 45 days to initiate the process of notice and exit. Another comment asserted that a period longer than 120 days is required because of the time needed to craft a legal plan effecting the discontinuance of the commercial activity and, in some cases, to obtain required governmental or third-party approvals. Yet another comment recommended tolling the curing period until the commercial activity is discovered by an officer or employee of the entity who is reasonably expected to be aware of the significance of the activity.

The Treasury Department and the IRS have determined that a period greater than 120 days to cure the inadvertent commercial activity is reasonable and appropriate to accommodate foreign legal and commercial or contractual considerations. The final regulations extend the cure period to 180 days from the date of the discovery by the employees who are responsible for monitoring and reviewing the entity's commercial activity pursuant to § 1.892-5(a)(2)(ii)(B) (the rule providing responsible employees undertake reasonable efforts to establish, follow, and enforce the adequate written policies and operational procedures). However, the final regulations do not adopt the other comments because adopting them would provide an entity the ability to select its own cure period based on contractual terms or by disputing whether an officer or employee of the entity was reasonably expected to have been aware of the significance of the activity.

Comments requested that the final regulations provide that an entity that is engaged in commercial activity solely by attribution through its interest in a partnership may cure inadvertent commercial activity by exchanging (including by amending the terms of) its partnership interest for one that qualifies for the exception under proposed § 1.892-5(d)(5)(iii) (the qualified partnership interest exception). The final regulations provide that an entity may, depending on the facts and circumstances, be able to satisfy the cure requirement by exchanging its partnership interest for one that is a qualified partnership interest within the meaning of § 1.892-5(d)(5)(iii) in the same partnership (including a deemed exchange from an agreed modification of terms). The final regulations do not adopt the comment as a bright-line rule because the Treasury Department and the IRS are concerned about the potential of abuse, such as negotiating for a partnership interest to be automatically exchanged for a different interest upon the discovery of commercial activity. Such an automatic feature also is inconsistent with the principles of satisfying the inadvertent commercial activity exception, which requires an entity's active involvement. The final regulations retain the language from proposed § 1.892-5(a)(2)(iii) that divesture by an entity of its interest in a partnership may be achieved by transferring its interest in the partnership to a related entity, such as to a related entity classified as a corporation for Federal tax purposes, so that commercial activity is not attributable to an entity that is eligible for the section 892 exemption.

Finally, a comment recommended that the final regulations use the term "promptly" in § 1.892-5(a)(2) rather than interchangeably using "promptly" and "timely." In the comment's view, the term "timely" indicates a deadline imposed by a governmental body. The final regulations do not adopt this comment, but instead replace the term "promptly" in § 1.892-5(a)(2)(i)(B) with the term "timely." Because § 1.892-5(a)(2)(i)(B) provides that the commercial activity is promptly cured as described in § 1.892-5(a)(2)(iii) which in turn describes a "timely" cure (relevant to a particular time period), it is appropriate to revise the general rule in § 1.892-5(a)(2)(i)(B) as requiring a "timely" cure.

C. *Annual CCE determination*

Proposed § 1.892-5(a)(3) would provide that, if an entity described in proposed § 1.892-5(a)(1)(i) or (ii) (relating to whether the entity is controlled by a foreign government) engages in commercial activities at any time during the taxable year, the entity will be considered a CCE for the entire taxable year. An entity not otherwise engaged in commercial activities during a taxable year will not be con-

sidered a CCE for a taxable year even if the entity engaged in commercial activities in a prior taxable year.

A comment recommended that the final regulations expressly provide that the relevant taxable year for purposes of this rule is the taxable year of the entity. Another comment requested guidance on whether an entity's commercial activity carries over to an acquiring entity in an asset reorganization or a transaction in which the transferee retains the tax attributes of the transferor under section 381.

The final regulations generally adopt the comment's recommendation that the annual determination of whether an entity is a CCE under proposed § 1.892-5(a)(3) be made with respect to the entity's taxable year, which may be less than a 12-month period if, for example, the entity's taxable year is terminated as a result of a transaction or reorganization. *See* § 1.892-5(a)(3)(i). If the taxable year of a corporation engaged in commercial activity is terminated as a result of an acquisition to which section 381(a) applies (except for a complete liquidation under section 332(a), which acquisition would fall within the exception to this general rule as described below), the acquiring corporation generally does not succeed to the commercial activity of the distributor or transferor corporation for the acquiring corporation's applicable taxable year, provided that after the acquisition, the acquiring corporation is not the entity that directly carries on such commercial activity. *See* § 1.892-5(a)(3)(ii)(A). This condition might be met in the case of reorganizations followed by transfers described in § 1.368-2(k). However, if the corporation engages in an acquisition to which section 381(a) applies with another corporation controlled by the same foreign sovereign under § 1.892-5(a)(1), for example, in a complete liquidation of a subsidiary under section 332(a), then the distributor or transferor corporation's commercial activity will cause the acquiring corporation to be treated as a CCE for the acquiring corporation's taxable year in which the acquisition occurred. *See* § 1.892-5(a)(3)(ii)(B).

As a result of adopting the taxable year as the relevant measurement period for the annual CCE test, it is possible without further safeguards that activity in one taxable year, considered in isolation, might not be characterized as commercial, even though it is part of a course of conduct or transaction spanning two taxable years which, taken as a whole, is characterized as commercial activity. For example, consider a controlled entity whose taxable year is the calendar year and conducts activity in December of year 1 that relates to a transaction the controlled entity enters into in January of year 2. Without any additional guardrails to the annual CCE test, if the January transaction in isolation is not considered commercial activity, and no commercial activities were otherwise performed by the controlled entity in year 2, the controlled entity would not be treated as a CCE in year 2, even if the activities in December of year 1 and January of year 2 constitute commercial activities when considered together. To address this scenario, the final regulations provide that for purposes of determining whether an entity is engaged in commercial activities during its taxable year, that entity's activities during its immediately preceding taxable year will also be taken into account to the extent relevant in characterizing the activities in the current taxable year. *See* § 1.892-5(a)(3)(i). The Treasury Department and the IRS concluded that this test should not look past the immediately preceding year for reasons of administrability, but other doctrines may still apply to activities that occur across multiple years in form and only one year in substance when making the commercial activity determination.

Another comment recommended that an entity that is a CCE under § 1.892-5T(b)(1) solely because it is a USRPHC should not be treated as a CCE for its entire taxable year if the entity ceases to be a USRPHC on any determination date under § 1.897-2(c) or through operation of the cleansing rule of section 897(c)(1)(B). The Treasury Department and the IRS have determined that an exception to proposed § 1.892-5(a)(3) in this limited situation would be inconsistent with the treatment of other types of entities that do not have the option to cleanse themselves of CCE status. Moreover, since the 2011 proposed regulations were published, the cleansing rule of section 897(c)(1)(B) generally was eliminated for regulated investment companies (RICs) and REITs and, therefore, adopting this comment would have limited effect only for domestic corporations that are not RICs or REITs. In addition, the final regulations provide that only domestic corporations are subject to the rule in § 1.892-5(b)(1)(i) that treats controlled USRPHCs as CCEs. This change to § 1.892-5(b)(1) narrows the scope of entities that are treated as CCEs, thereby partially addressing the comment's concerns. Therefore, the final regulations do not adopt this comment.

D. *Commercial activities of partnerships*

The 1988 temporary regulations generally attribute all commercial activities of a partnership to its general and limited partners except for partners of publicly traded partnerships (PTP). *See* § 1.892-5T(d)(3). Proposed § 1.892-5(d)(5)(i) of the 2011 proposed regulations generally would attribute commercial activities of an entity classified as a partnership for Federal tax purposes to its partners, subject to two exceptions, for trading activity and for limited partnership interests. *See* proposed § 1.892-5(d)(5)(ii) and (iii). The preamble to the 2011 proposed regulations explained that the limited partnership interest exception under proposed § 1.892-5(d)(5)(iii) "modifies the existing exception to the partnership attribution rule for PTP interests by providing a more general exception for limited partnership interests." Comments noted that it may be necessary to amend § 1.892-5T(d)(3) and (4) to coordinate with the final regulations to the extent they preserve proposed § 1.892-5(d)(5). The final regulations withdraw § 1.892-5T(d)(3) and, in its place, adopt proposed § 1.892-5(d)(5)(i) with minor modifications. In addition, the final regulations modify § 1.892-5T(d)(4) by removing Example 4, which is obsoleted by the final regulations.

The trading activity exception under proposed § 1.892-5(d)(5)(ii) would provide that an entity not otherwise engaged in commercial activities will not be considered to be engaged in commercial activities solely because the entity is a member of a partnership (whether domestic or foreign) that effects transactions in stocks, bonds, other securities (as defined in § 1.892-3T(a)(3)), commodities (as defined in proposed § 1.892-4(e)(1)

(ii)), or financial instruments (as defined in § 1.892-3T(a)(4)) for the partnership's own account or solely because an employee of such partnership, or a broker, commission agent, custodian, or other agent, pursuant to discretionary authority granted by such partnership, effects such transactions for the account of the partnership. This exception does not apply to any member in the case of a partnership that is a dealer in stocks, bonds, other securities, commodities, or financial instruments, as determined under the principles of § 1.864-2(c)(2)(iv)*(a)*. The final regulations adopt proposed § 1.892-5(d)(5)(ii) with minor modifications.

A comment recommended that transitory ownership of a pass-through entity not result in attribution of commercial activity from that pass-through entity. The final regulations do not adopt this comment because of administrability challenges as to whether a transfer was transitory. No other comments were received with respect to the attribution of commercial activities by a partnership under proposed § 1.892-5(d)(5)(i) or the trading activity exception under proposed § 1.892-5(d)(5)(ii). Instead, comments made recommendations about the treatment under section 892 of income derived from partnerships or gain arising from the disposition of a partnership interest.

The 2011 proposed regulations would not alter the treatment of the income derived by an entity. For example, proposed § 1.892-5(d)(5)(iii)(A) would provide that, despite an entity that holds an interest as a limited partner in a limited partnership not being treated as conducting commercial activities, that entity's distributive share of partnership income will not be exempt from taxation under section 892 to the extent that the partnership derives such income from the conduct of commercial activity. With the exception of § 1.892-3(a)(4) (regarding the definition of financial instruments), the final regulations do not address the items of income that are exempt under section 892. Accordingly, recommendations about the treatment under section 892 of income derived from partnerships or gain arising from the disposition of a partnership interest are outside the scope of the final regulations and are not adopted.

E. *Qualified partnership interest exception*

The 2011 proposed regulations would provide for a limited partnership interest exception in which an entity that is not otherwise engaged in commercial activities (including, for example, performing services for a partnership as described in section 707(a) or section 707(c)) will not be deemed to be engaged in commercial activities solely because it holds an interest as a limited partner in a limited partnership. Proposed § 1.892-5(d)(5)(iii)(A). The 2011 proposed regulations also would provide that a foreign government member's distributive share of partnership income will not be exempt from taxation under section 892 to the extent that the partnership derived such income from the conduct of commercial activity.

For this purpose, an interest in an entity classified as a partnership for Federal tax purposes would be treated as an interest as a limited partner in a limited partnership if the holder does not have rights to participate in the management and conduct of the partnership's business at any time during the partnership's taxable year under the law of the jurisdiction in which the partnership is organized or under the governing agreement. *See* proposed § 1.892-5(d)(5)(iii)(B). The 2011 proposed regulations would provide that rights to participate in the management and conduct of a partnership's business do not include consent rights in the case of extraordinary events such as admission or expulsion of a general or limited partner, amendment of the partnership agreement, dissolution of the partnership, disposition of all or substantially all of the partnership's property outside of the ordinary course of the partnership's activities, merger, or conversion. *Id.*

1. Tax Classification as a Partnership

Comments recommended that the final regulations confirm that § 1.892-5(d)(5)(iii) does not apply solely to limited partnerships under State or local law. To this end, the comments recommended replacing the phrase "interest as a limited partner in a limited partnership" with "a passive investment in a partnership or other flow-through entity" or expressly providing that interests as a limited partner in limited liability companies and other vehicles not taking the form of State law partnerships can qualify under § 1.892-5(d)(5)(iii).

The Treasury Department and the IRS are of the view that the 2011 proposed regulations already would provide that a qualifying partnership interest can include certain interests other than interests in a State law limited partnership. By providing that "an interest in an entity classified as a partnership for Federal tax purposes is treated as an interest as a limited partner in a limited partnership," the 2011 proposed regulations were not confining the scope of the exception to State law partnerships. Thus, for example, an interest in a limited liability company that is classified as a partnership for Federal tax purposes may qualify under proposed § 1.892-5(d)(5)(iii) if the other requirements are satisfied. To make this clearer, the final regulations adopt the term "qualified partnership interest" rather than "interest as a limited partner in a limited partnership." No inference is intended by this change as to the meaning of the phrase "limited partner" in other Code sections or Treasury regulations.

Because the qualified partnership interest exception applies to more than only State law partnerships, the Treasury Department and the IRS determined that the qualified partnership interest exception should set forth uniform requirements applicable to all relevant juridical forms to which the qualified partnership interest exception may apply. Accordingly, the final regulations contain requirements that a holder of a qualified partnership interest must not (1) have personal liability for claims against the partnership; or (2) have the right to enter into contracts or act on behalf of the partnership. These requirements are generally consistent with the rights of a limited partner under relevant State law, but apply regardless of the legal form of the entity or the governing law.

Further, the Treasury Department and the IRS agree with the comment that the qualified partnership interest exception should be available only for passive investments in partnerships. To that end, in addition to the two requirements provided in the previous paragraph, the qualified partnership interest exception retains the requirement that the holder of the partnership interest must not have

rights to participate in the management and conduct of the partnership's business and adopts a requirement that the holder must not control the partnership within the meaning of § 1.892-5(a)(1). The Treasury Department and the IRS have determined that these four requirements are necessary and appropriate guardrails to help ensure that the qualified partnership interest exception is available only to partnership equity interest holders with passive participation in the partnership. Accordingly, the final regulations do not adopt a separate comment suggesting that a greater than 50 percent economic interest (which would constitute a controlling interest in an entity under § 1.892-5(a)(1)(iii)(A)) in a partnership could be a qualified partnership interest.

2. Rights to Participate in the Management and Conduct of a Partnership's Business

With respect to the requirement under the qualified partnership interest exception that the holder does not have rights to participate in the management and conduct of the partnership's business, comments recommended that the final regulations provide greater specificity on exactly which rights satisfy the definition. For example, a comment recommended that the final regulations adopt a standard under which general oversight rights, consultation rights, and veto rights are treated as consistent with holding an interest as a limited partner under proposed § 1.892-5(d)(5)(iii)(B) because these rights serve the purpose of allowing the investor to monitor and protect its investment and do not convey control over the partnership's day-to-day operations. Another comment recommended that the final regulations provide that consent rights customarily granted to a significant lender, such as approval of a borrowing entity's annual budget, major transactions and expenses, and other similar items be permitted under § 1.892-5(d)(5)(iii)(B). Other comments recommended that the final regulations provide that investor rights typically granted by side letters, including certain veto rights and consent rights with respect to key decisions and extraordinary events outside of a partnership's day-to-day management, are consistent with holding an interest as a limited partner. Comments also recommended that the final regulations provide that holding an interest as a limited partner can include participating on a partnership's investment advisory committee or holding a minority position on a partnership's governing committee because these roles are consistent with being a passive investor by providing investors with consent rights normally afforded to minority investors for the purpose of monitoring and protecting their investments.

These comments generally suggested that participation in the management and conduct of a partnership's business refers to participation in the day-to-day management or operation of the partnership's business and does not include participation in activities relating to monitoring and protecting the partnership interest holder's capital investment. The Treasury Department and the IRS agree, and the final regulations clarify that rights to participate in the management and conduct of a partnership's business mean rights to participate in the day-to-day management or operation of the partnership's business. The final regulations also provide that rights to participate in monitoring or protecting the partnership interest holder's capital investment in the partnership do not constitute rights to participate in the management and conduct of the partnership's business, to the extent such rights are not rights to participate in the day-to-day management or operation of the partnership's business and do not result in effective control under § 1.892-5(a)(1)(iii)(B).

Due to the highly fact-intensive nature of determining whether rights to participate in the management and conduct of a partnership's business exist, the final regulations do not provide an exclusive list of rights that would (or would not) be consistent with participating in the management and conduct of a partnership's business. Instead, the Treasury Department and the IRS have determined that this analysis should be based on a holistic review taking into account all the facts and circumstances. The final regulations do specify, however, that participation in the management and conduct of a partnership's business includes the right to participate in ordinary-course personnel and compensation decisions, and the right to take active roles in formulating the business strategy for the partnership. The final regulations also specify that rights to monitor or protect capital investment in the partnership may include oversight or supervisory rights in the case of major strategic decisions, such as admission or expulsion of a partner, amendment of the partnership agreement, or dissolution of the partnership, unusual and non-ordinary course deviations from previously determined investment parameters, extending the term of the partnership's governing agreement, merger or conversion of the partnership, or disposition of all or substantially all of the partnership's property outside of the ordinary course of the partnership's activities. Facts and circumstances pertaining to the analysis of participation in the management and conduct of a partnership's business may be identified by reference to, for example, the conduct of the relevant parties, the law of the jurisdiction in which the partnership is organized, the governing documents of the partnership, contractual agreements such as side letters, shareholders' agreements, and the partnership's agreements with creditors. *See* § 1.892-5(d)(5)(iii)(B).

Comments also recommended that the final regulations eliminate the rule that the law of the jurisdiction in which a partnership is organized determines whether a partner has rights to participate in the management and conduct of the partnership's business. These comments asserted that making this determination under this standard would be complex and burdensome. These comments, therefore, also recommended that an investor be permitted to rely on the advice of local counsel when determining whether the investor has rights exceeding those permitted under proposed § 1.892-5(d)(5)(iii)(B).

The final regulations do not adopt these comments because the Treasury Department and the IRS have determined that the relevant law of the jurisdiction in which the partnership is organized often sets forth certain default rights where rights are not expressly provided by the entity's governing documents, and that those default rights are relevant to a facts and circumstances analysis.

No inference is intended as to the meaning of the phrase "participate in the

management and conduct of the partnership's business" or similar phrases and standards in other Code sections and Treasury regulations.

3. Qualified Partnership Interest Safe Harbors

A comment recommended that the final regulations provide certainty to investors by incorporating one or more of three proposed safe harbors for determining whether the investor holds an interest as a limited partner in a limited partnership. The first safe harbor would be available to investors who have obtained legal opinions stating that the investors are, in fact, and, at law, limited partners with limited liability. The second safe harbor recommended by the comment would cover interests in widely held investment partnerships with more than ten unrelated partners. The third recommended safe harbor would cover investors who hold less than a prescribed percentage of interests in a partnership. The comment recommended taking into account all investors both in the main investment vehicle and any related parallel or alternative investment vehicles for purposes of determining whether an investor qualifies for the widely held or the de minimis safe harbors.

The final regulations adopt a safe harbor for a holder who at all times during the partnership's taxable year (1) has no personal liability for claims against the partnership; (2) has no right to enter into contracts or act on behalf of the partnership; (3) is not a managing member or managing partner, and does not hold an equivalent role under applicable law; and (4) does not directly or indirectly (under the principles of § 1.892-5(d)(5)(iii)(B)*(2)(iii)*) own more than five percent of either the partnership's capital interests or the partnership's profits interests. *See* § 1.892-5(d)(5)(iii)(C). The Treasury Department and the IRS have determined that this safe harbor would ease the compliance burden for those investors who fall within its scope. The first two requirements typically would be met by a holder treated as a limited partner under State law. As to the last two requirements, an investor with no more than five percent of a partnership's capital or profits interests and who is neither a managing member (in the case of an entity organized as a limited liability company) nor a managing partner (in the case of an entity organized as a partnership) is unlikely to control the partnership under § 1.892-5(a)(1) or have any rights to participate in the management and conduct of a partnership's business and thus can be treated as a passive investor. Although a foreign government investor, for example, that satisfies the requirements of the safe harbor is not attributed the partnership's commercial activities, the investor's distributive share of the partnership's income from the conduct of commercial activity is not exempt from taxation under section 892. *See* § 1.892-5(d)(5)(iii)(A).

4. Holding Multiple Interests in a Partnership or in Tiered Partnerships

Finally, comments made requests and recommendations regarding tiers of partnerships and attribution of the qualified partnership interest exception among classes of partnership interests. Comments recommended that the final regulations provide rules for the operation of the qualified partnership interest exception in tiered partnership structures. These comments asserted that an investor should not be deemed to participate in the management and conduct of a lower-tier partnership's business if that investor holds an interest in an upper-tier partnership that does not engage in any commercial activity and does not afford the investor any rights to participate in the management and conduct of the lower-tier partnership's business. In other words, these comments requested that the final regulations apply a "bottom-up" approach in determining whether the requirements for the qualified partnership interest exception are met.

Another comment requested that the final regulations provide guidance on whether the rights of one class of partnership interest could be attributed to another class of partnership interest when determining whether an investor, who holds multiple classes of partnership interests, satisfies the exception under proposed § 1.892-5(d)(5)(iii). The comment asserted that the qualified partnership interest exception should apply in situations where an investor, in addition to holding its interest as a limited partner in a limited partnership, also holds an interest as a limited partner in the general partner of the same limited partnership.

The final regulations adopt with modifications the comment that the qualified partnership interest exception applies from the bottom up. An upper-tier partnership that holds a qualified partnership interest in a lower-tier partnership is not attributed the lower-tier partnership's commercial activities. If, however, the upper-tier partnership's interest in a lower-tier partnership is not a qualified partnership interest, the lower-tier partnership's commercial activity will be attributed to the upper-tier partnership and could, in turn, be further attributed to a foreign government investor holding an interest in the upper-tier partnership unless the investor holds a qualified partnership interest in the upper-tier partnership. *See* § 1.892-5(d)(5)(iii)(D).

The rules in § 1.892-5(d)(5)(iii)(D) applicable to tiered partnerships may provide relief in certain circumstances if, in addition to holding directly a qualified partnership interest in a lower-tier partnership, the foreign government investor holds a qualified partnership interest in the entity that is a general partner of the lower-tier partnership and does not have rights to participate in the management and conduct of the general partner's business in managing the lower-tier partnership.

With respect to holding multiple classes of interests in the same partnership, the final regulations provide that all interests held in a partnership by an investor are evaluated in their totality to determine whether the investor has rights to participate in the management and conduct of that partnership's business. *See* § 1.892-5(d)(5)(iii)(B)*(2)(i).* Thus, the final regulations do not adopt the approach that the qualified partnership interest exception ignores other interests held by an investor in the same partnership.

The final regulations also provide that where a foreign sovereign holds directly or indirectly multiple interests in a partnership through one or more integral parts or controlled entities as defined in § 1.892-2T, or controlled subsidiaries under § 1.892-5(a)(1), all of these entities' interests in the partnership are aggregated for purposes of the qualified partnership interest exception. To the extent any one entity's interest or all of

the interests aggregated together fails to satisfy the qualified partnership interest exception, then none of the entities would qualify for the qualified partnership interest exception. *See* § 1.892-5(d)(5)(iii)(B)*(2)(iii)*.

F. *Other comments and revisions*

In addition to the comments and revisions described in parts II and III of this Summary of Comments and Explanation of Revisions, the final regulations include several drafting changes. The final regulations revise the structure of the provisions of the 2011 proposed regulations to be consistent with the structure of the 1988 temporary regulations. In doing so, the final regulations change the placement of rules under § 1.892-4(c).

There were numerous comments that were outside the scope of the final regulations and, therefore, are not adopted by the final regulations. Several comments recommended that § 301.7701-2(b)(6) (treating a business entity wholly owned by a foreign government as a per se corporation) be modified so that a business entity that is wholly owned by a foreign government is not precluded from electing to be disregarded as an entity separate from its owner. Another comment requested guidance on whether incentive compensation arrangements for investment advisors, brokers, or employees would cause an entity to fail the requirement under § 1.892-2T(a)(3)(iii) (requiring that net earnings of the entity be credited to its own account or to other accounts of the foreign sovereign, with no portion of the entity's income inuring to the benefit of any private person) to be a controlled entity. The comment also requested guidance on whether an entity established under a statute with a separate legal personality can be an "integral part" of a foreign sovereign under § 1.892-2T(a). Finally, a comment recommended modifying § 1.882-5(a)(6) to remove the limitation on a foreign government's ability to deduct its allocable interest expense. The final regulations do not adopt these comments because they are outside the scope of the final regulations. However, the final regulations modify § 1.882-5(a)(6) to update the cross-reference to § 1.892-5.

IV. *Applicability Dates*

The 2011 proposed regulations were proposed to apply on the date the final regulations are published in the **Federal Register**. *See* proposed §§ 1.892-4(f) and 1.892-5(e). The preamble to the 2011 proposed regulations provided that taxpayers may rely on the 2011 proposed regulations until final regulations are issued. The 2022 proposed regulations were proposed to apply to taxable years ending on or after December 28, 2022. *See* proposed § 1.892-5(b)(1)(iii). The preamble to the 2022 proposed regulations provided that taxpayers may rely on the 2022 proposed regulations until the date of publication of the final regulations in the **Federal Register**. The rules under §§ 1.892-4T and 1.892-5T are effective for taxable years beginning after June 30, 1986, until, and only to the extent that, they are replaced by these final regulations.

The Treasury Department and the IRS have determined that the applicability date of the 2025 final regulations should be consistent with the 2011 proposed regulations and generally apply to taxable years beginning on or after the date the regulations become finalized in the **Federal Register**. A comment recommended that when the 2011 proposed regulations are finalized, taxpayers be permitted to apply the provisions of the final regulations to all open taxable years. The Treasury Department and the IRS agree that taxpayers should be permitted to apply the rules of the 2025 final regulations, once finalized, to their open taxable years subject to consistency requirements. Accordingly, except in the case of § 1.892-3(a)(6) and the second sentence of § 1.892-5(a)(1) (rules finalized in prior regulations), the final regulations provide that a taxpayer may choose to apply the 2025 final regulations to a taxable year beginning before December 15, 2025 (finalization date) if the period of limitations on assessment of the taxable year is open under section 6501 and the taxpayer and entities that are related (within the meaning of section 267(b) or section 707(b)) to the taxpayer consistently apply the rules of 2025 final regulations in their entirety to the taxable year and all succeeding taxable years beginning before the finalization date.

Another comment recommended that taxpayers who have structured investments in reliance on the 2011 proposed regulations be given a transition period to undertake any necessary restructuring if the final regulations are different from the 2011 proposed regulations. The final regulations do not adopt this comment. The Treasury Department and the IRS have determined that the provisions of the final regulations are consistent with the 2011 proposed regulations and the differences do not require a transition period. A separate notice of proposed rulemaking is published in this issue of the **Federal Register** which contains proposed changes and modifications that are materially different from the 2011 proposed regulations.

Special Analyses

I. *Regulatory Planning and Review – Economic Analysis*

These final regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (July 4, 2025) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations.

II. *Paperwork Reduction Act*

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) (PRA) generally requires that a Federal agency obtain the approval of the OMB before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collection of information in these final regulations contains recordkeeping requirements. The recordkeeping requirements are necessary for the IRS to validate if certain entities have met the regulatory requirements and are entitled to the inadvertent commercial activity exception under section 892. No public comments received by the IRS were directed at the recordkeeping requirements. The recordkeeping requirements in § 1.892-

5(a)(2)(ii)(B) and § 1.892-5(a)(2)(iv) are approved by OMB under Control Number 1545-2239.

III. *Regulatory Flexibility Act*

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act. This certification is based on the fact that the final regulations affect foreign governments, including their controlled entities, with income from sources within the United States. Accordingly, the entities affected by the final regulations are not considered small entities, and a regulatory flexibility analysis under the Regulatory Flexibility Act is not required.

IV. *Section 7805(f)*

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business. No comments on that notice of proposed rulemaking were received from the Chief Counsel for the Office of Advocacy of the Small Business Administration.

V. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. These final regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

VI. *Executive Order 13132: Federalism*

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. These final regulations do not have federalism implications and do not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

Statement of Availability of IRS Documents

IRS guidance cited in this preamble is published in the Internal Revenue Bulletin and is available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *https://www.irs.gov*.

Drafting Information

The principal authors of the final regulations are Jack Zhou of the Office of Associate Chief Counsel (International), and Joel Deuth, formerly of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, the Treasury Department and the IRS amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries for §§ 1.892-3 and 1.892-4 in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Section 1.892-3 also issued under 26 U.S.C. 892(c).

* * * * *

Section 1.892-4 also issued under 26 U.S.C. 892(c).

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Par. 2. Section 1.882-5 is amended by revising paragraph (a)(6) to read as follows:

§ 1.882-5 Determination of interest deduction.

(a) * * *

(6) *Special rule for foreign governments*. The amount of interest expense of a foreign government, as defined in § 1.892-2T(a), that is allocable to ECI is the total amount of interest paid or accrued within the taxable year by the United States trade or business on U.S. booked liabilities (as defined in paragraph (d)(2) of this section). Interest expense of a foreign government, however, is not allocable to ECI to the extent that it is incurred with respect to U.S. booked liabilities that exceed 80 percent of the total value of U.S. assets for the taxable year (determined under paragraph (b) of this section). This paragraph (a)(6) does not apply to controlled commercial entities within the meaning of § 1.892-5.

* * * * *

Par. 3. Section 1.892-3 is revised to read as follows:

§ 1.892-3 Income of foreign governments.

(a) *Types of income exempt*—(1) *In general*. For further guidance, *see* § 1.892-3T(a)(1).

(2) *Income from investments*. For further guidance, *see* § 1.892-3T(a)(2).

(3) *Securities*. For further guidance, *see* § 1.892-3T(a)(3).

(4) *Financial instrument*—(i) *Definition*. For purposes of this paragraph (a), the term *financial instrument* includes:

(A) Any interest rate, currency, equity, or commodity (as the term is used in section 864(b)(2)(B) and § 1.864-2(d)) notional principal contract (as the term is used in section 475(c)(2)); or

(B) Any evidence of an interest in options, forward or futures contracts, and any other similar contracts, the value of which, or any payment or other transfer

with respect to which, is (directly or indirectly) determined by reference to one or more of the following:

(*1*) Commodity (as the term is used in section 864(b)(2)(B) and § 1.864-2(d));

(*2*) Currency;

(*3*) Share of stock;

(*4*) Partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust;

(*5*) Note, bond, debenture, or other evidence of indebtedness; or

(*6*) Notional principal contract described in paragraph (a)(4)(i)(A) of this section.

(ii) *Special rule*. For purposes of paragraph (a)(4)(i) of this section, nonfunctional currency or gold is a financial instrument when physically held by a foreign central bank of issue (as defined in § 1.895-1(b)).

(5) *Execution of financial or monetary policy*. For further guidance, *see* § 1.892-3T(a)(5).

(6) *Dividend equivalents.* Income from investments in stocks includes the payment of a dividend equivalent described in section 871(m) and the regulations in this part under section 871(m).

(b) *Illustrations*. For further guidance, *see* § 1.892-3T(b).

(c) *Applicability dates*. (1) Paragraph (a)(4) of this section applies to taxable years beginning on or after December 15, 2025. *See* § 1.892-3T(a)(4), as contained in 26 CFR in part 1 in effect on April 1, 2025, for the rules that apply to taxable years beginning before December 15, 2025. A taxpayer may choose to apply paragraph (a)(4) of this section to a taxable year beginning before December 15, 2025, if the period of limitations on assessment of the taxable year is open under section 6501 and the taxpayer and entities that are related (within the meaning of section 267(b) or section 707(b)) to the taxpayer apply this rule and §§ 1.892-4 and 1.892-5 in their entirety to the taxable year and all succeeding taxable years beginning before December 15, 2025.

(2) Paragraph (a)(6) of this section applies to payments made on or after December 5, 2013.

Par. 4. Section 1.892-3T is amended by revising paragraph (a)(4) to read as follows:

§ 1.892-3T Income of foreign governments (temporary regulations).

(a) * * *

(4) *Financial instrument*. For further guidance, *see* § 1.892-3(a)(4).

* * * * *

Par. 5. Section 1.892-4 is added to read as follows:

§ 1.892-4 Commercial activities.

(a) *Purpose*. The exemption generally applicable to a foreign government (as defined in § 1.892-2T) for income described in §§ 1.892-3T and 1.892-3 does not apply to income derived from the conduct of commercial activity (whether within or outside the United States), income received by a controlled commercial entity or received (directly or indirectly) from a controlled commercial entity, or income derived from the disposition of any interest in a controlled commercial entity. This section provides rules for determining whether income is derived from the conduct of commercial activity. The rules in this section also apply in determining under §§ 1.892-5T and 1.892-5 whether an entity is a controlled commercial entity.

(b) *In general*. Except as provided in paragraph (c) of this section, all activities (whether conducted within or outside the United States) that are ordinarily conducted for the current or future production of income or gain are commercial activities. Only the nature of the activity, not the purpose or motivation for conducting the activity, is determinative of whether the activity is commercial in character. For purposes of this paragraph (b), activities that constitute a trade or business for purposes of section 162 or constitute (or would constitute if undertaken in the United States) a trade or business in the United States for purposes of section 864(b) are commercial activities except as otherwise provided in paragraph (c) of this section.

(c) *Activities that are not commercial*—(1) *Investments*—(i) *In general*. Subject to the provisions of this paragraph (c), the following are not commercial activities: investments in stocks, bonds, and other securities (as defined in § 1.892-3T(a)(3)); loans; investments in financial instruments (as defined in § 1.892-3(a)(4)); the holding of partnership equity interests; the holding of net leases on real property; the holding of real property which is not producing income (other than on its sale or from an investment in net leases on real property); and the holding of deposits in any currency in banks. Transferring securities under a loan agreement which meets the requirements of section 1058 is an investment for purposes of this paragraph (c)(1)(i). An activity will not cease to be an investment solely because of the volume of transactions of that activity or because of other unrelated activities.

(ii) [Reserved]

(iii) *Banking, financing, etc*. For further guidance, *see* § 1.892-4T(c)(1)(iii).

(2) *Trading.* Effecting transactions in stocks, bonds, other securities (as defined in § 1.892-3T(a)(3)), partnership equity interests, commodities, or financial instruments (as defined in § 1.892-3(a)(4)) for a foreign government's own account does not constitute commercial activity. Such transactions are not commercial activities regardless of whether they are effected by the foreign government through its employees or through a broker, commission agent, custodian, or other independent agent and regardless of whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. Such transactions undertaken as a dealer (as determined under the principles of § 1.864-2(c)(2)(iv)(*a*)), however, constitute commercial activity. For purposes of this paragraph (c)(2), the term *commodities* means commodities of a kind customarily dealt in on an organized commodity exchange but only if the transaction is of a kind customarily consummated at such place.

(3) *Disposition of a U.S. real property interest*. A disposition (including a deemed disposition under section 897(h)(1)) of a U.S. real property interest (as defined in section 897(c)), by itself, does not constitute the conduct of commercial activity. As described in § 1.892-3T(a), however, gain derived from a disposition of a U.S. real property interest defined in section 897(c)(1)(A)(i) will not qualify for exemption from tax under section 892.

(4) *Cultural events*. For further guidance, *see* § 1.892-4T(c)(2).

(5) *Non-profit activities*. For further guidance, *see* § 1.892-4T(c)(3).

(6) *Governmental functions*. For further guidance, *see* § 1.892-4T(c)(4).

(7) *Purchasing*. For further guidance, *see* § 1.892-4T(c)(5).

(d) *Applicability date.* Except as otherwise provided in this paragraph (d), this section applies to taxable years beginning on or after December 15, 2025. *See* § 1.892-4T, as contained in 26 CFR in part 1 in effect on April 1, 2025, for the rules that apply to taxable years beginning before December 15, 2025. A taxpayer may choose to apply this section to a taxable year beginning before December 15, 2025, if the period of limitations on assessment of the taxable year is open under section 6501 and the taxpayer and entities that are related (within the meaning of section 267(b) or section 707(b)) to the taxpayer apply this section and §§ 1.892-3(a)(4) and 1.892-5 in their entirety to the taxable year and all succeeding taxable years beginning December 15, 2025.

Par. 6. Section 1.892-4T is amended by revising paragraphs (a), (b), and (c)(1)(i) and (ii) to read as follows:

§ 1.892-4T Commercial activities (temporary regulations).

(a) *Purpose*. For further guidance, *see* § 1.892-4(a).

(b) *In general*. For further guidance, *see* § 1.892-4(b).

(c) * * *

(1) * * *

(i) *In general*. For further guidance, *see* § 1.892-4(c)(1)(i).

(ii) *Trading*. For further guidance, *see* § 1.892-4(c)(2).

* * * * *

Par. 7. Section 1.892-5 is revised to read as follows:

§ 1.892-5 Controlled commercial entity.

(a) *In general*—(1) *General rule and definition of the term controlled commercial entity*. (i) Under section 892(a)(2)(A)(ii) and (iii), the exemption generally applicable to a foreign government (as defined in § 1.892-2T) for income described in §§ 1.892-3T and 1.892-3 does not apply to income received by a controlled commercial entity or received (directly or indirectly) from a controlled commercial entity, or to income derived from the disposition of any interest in a controlled commercial entity.

(ii) For purposes of section 892(a)(2)(B) and this section, the term *entity* includes a corporation, a partnership, a trust (including a pension trust described in § 1.892-2T(c)), and an estate.

(iii) The term *controlled commercial entity* means any entity (including a controlled entity as defined in § 1.892-2T(a)(3)) engaged in commercial activities (as defined in §§ 1.892-4T and 1.892-4) (whether conducted within or outside the United States) if the foreign government—

(A) Holds (directly or indirectly) any interest in such entity which (by value or voting power) is 50 percent or more of the total of such interests in such entity; or

(B) Holds (directly or indirectly) any other interest in such entity which provides the foreign government with effective control of such entity.

(2) *Inadvertent commercial activity*—(i) *General rule*. For purposes of section 892(a)(2)(B) and paragraph (a)(1) of this section, a tested entity that conducts, including by attribution, only inadvertent commercial activity will not be considered to be engaged in commercial activities. However, any income derived from any foreign government's inadvertent commercial activity (including activity attributed from a partnership) will not qualify for exemption from tax under section 892. Commercial activity of a tested entity will be treated as inadvertent commercial activity only if:

(A) Failure to avoid conducting the commercial activity is reasonable as described in paragraph (a)(2)(ii) of this section;

(B) The commercial activity is timely cured as described in paragraph (a)(2)(iii) of this section; and

(C) The record maintenance requirements described in paragraph (a)(2)(iv) of this section are met.

(ii) *Reasonable failure to avoid commercial activity*—(A) *In general.* Subject to paragraphs (a)(2)(ii)(B) and (C) of this section, whether a tested entity's failure to prevent its worldwide activities from resulting in commercial activity is reasonable will be determined based on all the facts and circumstances. Due regard will be given to the number of commercial activities conducted during the taxable year and the activities in the immediately preceding taxable year to the extent relevant in characterizing the activities in the current taxable year, as well as the amount of income earned from, and assets used in, the conduct of the commercial activities in relationship to the tested entity's total income and assets. For purposes of this paragraph (a)(2)(ii)(A) and paragraph (a)(2)(ii)(C) of this section, where commercial activity conducted by a partnership is attributed under paragraph (d)(5)(i) of this section to a tested entity owning an interest in the partnership—

(*1*) Assets used in the conduct of the commercial activity by the partnership are treated as assets used in the conduct of commercial activity by the entity in proportion to the tested entity's interest in the partnership; and

(*2*) The tested entity's distributive share of the partnership's income from the conduct of the commercial activity is treated as income earned by the tested entity from the conduct of commercial activities.

(B) *Continuing due diligence requirement*. A failure to avoid commercial activity will not be considered reasonable unless there is continuing due diligence to prevent the tested entity from engaging in commercial activities within or outside the United States as evidenced by having adequate written policies and operational procedures, within the meaning of this paragraph (a)(2)(ii)(B), in place to monitor the tested entity's worldwide activities. A failure to avoid commercial activity will not be considered reasonable if responsible employees have not undertaken reasonable efforts, based on all facts and circumstances, to establish, follow, and enforce such written policies and operational procedures with respect to the tested entity. For purposes of this paragraph (a)(2)(ii)(B), all facts and circumstances are considered in the determination of whether written policies and operational procedures are considered adequate, including whether the written policies and operational procedures:

(*1*) Prohibit the tested entity from engaging in commercial activities both directly and through investments in entities whose commercial activities would

be attributed to the tested entity within the meaning of this section;

(*2*) Are communicated in writing to all persons who exercise discretionary authority, acting alone or as part of a decisional body, to cause the tested entity to undertake an investment;

(*3*) Require an advance determination, by receipt of an opinion of counsel or otherwise, as to whether an investment is commercial activity;

(*4*) Include an annual internal or external audit or review of direct investments and investments in entities whose commercial activities would be attributed to the tested entity within the meaning of this section; and

(*5*) Require the result of periodic tests to be reviewed and certified by responsible employees who have authority and obligation to cause the curing of any commercial activity disclosed in such procedures.

(C) *Safe Harbor*—(*1*) *In general*. Provided that adequate written policies and operational procedures are in place to monitor the tested entity's worldwide activities as required in paragraph (a)(2)(ii)(B) of this section, the tested entity's failure to avoid commercial activity during the taxable year will be considered reasonable if:

(*i*) The value of the assets used in, or held for use in, all commercial activity does not exceed five percent of the total value of the assets reflected on the tested entity's balance sheet for the taxable year, determined using the average of the value of the assets as of the close of each quarter of the taxable year, as prepared for an applicable financial statement as defined in section 451(b)(3) and § 1.451-3(a), or, if the tested entity is not required to prepare a balance sheet for an applicable financial statement, as reflected in the books of account or records that are adequate and sufficient to establish the amount; and

(*ii*) The income earned by the tested entity from commercial activity does not exceed five percent of the tested entity's gross income as reflected on its income statement for the taxable year, as prepared for an applicable financial statement as defined in section 451(b)(3) and § 1.451-3(a), or, if the tested entity is not required to prepare an income statement for an applicable financial statement, as reflected in the books of account or records that are adequate and sufficient to establish the amount.

(*2*) *Calculation of total assets and income*. For purposes of paragraph (a)(2)(ii)(C)(*1*) of this section, the amount of total assets includes the value of the tested entity's qualified partnership interests under paragraph (d)(5)(iii) of this section, and the amount of total gross income includes the tested entity's distributive share of income, including income derived from commercial activity, from partnerships in which the tested entity holds a qualified partnership interest under paragraph (d)(5)(iii) of this section.

(iii) *Cure requirement*. A timely cure is considered to have been made if the tested entity discontinues the conduct of the commercial activity within 180 days of the date of discovery of the commercial activity by responsible employees who are responsible for monitoring and reviewing the tested entity's commercial activity pursuant to paragraph (a)(2)(ii)(B) of this section. For example, if a responsible employee discovers that the partnership in which the tested entity holds an interest as a partner is conducting commercial activity, the entity will satisfy the cure requirement if, within 180 days of that person discovering the commercial activity, the tested entity discontinues the conduct of the activity by divesting itself of its interest in the partnership (including by transferring its interest in the partnership to a related entity), or the partnership discontinues its conduct of commercial activity. The tested entity may, depending on the facts and circumstances, be able to satisfy the cure requirement if, within 180 days of a responsible employee discovering the commercial activity, the tested entity exchanges its interest in the partnership for one that is a qualified partnership interest, within the meaning of paragraph (d)(5)(iii) of this section, of the same partnership (including a deemed exchange from an agreed modification of terms).

(iv) *Record maintenance*. Adequate records of each discovered commercial activity and the remedial action taken to cure that activity must be maintained. The records must be retained so long as the contents thereof may become material in the administration of section 892.

(v) *Definitions*. The following definitions apply for purposes of this paragraph (a)(2).

(A) *Tested entity*. A *tested entity* means an entity that is engaged, including by attribution under paragraph (d)(5)(i) of this section, in commercial activity without regard to paragraph (a)(2)(i) of this section.

(B) *Responsible employees*. Responsible employees may include employees of a tested entity or employees of an entity that controls (within the meaning of paragraph (a)(1) of this section) the tested entity.

(C) *Reasonable efforts*. The term *reasonable efforts* means exercising ordinary business care and prudence.

(3) *Annual determination of controlled commercial entity status*—(i) *In general*. If an entity described in paragraph (a)(1) of this section engages in commercial activities at any time during its taxable year, the entity will be considered a controlled commercial entity for its entire taxable year. An entity that is not engaged in commercial activities during its taxable year will not be considered a controlled commercial entity for its taxable year. For purposes of determining whether an entity is engaged in commercial activities during its taxable year, that entity's activities during its immediately preceding taxable year will also be taken into account to the extent relevant in characterizing the activities in the current taxable year.

(ii) *Certain corporate acquisitions*—(A) *In general*. For purposes of paragraph (a)(3)(i) of this section, if the assets of a corporation that is engaged in commercial activity in a taxable year are acquired by another corporation in an acquisition described in section 381(a), then, except as provided in paragraph (a)(3)(ii)(B) of this section, the acquiring corporation will not be treated as conducting commercial activity for the taxable year in which the acquisition occurs solely by reason of acquiring and holding the distributor or transferor corporation's assets, provided that the taxable year of the distributor or transferor corporation ends under section 381(b), and after the acquisition, the acquiring corporation is not the entity that directly continues the distributor or transferor corporation's commercial activity. If the taxable year of the distributor or

transferor corporation does not end as a result of such acquisition, the acquiring corporation will be treated as conducting commercial activity for the taxable year in which the acquisition occurs.

(B) *Exception*. If the acquisition described in paragraph (a)(3)(ii)(A) of this section to which section 381(a) applies is between corporations that are controlled by the same foreign sovereign within the meaning of paragraph (a)(1) of this section, the acquiring corporation will be treated as conducting commercial activity for the taxable year of the acquiring corporation in which such acquisition occurs regardless of whether the taxable year of the distributor or transferor corporation ends as described in section 381(b) or whether the acquiring corporation directly continues the distributor or transferor corporation's commercial activity.

(b) *Entities treated as engaged in commercial activity*—(1) *United States real property holding corporations*—(i) *General rule.* Except as provided in paragraph (b)(1)(ii) of this section, a corporation that is a United States real property holding corporation as defined in section 897(c)(2), is treated as engaged in commercial activity and, therefore, is a controlled commercial entity if the requirements of paragraph (a)(1)(iii)(A) or (B) of this section are satisfied.

(ii) *Exceptions*. Paragraph (b)(1)(i) of this section does not apply to the following—

(A) Corporations that are foreign; or

(B) A corporation that is a United States real property holding corporation, as defined in section 897(c)(2), solely by reason of its direct or indirect ownership interest in one or more other corporations that are not controlled by the foreign government (as determined under paragraph (a)(1) of this section). For this purpose, the phrase *solely by reason of its direct or indirect ownership interest in one or more other corporations that are not controlled by the foreign government (as determined under paragraph (a)(1) of this section)* means disregarding any ownership interests, held directly or indirectly, in noncontrolled corporations (as determined under paragraph (a)(1) of this section), after applying the asset test under section 897(c)(2) and § 1.897-2.

(2) *Central banks*. For further guidance, *see* § 1.892-5T(b)(2).

(3) *Pension trusts*. For further guidance, *see* § 1.892-5T(b)(3).

(c) *Control*—(1) *Attribution*. For further guidance, *see* § 1.892-5T(c)(1).

(2) *Effective control*. For further guidance, *see* § 1.892-5T(c)(2).

(d) *Related controlled entities*—(1) *Brother/sister entities*. For further guidance, *see* § 1.892-5T(d)(1).

(2) *Parent/subsidiary entities*. For further guidance, *see* § 1.892-5T(d)(2).

(3) [Reserved]

(4) *Illustrations*. For further guidance, *see* § 1.892-5T(d)(4).

(5) *Partnerships*—(i) *General rule*. Except as provided in paragraphs (d)(5)(ii) and (iii) of this section, the commercial activities of an entity classified as a partnership for Federal tax purposes are attributable to its partners for purposes of section 892. For example, if an entity described in paragraph (a)(1)(iii)(A) or (B) of this section holds an interest as a general or limited partner in a partnership that is engaged in commercial activities, except as provided in paragraphs (d)(5)(ii) and (iii) of this section, the partnership's commercial activities are attributed to that entity for purposes of determining if the entity is a controlled commercial entity within the meaning of section 892(a)(2)(B) and paragraph (a)(1) of this section.

(ii) *Trading activity exception*. An entity not otherwise engaged in commercial activities will not be considered to be engaged in commercial activities solely because the entity is a member of a partnership (whether domestic or foreign) that effects transactions in stocks, bonds, other securities (as defined in § 1.892-3T(a)(3)), partnership equity interests, commodities (as defined in § 1.892-4(c)(2)), or financial instruments (as defined in § 1.892-3(a)(4)) for the partnership's own account or solely because an employee of such partnership, or a broker, commission agent, custodian, or other agent, pursuant to discretionary authority granted by such partnership, effects such transactions for the account of the partnership. This paragraph (d)(5)(ii) does not apply to any member in the case of a partnership that is a dealer in stocks, bonds, other securities, partnership equity interests, commodities, or financial instruments, as determined under the principles of § 1.864-2(c)(2)(iv)(*a*).

(iii) *Qualified partnership interest exception*—(A) *General rule*. An entity that is not otherwise engaged in commercial activities (including, for example, performing services for a partnership as described in section 707(a) or section 707(c)) will not be deemed to be engaged in commercial activities solely because it holds a *qualified partnership interest* in a partnership, notwithstanding that the entity may be considered as being engaged in a trade or business within the United States under section 875(1). Nevertheless, pursuant to section 892(a)(2)(A)(i), a foreign government member's distributive share of partnership income will be treated as from commercial activity, and thus will not be exempt from taxation under section 892 to the extent that the partnership derived such income from the conduct of commercial activity. For example, where a controlled entity described in § 1.892-2T(a)(3) that is not otherwise engaged in commercial activities holds a qualified partnership interest in a partnership that is a dealer in stocks, bonds, other securities, partnership equity interests, commodities, or financial instruments in the United States, although the controlled entity partner will not be deemed to be engaged in commercial activities solely because of its interest in the partnership, its distributive share of partnership income derived from the partnership's activity as a dealer will not be exempt from tax under section 892 because it was derived from the conduct of commercial activity.

(B) *Qualified partnership interest*—(*1*) *In general*. Solely for purposes of paragraph (d)(5)(iii) of this section, an interest classified as equity in an entity classified as a partnership for Federal tax purposes is treated as a qualified partnership interest if the holder of such interest has limited liability within the meaning of § 301.7701-3(b)(2)(ii) of this chapter, does not possess the legal authority to bind or to act on behalf of the partnership, does not control the partnership within the meaning of paragraph (a)(1) of this section, and does not have rights to participate in the management and conduct of the partnership's business at any time during the partnership's taxable year.

(*2*) *Rights to participate in the management and conduct of a partnership's business*—(*i*) *In general*. Rights to participate in the management and conduct of a partnership's business mean rights to participate in the day-to-day management or operation of the partnership's business, including, for example, the right to participate in ordinary-course personnel and compensation decisions, or take active roles in formulating the partnership's business strategy or in respect of the partnership's acquisition or disposition of a specific investment. The existence of these rights is determined based on all facts and circumstances. In addition to the conduct of relevant parties, such determination shall consider the totality of all rights arising from all direct or indirect interests of the holder of the partnership, including rights provided under the law of the jurisdiction in which the partnership is organized, the partnership's governing documents, contractual agreements such as side letters, shareholders' agreements, and agreements with creditors of the partnership.

(*ii*) *Rights to participate in the monitoring or protection of a partner's capital investment*. Rights to participate in the management and conduct of a partnership's business generally do not include participation rights with respect to monitoring or protecting the partner's capital investment in the partnership, but only if such rights do not include rights to participate in the day-to-day management or operation of the partnership's business and do not result in effective control under paragraph (a)(1)(iii)(B) of this section. These rights may, subject to the limitations of the previous sentence, include oversight and supervision rights in the case of major strategic decisions such as: admission or expulsion of a partner; hiring or firing key strategic personnel; amendment of the partnership agreement; dissolution, merger, or conversion of the partnership; unusual and non-ordinary course deviations from previously determined investment parameters; extending the term of the partnership's governing agreement; and disposition of all or substantially all of the partnership's property outside of the ordinary course of the partnership's activities.

(*iii*) *Holding more than one interest in a partnership*. If a foreign sovereign holds directly or indirectly interests in a partnership through one or more integral parts or controlled entities (within the meaning of § 1.892-2T) or entities controlled by such foreign sovereign under paragraph (a)(1) of this section, then such interests are aggregated for purposes of this paragraph (d)(5)(iii)(B)(*2*). For example, if a controlled entity (within the meaning of § 1.892-2T) of a foreign sovereign or an entity controlled by the foreign sovereign under paragraph (a)(1) of this section holds a partnership interest that is not a qualified partnership interest, then any other equity interest held in the same partnership by any other controlled entities of the foreign sovereign is also not treated as a qualified partnership interest. Furthermore, if a foreign sovereign directly or indirectly holds more than one interest in a partnership through one or more integral parts or controlled entities (within the meaning of § 1.892-2T) or entities controlled by such foreign sovereign under paragraph (a)(1) of this section and those partnership interests in the aggregate result in a disqualification from qualified partnership interest, then each such interest in the partnership is not treated as a qualified partnership interest.

(C) *Safe harbor for de minimis interests.* For purposes of this paragraph (d)(5)(iii), a holder of an interest classified as equity in an entity classified as a partnership for Federal tax purposes is treated as holding a qualified partnership interest (within the meaning of paragraph (d)(5)(iii)(B) of this section) if the holder at all times during the partnership's taxable year:

(*1*) Has limited liability within the meaning of § 301.7701-3(b)(2)(ii) of this chapter;

(*2*) Does not possess the legal authority to bind or to act on behalf of the partnership;

(*3*) Is not the partnership's managing partner, managing member, or an equivalent role under applicable law; and

(*4*) Does not own, directly or indirectly (under the principles of paragraph (d)(5)(iii)(B)(*2*)(*iii*) of this section), more than five percent of either the partnership's capital interests or the partnership's profits interests.

(D) *Tiered partnerships*. The rules of this paragraph (d)(5)(iii) apply in cases where a partnership (lower-tier partnership) that conducts commercial activity has a partner that is a partnership (upper-tier partnership). If an upper-tier partnership holds no interest in the lower-tier partnership other than a qualified partnership interest, within the meaning of paragraph (d)(5)(iii)(B) or (C) of this section, the lower-tier partnership's commercial activity is not attributed to the upper-tier partnership. Nevertheless, the upper-tier partnership's distributive share of the lower-tier partnership's income that is derived from the conduct of commercial activity will not be exempt from tax under section 892.

(iv) *Illustration*. The following examples illustrate the application of this paragraph (d)(5):

(A) *Example 1*—(*1*) *Facts*. K is a controlled entity of a foreign sovereign under § 1.892-2T(a)(3). K holds a 20 percent equity interest in Opco, a domestic limited liability company that is classified as a partnership for Federal tax purposes. Opco owns and manages an office building that produces income from rental and advertising activities that constitute commercial activity under § 1.892-4. Under the governing agreement and the applicable law of Opco, K is not liable for the debts of or claims against Opco by reason of being a member, does not possess the legal authority to bind or act on behalf of Opco, and does not control Opco within the meaning of paragraph (a)(1) of this section. K is not the managing member of, and does not hold an equivalent role under applicable law in, Opco. Pursuant to a side letter between K and Opco, K, however, has rights to review and advise on Opco's material business contracts and business expenses.

(*2*) *Analysis*. Opco's commercial activity is attributable to K under paragraph (d)(5)(i) of this section unless K's interest in Opco is a qualified partnership interest. K's interest in Opco does not satisfy the safe harbor under paragraph (d)(5)(iii)(C) of this section because K holds a 20 percent equity interest in Opco. Under all facts and circumstances as provided in paragraph (d)(5)(iii)(B) of this section, K's rights to review and advise on Opco's material business contracts and business expenses constitutes the right to participate in the day-to-day management and operation of Opco's business. As a result, K's interest in Opco is not a qualified partnership interest. Therefore, Opco's commercial activity is attributable to K under paragraph (d)(5)(i) of this section, and K will be treated as a controlled commercial entity.

(B) *Example 2*—(*1*) *Facts*. The facts are the same as in paragraph (c)(5)(iv)(A) of this section (*Example 1*), except that K does not have rights to review and advise on Opco's material business contracts and business expenses. Instead, K is a member of Opco's member committee that only has the abil-

ity to make non-binding recommendations, but not decisions in respect of investor-level strategic matters such as dissolution of the partnership, deviations from previously determined investment parameters, and extending the term of the partnership's governing agreement. The extent of K's membership and participation in Opco's member committee does not result in control over Opco within the meaning of paragraph (a)(1) of this section. K does not otherwise have control over Opco within the meaning of paragraph (a)(1) of this section.

(*2*) *Analysis*. Although K is on Opco's member committee, the committee only has the ability to make non-binding recommendations but not decisions of an investor-level nature in respect of strategic matters, and not in respect of Opco's day-to-day operations. As a result, Opco's commercial activities will not be attributable to K pursuant to paragraph (d)(5)(iii)(A) of this section. Accordingly, if K is not treated as engaged in any other activities that are commercial activities, K will not be a controlled commercial entity. The portion of K's distributive share of income from Opco, however, that is derived from commercial activity will not be exempt from tax under section 892.

(e) *Applicability date.* Except as otherwise provided in this paragraph (e), this section applies to taxable years beginning on or after December 15, 2025. *See* §§ 1.892-5 and 1.892-5T, as contained in 26 CFR in part 1 in effect on April 1, 2025, for the rules that apply to taxable years beginning before December 15, 2025. A taxpayer may choose to apply this section to a taxable year beginning before December 15, 2025, if the period of limitations on assessment of the taxable year is open under section 6501 and the taxpayer and entities that are related (within the meaning of section 267(b) or section 707(b)) to the taxpayer apply this section and §§ 1.892-3(a)(4) and 1.892-4 in their entirety to the taxable year and all succeeding taxable years beginning before December 15, 2025. The rule in paragraph (a)(1)(ii) of this section applies on or after January 14, 2002.

Par. 8. Section 1.892-5T is amended by:

a. Revising paragraph (a), the heading of paragraph (b), and paragraph (b)(1);

b. Removing and reserving paragraph (d)(3); and

c. Revising paragraph (d)(4).

The revisions read as follows:

§ 1.892-5T Controlled commercial entity (temporary regulations).

(a) *In general*. For further guidance, *see* § 1.892-5(a).

(b) *Entities treated as engaged in commercial activity*—(1) *U.S. real property holding corporations*. For further guidance, *see* § 1.892-5(b)(1).

* * * * *

(d) * * *

(4) *Illustrations*. The principles of this section may be illustrated by the following examples.

(i) *Example 1*. (A) The Ministry of Industry and Development is an integral part of a foreign sovereign under § 1.892-2T(a)(2). The Ministry is engaged in commercial activity within the United States. In addition, the Ministry receives income from various publicly traded stocks and bonds, soybean futures contracts and net leases on U.S. real property. Since the Ministry is an integral part, and not a controlled entity, of a foreign sovereign, it is not a controlled commercial entity within the meaning of paragraph (a) of this section. Therefore, income described in § 1.892-3T is ineligible for exemption under section 892 only to the extent derived from the conduct of commercial activities. Accordingly, the Ministry's income from the stocks and bonds is exempt from U.S. tax.

(B) The facts are the same as in paragraph (d)(4)(i)(A) of this section, except that the Ministry also owns 75 percent of the stock of R, a U.S. holding company that owns all the stock of S, a U.S. operating company engaged in commercial activity. Ministry's dividend income from R is income received indirectly from a controlled commercial entity. The Ministry's income from the stocks and bonds, with the exception of dividend income from R, is exempt from U.S. tax.

(C) The facts are the same as in paragraph (d)(4)(i)(A) of this section, except that the Ministry is a controlled entity of a foreign sovereign. Since the Ministry is a controlled entity and is engaged in commercial activity, it is a controlled commercial entity within the meaning of paragraph (a) of this section, and none of its income is eligible for exemption.

(ii) *Example 2*. (A) Z, a controlled entity of a foreign sovereign, has established a pension trust under the laws of the sovereign as part of a pension plan for the benefit of its employees and former employees. The pension trust (T), which meets the requirements of § 1.892-2T(c), has investments in the U.S. in various stocks, bonds, annuity contracts, and a shopping center which is leased and managed by an independent real estate management firm. T also makes securities loans in transactions that qualify under section 1058. T's investment in the shopping center is not considered an unrelated trade or business within the meaning of section 513(b). Accordingly, T will not be treated as engaged in commercial activities. Since T is not a controlled commercial entity, its investment income described in § 1.892-3T, with the exception of income received from the operations of the shopping center, is exempt from taxation under section 892.

(B) The facts are the same as paragraph (d)(4)(ii)(A) of this section, except that T has an interest in a limited partnership (that is not a qualified partnership interest within the meaning of § 1.892-5(d)(5)(iii)) which owns the shopping center. The shopping center is leased and managed by the partnership rather than by an independent management firm. Managing a shopping center, directly or indirectly through a partnership of which a trust is a member, would be considered an unrelated trade or business within the meaning of section 513(b) giving rise to unrelated business taxable income. Since the commercial activities of a partnership are attributable to its partners, T will be treated as engaged in commercial activity and thus will be considered a controlled commercial entity. Accordingly, none of T's income will be exempt from taxation under section 892.

(C) The facts are the same as paragraph (d)(4)(ii)(A) of this section, except that Z is a controlled commercial entity. The result is the same as in paragraph (d)(4)(ii)(A) of this section.

(iii) *Example 3*. (A) The Department of Interior, an integral part of foreign sovereign FC, wholly owns corporations G and H. G, in turn, wholly owns S. G, H and S are each controlled entities. G, which is not engaged in commercial activity anywhere in the world, receives interest income from deposits in banks in the United States. Both H and S do not have any investments in the U.S. but are both engaged in commercial activities. However, only S is engaged in commercial activities within the United States. Because neither the commercial activities of H nor the commercial activities of S are attributable to the Department of Interior or G, G's interest income is exempt from taxation under section 892.

(B) The facts are the same as paragraph (d)(4)(iii)(A) of this section, except that G rather than S is engaged in commercial activities and S rather than G receives the interest income from the United States. Since the commercial activities of G are attributable to S, S's interest income is not exempt from taxation.

Frank J. Bisignano,
Chief Executive Officer.

Approved: October 30, 2025

Kenneth J. Kies,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register December 12, 2025, 8:45 a.m., and published in the issue of the Federal Register for December 15, 2025, 90 FR 57901)

Part III

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also, Sections 42, 280G, 382, 467, 468, 482, 483, 1288, 7520, 7702, 7872.)

Rev. Rul. 2026-2

This revenue ruling provides various prescribed rates for federal income tax purposes for January 2026 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Table 6 contains the deemed rate of return for transfers made during calendar year 2026 to pooled income funds described in section 642(c)(5) that have been in existence for less than 3 taxable years immediately preceding the taxable year in which the transfer was made. Finally, Table 7 contains the average of the applicable federal mid-term rates (based on annual compounding) for the 60-month period ending December 31, 2025, for purposes of section 7702(f)(11).

REV. RUL. 2026-2 TABLE 1
Applicable Federal Rates (AFR) for January 2026
Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
		Short-term		
AFR	3.63%	3.60%	3.58%	3.57%
110% AFR	4.00%	3.96%	3.94%	3.93%
120% AFR	4.37%	4.32%	4.30%	4.28%
130% AFR	4.73%	4.68%	4.65%	4.64%
		Mid-term		
AFR	3.81%	3.77%	3.75%	3.74%
110% AFR	4.19%	4.15%	4.13%	4.11%
120% AFR	4.57%	4.52%	4.49%	4.48%
130% AFR	4.96%	4.90%	4.87%	4.85%
150% AFR	5.74%	5.66%	5.62%	5.59%
175% AFR	6.71%	6.60%	6.55%	6.51%
		Long-term		
AFR	4.63%	4.58%	4.55%	4.54%
110% AFR	5.10%	5.04%	5.01%	4.99%
120% AFR	5.58%	5.50%	5.46%	5.44%
130% AFR	6.04%	5.95%	5.91%	5.88%

REV. RUL. 2026-2 TABLE 2
Adjusted AFR for January 2026
Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	2.75%	2.73%	2.72%	2.71%
Mid-term adjusted AFR	2.88%	2.86%	2.85%	2.84%
Long-term adjusted AFR	3.51%	3.48%	3.46%	3.46%

REV. RUL. 2026-2 TABLE 3 Rates Under Section 382 for January 2026	
Adjusted federal long-term rate for the current month	3.51%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	3.51%

REV. RUL. 2026-2 TABLE 4 Appropriate Percentages Under Section 42(b)(1) for January 2026	
Note: Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%.	
Appropriate percentage for the 70% present value low-income housing credit	7.98%
Appropriate percentage for the 30% present value low-income housing credit	3.42%

REV. RUL. 2026-2 TABLE 5 Rate Under Section 7520 for January 2026	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	4.6%

REV. RUL. 2026-2 TABLE 6 Deemed Rate for Transfers to New Pooled Income Funds During 2026	
Deemed rate of return for transfers during 2026 to pooled income funds that have been in existence for less than 3 taxable years	4.0%

REV. RUL. 2026-2 TABLE 7 Average of the Applicable Federal Mid-Term Rates for 2025
For purposes of section 7702(f)(11), the average of the applicable federal mid-term rates (based on annual compounding) for the 60-month period ending December 31, 2025, is 3.19% rounded to 3%.

Section 42.—Low-Income Housing Credit

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2026. See Rev. Rul. 2026-2, page 386.

Section 280G.—Golden Parachute Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2026. See Rev. Rul. 2026-2, page 386.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of January 2026. See Rev. Rul. 2026-2, page 386.

Section 467.—Certain Payments for the Use of Property or Services

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2026. See Rev. Rul. 2026-2, page 386.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The applicable federal short-term rates are set forth for the month of January 2026. See Rev. Rul. 2026-2, page 386.

Section 482.—Allocation of Income and Deductions Among Taxpayers

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2026. See Rev. Rul. 2026-2, page 386.

Section 483.—Interest on Certain Deferred Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2026. See Rev. Rul. 2026-2, page 386.

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2026. See Rev. Rul. 2026-2, page 386.

Section 7520.—Valuation Tables

The applicable federal mid-term rates are set forth for the month of January 2026. See Rev. Rul. 2026-2, page 386.

Section 7702.—Life Insurance Contract Defined

The average of the applicable federal mid-term rates for the 60-month period ending December 31, 2025, for purposes of section 7702(f)(11). See Rev. Rul. 2026-2, page 386.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2026. See Rev. Rul. 2026-2, page 386.

Part IV

Notice of Proposed Rulemaking

Income of Foreign Governments and of International Organizations

REG-101952-24

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the taxation of the income of foreign governments from investments in the United States. In particular, these proposed regulations provide guidance for determining when an acquisition of debt by a foreign government is considered to be commercial activity, and when a foreign government has effective control of an entity engaged in commercial activities. These proposed regulations will affect foreign governments that derive income from sources within the United States.

DATES: Written or electronic comments and requests for a public hearing must be received by February 13, 2026.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically via the Federal eRulemaking Portal at *https://*www.*regulations.gov* (indicate IRS and REG-101952-24) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the "Comments and Requests for a Public Hearing" section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted to the IRS's public docket. Send paper submissions to: CC:PA:01:PR (REG-101952-24), Room 5503, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jack Zhou at (202) 317-6938; concerning submissions of comments, requests for a public hearing, and access to a public hearing, Publication and Regulations Section at (202) 317-6901 (not toll-free numbers) or by email to *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Authority

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 892 of the Internal Revenue Code (Code). These regulations are issued under the express delegations of authority under sections 892(c) and 7805(a) of the Code.

Background

I. *Overview*

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 892 of the Code relating to income of foreign governments (proposed regulations). Any terms used but not defined in this preamble have the meanings given to them in the proposed regulations.

Section 892(a)(1) provides that income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities owned by the foreign governments, or financial instruments held in the execution of governmental financial or monetary policy, or interest on deposits in banks in the United States of moneys belonging to the foreign governments, is not included in gross income and is exempt from taxation under subtitle A of the Code. Section 892(a)(2)(A) provides that section 892(a)(1) does not apply to any income that is (1) derived from the conduct of any commercial activity (whether within or outside the United States), (2) received by a controlled commercial entity (CCE) or received (directly or indirectly) from a CCE, or (3) derived from the disposition of any interest in a CCE.

Section 892(a)(2)(B) provides that, for purposes of section 892(a)(2)(A), a CCE means any entity engaged in commercial activities (whether within or outside the United States) if the foreign government holds (directly or indirectly) any interest in the entity which (by value or voting interest) is 50 percent or more of the total of the interests in the entity, or holds (directly or indirectly) any other interest in the entity which provides the foreign government with effective control of the entity. Section 892(c) authorizes the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 892.

II. *Regulations Addressing the Application of Section 892*

On June 27, 1988, the Treasury Department and the IRS published in the **Federal Register** a notice of proposed rulemaking (53 FR 24100) (1988 proposed regulations) with a cross-reference to temporary regulations under section 892 (TD 8211, 53 FR 24060) (1988 temporary regulations) to provide guidance under section 892.

On August 1, 2002, the Treasury Department and the IRS published § 1.892-5(a)(3) in the **Federal Register** (TD 9012, 67 FR 49864) to provide that the term "entity" for purposes of section 892(a)(2)(B) (defining "controlled commercial entity") includes partnerships (2002 final regulations).

On November 3, 2011, the Treasury Department and the IRS published in the **Federal Register** a notice of proposed rulemaking (76 FR 68119) that would provide additional guidance for determining when a foreign government is engaged in commercial activities (2011 proposed regulations). On December 29, 2022, the Treasury Department and the IRS published in the **Federal Register** a notice of proposed rulemaking (87 FR 80097) that would make changes to § 1.892-5T(b)(1) to provide exceptions to the general rule

that a United States real property holding corporation (USRPHC), as defined in section 897(c)(2), which may include a foreign corporation, is treated as engaged in commercial activity and, therefore, is a CCE if the requirements of § 1.892-5T(a)(1) or (2) are satisfied (2022 proposed regulations).

The rules in the 2011 proposed regulations and the 2022 proposed regulations are finalized, with modifications, in the Final Rules section of this issue of the **Federal Register** (2025 final regulations). The 2025 final regulations also finalized proposed § 1.892-3(a)(4) (definition of financial instrument) of the 1988 proposed regulations.

Explanation of Provisions

I. *Definition of Controlled Entity*

Section 892 does not define the term "foreign government." The 1988 temporary regulations define a foreign government to consist only of integral parts and controlled entities of a foreign sovereign. Section 1.892-2T(a)(3) defines "controlled entity" to mean an entity that is separate in form from a foreign sovereign or otherwise constitutes a separate juridical entity if it satisfies certain requirements, including that it is wholly owned and controlled by a single foreign sovereign directly or indirectly through one or more controlled entities. The flush language of § 1.892-2T(a)(3) states "[a] controlled entity does not include partnerships or any other entity owned and controlled by more than one foreign sovereign."

The Treasury Department and the IRS are aware that the flush language of § 1.892-2T(a)(3) may be interpreted by taxpayers as referring only to partnerships owned by more than one foreign sovereign. The Treasury Department and the IRS are of the view, however, the better reading of this flush language is that partnerships, including ones wholly owned and controlled by a single foreign sovereign (including indirectly through controlled entities), are not included in the term "controlled entity" for purposes of § 1.892-2T(a)(3). The concept of a controlled entity was developed to address the question of whether an entity separate from a foreign sovereign and otherwise subject to Federal income tax could be exempt from such tax under section 892.[1] Since an entity treated as a partnership for Federal tax purposes generally is not subject to such tax, without regard to the exemption under section 892, the question addressed by the concept of a controlled entity does not arise in the case of a partnership.[2] Therefore, the proposed regulations would clarify that a partnership for Federal tax purposes is not a controlled entity within the meaning of § 1.892-2T(a)(3). The proposed regulations would remove the flush language following § 1.892-2T(a)(3) and replace it with proposed § 1.892-2(a)(4), which would provide that a controlled entity, within the meaning of § 1.892-2T(a)(3), does not include any partnership for Federal tax purposes. The proposed regulations also would revise the concluding sentence of the flush language following § 1.892-2T(a)(3) to clarify that the rule is not confined to "foreign financial organizations" and to make other drafting changes.

II. *Acquisition of Debt*

A. *In general*

Proposed § 1.892-4(e)(1)(i) of the 2011 proposed regulations would provide in part, under the heading titled "investments," that subject to the provisions of proposed § 1.892-4(e)(1)(ii) and (iii) (rules on trading activities and investments made by a banking, financing, or similar business), loans and investments in stocks, bonds, and other securities are not commercial activities. Proposed § 1.892-4(e)(1)(iii) would provide that investments (including loans) made by a banking, financing, or similar business constitute commercial activities, even if the income derived from those investments is not considered to be income effectively connected to the active conduct of a banking, financing, or similar business in the United States by reason of the application of § 1.864-4(c)(5). A comment to the 2011 proposed regulations stated that there is uncertainty as to the circumstances in which loan origination is commercial activity. The Treasury Department and the IRS acknowledged the comment when finalizing proposed § 1.892-4(e)(1)(i) and (ii) in the 2025 final regulations and stated that the issue will be addressed by these proposed regulations.

The Treasury Department and the IRS are of the view that whether the activity of lending or otherwise acquiring debt, including at original issuance, qualifies as investment rather than commercial activity under section 892 is highly fact-dependent, so that a consideration of all facts and circumstances is needed to determine the appropriate characterization. Accordingly, the Treasury Department and the IRS are proposing these regulations to provide a framework for determining when acquiring any debt, including at original issuance, qualifies as investment for purposes of section 892.

The proposed regulations would provide as a general rule that all acquisition of debt is treated as commercial activity unless the acquisition is characterized as investment for purposes of section 892 under either of two safe harbors or under a facts-and-circumstances test. *See* proposed § 1.892-4(c)(1)(ii)(A). The term "debt" means an obligation treated as debt for Federal tax purposes, regardless of its legal form. Accordingly, proposed § 1.892-4(c)(1)(ii) would also apply to a financial instrument, within the meaning of § 1.892-3(a)(4), that is treated as debt. An acquisition of debt undertaken as a dealer, as defined in § 1.864-2(c)(2)(iv) *(a)*, would be treated in any event as commercial activity.

The proposed regulations' framework would constitute the exclusive set of rules for determining whether acquiring debt, including at original issuance, is treated

[1] *See* Rev. Rul. 75-298, 1975-2 C.B. 290 (providing criteria to determine whether an organization will be considered part of a foreign government for purposes of qualifying for exemption from Federal income tax pursuant to section 892), obsoleted by Rev. Rul. 2003-99, 2003-2 C.B. 388, and revoking Rev. Rul. 66-73, 1966-1 C.B. 174 (examining whether an organization constitutes a corporation for purposes of section 892).

[2] *See* section 701, which was enacted in 1954 and states that "[a] partnership as such shall not be subject to the income tax imposed by this chapter." Section 701 refers to "this chapter" (chapter 1) while section 892(a)(1) states that certain income of foreign governments is exempt "under this subtitle." However, the taxes for which section 892 provides an exemption (section 892(a)(1)) are described in chapter 1 of the subtitle.

as investment and thus not as commercial activity for purposes of section 892. Whether debt acquisition is investment for purposes of section 892 would be, unless otherwise provided, determined without regard to whether the debt acquisition is treated as a trade or business for Federal tax purposes. Thus, no inference is intended from the proposed regulations as to the circumstances in which acquiring debt, including at original issuance, would or would not be a trade or business for other purposes of the Code, including section 864, section 162, or section 166 of the Code.

B. *Debt acquisition safe harbors*

Proposed § 1.892-4(c)(1)(ii)(B) would provide two safe harbors that treat debt acquired in a registered offering or in a qualified secondary market acquisition as investment for purposes of § 1.892-4(c)(1)(i) and, thus, not subject to the general rule of proposed § 1.892-4(c)(1)(ii)(A).

The first safe harbor would treat acquisitions of bonds or other debt securities acquired in an offering registered under the Securities Act of 1933, as amended (Securities Act), as investment provided that the underwriters of the offering are not related to the acquirer within the meaning of sections 267(b) and 707(b). Although the first safe harbor would except only offerings of debt securities registered under the Securities Act, the Treasury Department and the IRS recognize that the securities laws of some foreign countries may provide a regulatory framework for debt offerings sufficiently similar to the Securities Act such that this exception may appropriately apply in those circumstances. Comments are requested regarding the circumstances, if any, in which the safe harbor should be extended to offerings registered under foreign securities laws in addition to the Securities Act.

The second safe harbor would treat a qualified secondary market acquisition of debt as investment for purposes of § 1.892-4(c)(1)(i). This generally would include acquisitions of debt traded on an established securities market provided that the acquirer is not purchasing from the issuer or participating in negotiation of the terms or issuance of the debt. A qualified secondary market acquisition must not be from a person that is under common management or control with the acquirer, unless that person acquired the debt as investment within the meaning of § 1.892-4(c)(1)(i). Comments are requested on this safe harbor, including the circumstances, if any, in which it should apply to an acquisition of debt that is not traded on an established securities market.

C. *Qualification as investment based on all facts and circumstances*

Proposed § 1.892-4(c)(1)(ii)(C) would provide that debt acquisitions that do not satisfy the safe harbors of proposed § 1.892-4(c)(1)(ii)(B) may be an investment based on consideration of all relevant facts and circumstances. In general, facts and circumstances would be relevant to the extent they indicate that the entity's expected return from acquiring the debt is exclusively a return on its capital rather than including a return on activities it conducts. The proposed regulations provide a non-exclusive list of relevant factors, in proposed § 1.892-4(c)(1)(ii)(C)*(1)* through *(8)*, that would apply in determining whether a debt acquisition is investment for purposes of § 1.892-4(c)(1)(i). Under this proposed analysis, all factors would be taken into account and, depending on the particular case, the weight given to each relevant factor (including factors not listed in the proposed regulations) may vary.

Comments are requested on whether proposed § 1.892-4(c)(1)(ii)(C) should include additional factors or examples of transactions undertaken by foreign government investors. In particular, comments are requested on the circumstances, if any, in which acquisitions of distressed debt, broadly syndicated loans, revolving credit facilities, and delayed-draw debt obligations should be treated as investment rather than commercial activities for purposes of section 892.

D. *Other changes*

The proposed regulations would retain the exception for investments in "other securities" (which follows the reference to stocks and bonds) and retain the definition of "other securities" as "any note or other evidence of indebtedness" which includes loans. *See* proposed §§ 1.892-4(c)(1)(i) and 1.892-3T(a)(3). Accordingly, the proposed regulations would remove "loans" from the list of investments in § 1.892-4(c)(1)(i) of the 2025 final regulations that are not treated as commercial activities.

Additionally, the proposed regulations would withdraw the rule on banking, financing, or similar businesses in § 1.892-4T(c)(1)(iii). This is a conforming change given that the proposed regulations' framework would constitute the exclusive set of rules for determining whether acquiring debt, including at original issuance, is treated as investment and thus not as commercial activity for purposes of section 892.

The proposed regulations also would remove the phrase "or from an investment in net leases on real property" from the parentheses that follow "the holding of real property which is not producing income" in § 1.892-4(c)(1)(i). The clause that would be removed is duplicative of "the holding of net leases on real property," which is another activity identified in § 1.892-4(c)(1)(i) that is not a commercial activity. Thus, no substantive change to § 1.892-4(c)(1)(i) is intended by this removal. An additional non-substantive change is made in proposed § 1.892-4(c)(1)(i) that would add "the transfer of securities under a loan agreement which meets the requirements of section 1058" to the list of activities that are not commercial activities, rather than setting off that activity in its own sentence.

III. *Defining Effective Control*

Section 892(a)(2)(B) defines a CCE as any entity engaged in commercial activities (whether within or outside the United States) if the government (i) holds (directly or indirectly) any interest in such entity which (by value or voting interest) is 50 percent or more of the total of such interests in such entity, or (ii) holds (directly or indirectly) any other interest in the entity which provides the foreign government with effective control of the entity.

The 1988 temporary regulations provide that an entity that is engaged in commercial activities is a CCE if the foreign government has "effective practical control" of the entity. *See* § 1.892-5T(a)(2).

The 1988 temporary regulations explain that effective practical control may be achieved through a minority interest which is sufficiently large to achieve effective control, or through creditor, contractual, or regulatory relationships which, together with ownership interests held by the foreign government, achieve effective control. For example, an entity engaged in commercial activities may be treated as a CCE if a foreign government, in addition to holding a minority interest (by value or voting power), is also a substantial creditor of the entity or controls a strategic natural resource which the entity uses in the conduct of its trade or business, providing the foreign government effective practical control over the entity. *See* § 1.892-5T(c)(2). Thus, under the 1988 temporary regulations, the term "other interest" in section 892(a)(2)(B)(ii) includes business relationships, and an interest in the entity for purposes of an analysis of effective control may exist when the foreign government has the ability to exert influence over the entity. A comment to the 2011 proposed regulations suggested that the regulations should be expanded to provide a more thorough definition of effective practical control with more specific examples. The Treasury Department and the IRS acknowledged the comment in the 2025 final regulations and stated that the issue will be addressed by these proposed regulations.

The proposed regulations would revise § 1.892-5T(c)(2) to provide further guidance on what constitutes effective control under section 892(a)(2)(B)(ii). The Treasury Department and the IRS are of the view that it is necessary and appropriate to define the terms "other interest" and "effective control" broadly to include circumstances in which a foreign government would have control over either the operational, managerial, board-level, or investor-level decisions of an entity. The proposed regulations would provide that, generally, effective control is achieved by any interest in the entity that, either separately or in combination, results in control over the operational, managerial, board-level, or investor-level decisions of the entity. All of the facts and circumstances related to the interests would be considered in determining effective control. Interests may include equity interests, voting power in the entity, debt interests, contractual rights in or arrangements with the entity or with holders of equity or other interests in the entity, certain business relationships with the entity or with other interest holders in the entity, regulatory authority over the entity, or any other arrangement or relationship that provides influence over the entity's operational, managerial, board-level, or investor-level decisions. (Although the 1988 temporary regulations provide guidance under section 892(a)(2)(B) using the term "effective practical control," the proposed regulations use the term "effective control" to be consistent with section 892(a)(2)(B)(ii) and the 2025 final regulations.)

For example, a foreign government would have effective control of an entity in a case in which it owns a minority equity interest in the entity that entitles that foreign government to appoint only one out of several directors of the entity, if that one director has the sole power to unilaterally appoint or dismiss the entity's manager. *See* proposed § 1.892-5(c)(2)(iii)(E) (*Example 4*). In contrast, a foreign government that holds only a minority interest by value and voting power in an entity, and no other interest, would not have effective control of the entity if the foreign government lacks the power (directly or indirectly through other arrangements) to unilaterally elect the entity's board, choose its management, or otherwise direct the entity's operational, managerial, board-level, or investor-level decisions. *See* proposed § 1.892-5(c)(2)(iii)(B) (*Example 1*).

A foreign government would be deemed to have effective control of an entity if the foreign government is, or under § 1.892-5(a)(1) controls an entity that is, a managing partner or managing member of such entity, or holds or controls an entity that holds an equivalent role with respect to such entity under local law applicable to the entity. The Treasury Department and the IRS are of the view that these roles inherently carry control over an entity so that the facts-and-circumstances test is unnecessary to determine whether a foreign government has effective control of the entity. On the other hand, the mere right to be consulted with respect to operational, managerial, board-level, or investor-level decisions of an entity will not alone give rise to effective control.

Additionally, a foreign government would not need to hold any particular amount of (or any) equity in an entity to have effective control of the entity. For example, if a foreign government is a creditor of an entity with sufficient creditor rights to give it effective control, then that entity would be a CCE of the foreign government, and any interest payments (or other payments) made by the debtor entity to the foreign government would not qualify for the exemption under section 892. *See* proposed § 1.892-5(c)(2)(iii)(I) (*Example 8*) (finding effective control when creditor's rights generally included veto rights over the debtor's capital transactions and operating budget).

With respect to related foreign government entities, the proposed regulations would provide that the principles of § 1.892-5T(c)(1)(i) (attributing an interest owned directly or indirectly by an integral part or controlled entity to the foreign sovereign) apply for purposes of an effective control analysis. For example, if two controlled entities (within the meaning of § 1.892-2T(a)(3)) of the same foreign sovereign have direct or indirect equity or non-equity interests in a corporation, all of those interests would be considered together for purposes of the effective control analysis with respect to either controlled entity. Comments are requested as to the circumstances, if any, in which a determination could be made that controlled entities (within the meaning of § 1.892-2T(a)(3)) are functionally independent of one another and therefore may be appropriately considered separately for purposes of an effective control analysis.

Comments are also requested as to the circumstances, if any, in which the holder of a minority equity interest in an entity should not be treated as having effective control (or as having at least 50 percent of voting power) of the entity if managerial or board-level decisions of the entity are subject to veto or "blocking" rights of the holder and other holders (for example, through consent rights, supermajority requirements, or otherwise).

Applicability Dates

These regulations are proposed to apply to taxable years beginning on or after the date of publication of the Trea-

sury decision adopting these rules as final regulations in the **Federal Register** (the finalization date). A foreign government within the meaning of §§ 1.892-2 and 1.892-2T may choose to apply § 1.892-2(a)(4), once finalized, to a taxable year of its directly or indirectly wholly-owned entities beginning before the finalization date if the period of limitations on assessment of the taxable year is open under section 6501, and provided that the foreign government consistently applies the rule in its entirety to the taxable year and all succeeding taxable years of its directly or indirectly wholly-owned entities beginning before the finalization date.

Special Analyses

I. *Regulatory Planning and Review – Economic Analysis*

These proposed regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (July 4, 2025) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations.

II. *Paperwork Reduction Act*

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) generally requires that a Federal agency obtain the approval of the OMB before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. There are no additional information collection requirements associated with these proposed regulations.

III. *Regulatory Flexibility Act*

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act. This certification is based on the fact that the proposed regulations affect foreign governments, including their controlled entities, with income from sources within the United States. Accordingly, the entities affected by the proposed regulations are not considered small entities, and a regulatory flexibility analysis under the Regulatory Flexibility Act is not required.

IV. *Section 7805(f)*

Pursuant to section 7805(f) of the Code, these proposed regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

V. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. The proposed regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

VI. *Executive Order 13132: Federalism*

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. The proposed regulations do not have federalism implications and do not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

Comments and Requests for Public Hearing

Before the proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any comments submitted will be made available at *https://www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of the proposed regulations are Jack Zhou of the Office of Associate Chief Counsel (International), and Joel Deuth, formerly of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

Statement of Availability of IRS Documents

IRS guidance cited in this preamble is published in the Internal Revenue Bulletin and is available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *https://www.irs.gov*.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry for § 1.892-2 in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Section 1.892-2 also issued under 26 U.S.C. 892(c).

* * * * *

Par. 2. Section 1.892-2 is added to read as follows:

§ 1.892-2 Foreign government defined.

(a) *Foreign government*—(1) *Definition*. For further guidance, *see* § 1.892-2T(a)(1).

(2) *Integral part*. For further guidance, *see* § 1.892-2T(a)(2).

(3) *Controlled entity.* For further guidance, *see* § 1.892-2T(a)(3).

(4) *Exceptions.* A controlled entity, within the meaning of paragraph (a)(3) of this section, does not include any partnership for Federal tax purposes. A controlled entity also does not include any entity owned and controlled by more than one foreign sovereign. Thus, a foreign entity organized and wholly owned and controlled by multiple foreign sovereigns to invest jointly, or to foster economic, financial, and/or technical cooperation, is not a controlled entity for purposes of paragraph (a)(3) of this section.

(b) *Inurement to the benefit of private persons*. For further guidance, *see* § 1.892-2T(b).

(1) through (2) [Reserved]

(c) *Pension trusts*—(1) *In general*. For further guidance, *see* § 1.892-2T(c)(1) introductory text through (c)(1)(iv).

(i) through (v) [Reserved]

(2) *Illustrations*. For further guidance, *see* § 1.892-2T(c)(2).

(d) *Political subdivision and transnational entity*. For further guidance, *see* § 1.892-2T(d).

(e) A*pplicability date*. Paragraph (a)(4) of this section applies to taxable years beginning on or after [DATE OF PUBLICATION OF FINAL RULE]. However, a foreign government within the meaning of §§ 1.892-2 and 1.892-2T may choose to apply paragraph (a)(4) of this section to a taxable year of its directly or indirectly wholly-owned entities beginning before [DATE OF PUBLICATION OF FINAL RULE] if the period of limitations on assessment of the taxable year is open under section 6501, and provided that the foreign government consistently applies the rule in its entirety to the taxable year and all succeeding taxable years of its directly or indirectly wholly-owned entities beginning before [DATE OF PUBLICATION OF FINAL RULE].

Par. 3. Section 1.892-2T is amended by:

a. Removing the undesignated text under paragraph (a)(3)(iv); and

b. Adding paragraph (a)(4).

The addition reads as follows:

§ 1.892-2T Foreign government defined (temporary regulations).

(a) * * *

(4) *Exceptions*. For further guidance, *see* § 1.892-2(a)(4).

* * * * *

Par. 4. Section 1.892-4, as amended in a final rule published elsewhere in this issue of the **Federal Register**, effective December 15, 2025, is amended by:

a. Revising paragraphs (c)(1)(i) through (iii); and

b. Adding a sentence after the first sentence of paragraph (d).

The revisions and addition read as follows:

§ 1.892-4 Commercial activities.

* * * * *

(c) * * *

(1) * * *

(i) *In general*. Subject to the provisions of this paragraph (c)(1)(i) and paragraphs (c)(1)(ii) through (c)(7) of this section, the following are not commercial activities: investments in stocks, bonds, and other securities (as defined in § 1.892-3T(a)(3)); investments in financial instruments (as defined in § 1.892-3(a)(4)); the holding of partnership equity interests; the holding of net leases on real property; the holding of real property which is not producing income (other than on its sale); the holding of deposits in any currency in banks; and the transfer of securities under a loan agreement which meets the requirements of section 1058. An activity will not cease to be an investment solely because of the volume of transactions of that activity or because of other unrelated activities.

(ii) *Acquisition of debt*—(A) *In general*. An acquisition of debt is considered a commercial activity for purposes of paragraph (b) of this section notwithstanding any other provision of this section, unless the acquisition qualifies as investment under the rules of paragraph (c)(1)(ii)(B) or (C) of this section. For purposes of this paragraph (c)(1)(ii), the term *debt* means an obligation treated as debt for Federal tax purposes. For purposes of applying paragraphs (c)(1)(ii)(B) and (C) of this section, actions by an agent or a person otherwise acting on behalf of the acquirer are treated as the actions of the acquirer. An acquisition of debt undertaken as a dealer, as defined in § 1.864-2(c)(2)(iv) *(a)*, constitutes commercial activity without regard to paragraphs (c)(1)(ii)(B) and (C) of this section.

(B) *Safe harbors*. An acquisition of debt that satisfies paragraph (c)(1)(ii)(B)(*1*) or (*2*) of this section is treated as investment and not commercial activity for purposes of paragraph (c)(1)(i) of this section.

(*1*) *Registered offerings*. An acquisition of bonds or other debt securities in an offering registered under the Securities Act of 1933, as amended (15 U.S.C. 77a, *et seq*.), (*the Securities Act)*, provided that the underwriters of the offering are not related to the acquirer within the meaning of sections 267(b) and 707(b).

(*2*) *Qualified secondary market acquisitions*. An acquisition of debt traded on an established securities market, within the meaning of § 1.7704-1(b), provided that—

(*i*) The acquirer does not acquire the debt from the debt issuer or participate in the negotiation of the terms or issuance of the debt; and

(*ii*) The acquisition is not from a person that is under common management or control with the acquirer, unless that person acquired the debt as investment within the meaning of paragraph (c)(1)(i) of this section.

(C) *Investments in debt*. An acquisition of debt that does not satisfy either paragraph (c)(1)(ii)(B)(*1*) or (*2*) of this section may be an investment for purposes of paragraph (c)(1)(i) of this section based on all relevant facts and circumstances, including the following:

(*1*) Whether the acquirer solicited prospective borrowers, or otherwise held itself out as willing to make loans or oth-

erwise acquire debt at or in connection with its original issuance;

(*2*) Whether the acquirer materially participated in negotiating or structuring the terms of the debt;

(*3*) Whether the acquirer is entitled to compensation (whether or not labelled as a fee) that is not treated as interest (including original issue discount) for Federal tax purposes;

(*4*) The form of the debt and the issuance process, including, for example, whether the debt is a bank loan or instead a privately placed debt security pursuant to Regulation S or Rule 144A under the Securities Act;

(*5*) The percentage of the debt issuance acquired by the acquirer relative to the percentages acquired by other purchasers;

(*6*) The percentage of equity in the debt issuer held or to be held by the acquirer;

(*7*) The value of that equity relative to the amount of the debt acquired; and

(*8*) If debt is deemed to be acquired in a debt-for-debt exchange as a result of a significant modification under § 1.1001-3, whether there was, at the time of acquisition of the original unmodified debt, a reasonable expectation, based on objective evidence, such as a decline in the financial condition or credit rating of the debt issuer between original issuance and the time of the acquisition of the original unmodified debt, that the original unmodified debt would default.

(D) *Examples*—(*1*) *Assumed facts.* The rules of this paragraph (c)(1)(ii) are illustrated by the examples in this paragraph (c)(1)(ii)(D). Except as otherwise stated, the following facts are assumed for purposes of paragraphs (c)(1)(ii)(D)(*2*) through (*6*) of this section (*Examples 1* through *5*):

(*i*) FC is a foreign entity organized under the laws of country X and is treated as a corporation for Federal tax purposes; FC is a controlled entity of the government of country X under § 1.892-2T(a)(3);

(*ii*) FC has neither engaged in, nor has been attributed, any conduct of commercial activities for purposes of section 892;

(*iii*) FC has not previously acquired any debt; and

(*iv*) FC is not a dealer as defined in § 1.864-2(c)(2)(iv)*(a)*.

(*2*) *Example 1*: *Isolated debt financing as commercial activity*—(*i*) *Facts*. In year 1, representatives of FC offered, on behalf of FC, to provide debt financing to a foreign corporation. FC's representatives structured and negotiated the terms of that debt financing, and FC made a loan to the foreign corporation pursuant to those terms in year 1. FC does not own any equity in that corporation. The debt was not issued in a registered offering. All of the activities occurred outside the United States in year 1.

(*ii*) *Analysis*. FC's debt acquisition activity is commercial activity under this paragraph (c)(1)(ii), unless the acquisition qualifies as investment under paragraph (c)(1)(ii)(B) or (C) of this section. The debt acquisition does not qualify as investment under either of the safe harbors in paragraph (c)(1)(ii)(B) of this section because the debt was not issued in an offering registered under the Securities Act, and because FC materially participated in negotiating the terms of the debt through its representatives and acquired the debt at original issuance from the issuer. This debt acquisition also does not qualify as investment under paragraph (c)(1)(ii)(C) of this section because, through its representatives, FC held itself out as a lender and solicited, structured, negotiated, and funded the debt at original issuance, and because FC acquired the debt in the form of a loan and did not own any equity in the debt issuer. Although FC made only one loan in year 1, the number of loans does not change the determination that the acquisition is commercial activity under this paragraph (c)(1)(ii), regardless of whether FC is treated as engaged in a trade or business for purposes of section 162, section 166, or section 864(b).

(*3*) *Example 2: Debt financing as investment when combined with certain equity investments*—(*i*) *Facts.* In year 1, FC owned 80 percent of a foreign corporation's equity interests, which had a total value of $100 million. During year 1, FC lent $50 million to the foreign corporation to finance the foreign corporation's activities. FC's management structured the terms of the debt in the form of a loan between FC and the foreign corporation. FC acquired the debt at original issuance without a registered offering. All of the activities occurred outside the United States in year 1.

(*ii*) *Analysis*. FC's debt acquisition activity is a commercial activity under this paragraph (c)(1)(ii), unless the acquisition qualifies as investment under paragraph (c)(1)(ii)(B) or (C) of this section. The debt acquisition does not qualify as investment under either of the safe harbors in paragraph (c)(1)(ii)(B) of this section because the debt was not issued in an offering registered under the Securities Act and because FC acquired the debt at original issuance from the issuer. Nonetheless, taking into account all relevant facts and circumstances, including those under paragraph (c)(1)(ii)(C) of this section, FC's acquisition of the foreign corporation's debt is investment for purposes of paragraph (c)(1)(i) of this section. FC did not hold itself out as a lender or solicit borrowers. Even though FC structured the terms of the debt and acquired the debt in the form of a loan, FC owned a substantial percentage of the equity interests in the debt issuer and acquired an amount of debt that is not significant relative to the value of FC's equity investment in the debt issuer. Accordingly, taking into account all relevant facts and circumstances, FC's debt acquisition qualifies as investment for purposes of paragraph (c)(1)(i) of this section, and therefore is not commercial activity under this paragraph (c)(1)(ii).

(*4*) *Example 3: Private placement of debt securities and U.S. Treasury securities as investment*—(*i*) *Facts.* In year 1, representatives of FC met with financial institutions unrelated to FC that were serving as placement agents for the debt of a number of domestic corporations. At those meetings, FC's representatives communicated FC's interest in purchasing privately placed debt of U.S. corporate issuers and communicated the terms on which FC would be willing to purchase that debt. Based on those discussions, in the same year, FC purchased, at original issuance, ten privately placed debt securities of several domestic corporations. Each of the debt securities was offered by the placement agents under Regulation S through a private placement memorandum. FC purchased less than one-third by principal amount of each debt offering and at least one other unrelated purchaser purchased a larger percentage of each debt offering than FC. In addition, in the same year, FC purchased U.S. Treasury debt securities at original issuance in a public auction.

(*ii*) *Analysis*. FC's debt acquisition activities are commercial activities under this paragraph (c)(1)(ii), unless the acquisitions qualify as investments under paragraph (c)(1)(ii)(B) or (C) of this section. Because FC acquired the debt at original issuance from the issuers and not in offerings registered under the Securities Act, the acquisitions do not qualify for either of the safe harbors under paragraph (c)(1)(ii)(B) of this section. Nonetheless, taking into account all relevant facts and circumstances, including those under paragraph (c)(1)(ii)(C) of this section, FC's acquisitions of privately placed debt securities and of U.S. Treasury debt securities are investments for purposes of paragraph (c)(1)(i) of this section. The corporate debt was structured on behalf of the issuers by financial institutions unrelated to FC that were serving as placement agents. The U.S. Treasury debt securities were offered with terms and conditions set by the Treasury Department. FC did not hold itself out as a lender, solicit borrowers, or materially participate in structuring or negotiating the terms of the debt. Although FC did communicate to the placement agents for the corporate debt before issuance the terms on which FC would be willing to acquire the debt and bid in the auction of U.S. Treasury debt securities, these activities do not indicate material participation in the structuring or negotiation of the terms of the debt. Moreover, the corporate debt was offered to FC in the form of a privately placed security, and FC was not the largest purchaser of any debt offering based on principal amount. Accordingly, taking into account all relevant facts and circumstances, FC's debt acquisitions qualify as investments for purposes of paragraph (c)(1)(i) of this section, and therefore are not commercial activities under this paragraph (c)(1)(ii).

(*5*) *Example 4: Debt modification as investment*—(*i*) *Facts.* In year 1, FC purchased debt of a foreign issuer, *X*, in secondary market acquisitions that qualify as investments under paragraph (c)(1)(ii)(B)(*2*) of this section (the *X Debt*). At the time of FC's acquisitions, the X Debt was not in default, and there were no objective indications at the time of the purchase of the X Debt, such as a declining trend in X's financial condition or credit rating, that X would default on the X Debt. In year 4, due to unexpected changes in market conditions, X defaulted on the X Debt. A committee of creditors of X, acting on behalf of all holders of the X Debt, negotiated with X to

modify the terms of the X Debt, including extensions of maturity, deferral of interest payments, and changes in interest rates. FC did not participate in the creditors' committee, thus was not involved in any negotiations between the committee and X, and did not directly negotiate with X on any aspect of the X Debt. The modifications to the X Debt were significant modifications within the meaning of § 1.1001-3, and FC was deemed to acquire a new debt from X (the *Modified X Debt*) in exchange for the unmodified X Debt.

(*ii*) *Analysis*. FC's debt acquisition activity is commercial activity under this paragraph (c)(1)(ii), unless the acquisition qualifies as investment under paragraph (c)(1)(ii)(B) or (C) of this section. FC's deemed acquisition of the Modified X Debt does not qualify for either of the safe harbors under paragraph (c)(1)(ii)(B) of this section because FC is deemed to have acquired the Modified X Debt at original issuance from the issuer and not in an offering registered under the Securities Act. However, taking into account all relevant facts and circumstances, including those under paragraph (c)(1)(ii)(C) of this section, FC's acquisition of the Modified X Debt qualifies as investment for purposes of paragraph (c)(1)(i) of this section because the X Debt was not in default at the time of FC's acquisition, at that time there was no expectation, based on objective indications, that X would default on the X Debt, and because FC did not participate in the creditors' committee which negotiated the terms of the Modified X Debt. Accordingly, FC's deemed acquisition of the Modified X Debt qualifies as investment for purposes of paragraph (c)(1)(i) of this section, and therefore is not treated as commercial activity under this paragraph (c)(1)(ii).

(*6*) *Example 5: Debt restructuring as commercial activity—*(*i*) *Facts*. The facts are the same as in paragraph (c)(1)(ii)(D)(*5*) of this section (*Example 4*), except that FC was a member of the creditors' committee of X, which materially participated in negotiating and structuring the terms of the Modified X Debt.

(ii) Analysis. In contrast to the acquisition in paragraph (c)(1)(ii)(D)(*5*) of this section (*Example 4*), FC's acquisition of the Modified X Debt is commercial activity under this paragraph (c)(1)(ii). Taking into account all relevant facts and circumstances, the acquisition does not qualify as investment under paragraph (c)(1)(i) of this section because FC was a member of the creditors' committee and, as a result, presumed to have materially participated in negotiating and structuring the terms of the Modified X Debt.

(iii) [Reserved]

* * * * *

(d) *Applicability date.* * * * Paragraph (c)(1) of this section applies to taxable years beginning on or after [DATE OF PUBLICATION OF FINAL RULE]. * * *

Par. 5. Section 1.892-4T is amended by revising paragraph (c)(1)(iii) to read as follows:

§ 1.892-4T Commercial activities (temporary regulations).

* * * * *

(c) * * *

(1) * * *

(iii) [Reserved]

* * * * *

Par. 6. Section 1.892-5, as amended in a final rule published elsewhere in this issue of the **Federal Register**, effective December 15, 2025, is amended by:

a. Revising paragraph (c)(2); and

b. Adding a sentence after the second sentence of paragraph (e).

The revision and addition read as follows:

§ 1.892-5 Controlled commercial entity.

* * * * *

(c) * * *

(2) *Effective control*—(i) *Rule*. An entity engaged in commercial activity is a controlled commercial entity under paragraph (a)(1)(ii) of this section if a foreign government (within the meaning of § 1.892-2T(a)) has *effective control* of the entity. Except as provided in paragraph (c)(2)(ii) of this section, effective control is achieved by any interest in the entity that, directly or indirectly, either separately or in combination with other interests, results in control of the operational, managerial, board-level, or investor-level decisions of the entity. However, mere consultation rights with respect to operational, managerial, board-level, or investor-level decisions of an entity (such as extending the term of the entity's investment period, change in control of the entity, or liquidation of the entity) do not alone give rise to effective control. The determination of effective control is made considering all of the facts and circumstances related to the interests in an entity. Interests in an entity may include, for example:

(A) Equity interests;

(B) Debt interests;

(C) Voting rights in the entity, including the power to appoint directors or managers, and to veto decisions;

(D) Contractual rights in or arrangements with the entity, or with other interest holders in the entity;

(E) Business relationships with the entity, or with other interest holders in the entity, including as a major customer or a supplier having control over a strategic natural resource used in the entity's business;

(F) Regulatory authority over the entity; or

(G) Any other interest in or other relationship with the entity that may provide influence over decisions relating to the entity's operations, management, board-level, or investor-level matters.

(ii) *Special rule*. A foreign government is deemed to have effective control of an entity if the foreign government is, or under paragraph (a)(1) of this section controls an entity that is, a managing partner or managing member of such entity, or holds or controls an entity that holds an equivalent role with respect to such entity under local law applicable to the entity.

(iii) *Examples*—(A) *Assumed facts.* The application of this paragraph (c)(2) is illustrated by the examples in this paragraph (c)(2)(iii). Except as otherwise stated, the following facts are assumed for purposes of paragraphs (c)(2)(iii)(B) through (I) of this section (*Examples 1* through *8*):

(*1*) FX is a foreign entity organized under the laws of country C and is treated as a corporation for Federal tax purposes; FX is a controlled entity of the government of country C under § 1.892-2T(a)(3);

(*2*) Corp 1 is a corporation for Federal tax purposes that is engaged in commercial activities;

(*3*) Corp 1 has a single class of equity interest and, unless otherwise stated, Corp 1's governing documents or local law require that more than 50 percent of its equity holders approve the election of its directors, the selection of its officers, and certain major corporate decisions;

(*4*) FX owns less than 50 percent of the value or voting power in Corp 1 under paragraph (a)(1)(i) of this section and whether Corp 1 is a controlled commercial entity with respect to FX is determined under paragraphs (a)(1)(ii) and (c)(2)(i) of this section based on all of the facts and circumstances; and

(*5*) The remaining equity interests of Corp 1 are owned by several other investors unrelated to FX, none of which has control of Corp 1 within the meaning of paragraph (a)(1)(i) of this section.

(B) *Example 1—*(*1*) *Facts*. FX owns 40 percent of the equity in Corp 1. Two other investors each own 30 percent of the equity in Corp 1. FX is not a party to any arrangement with other equity holders or holders of other interests in Corp 1 that would give

FX the right to elect a majority of Corp 1's directors or to appoint or replace officers of Corp 1. Under Corp 1's governing documents and local law, FX does not have the power to unilaterally authorize or veto a corporate action or appoint a majority of Corp 1's directors or officers, and FX does not hold any other interest in Corp 1, including by reason of any business relationship that provides it with influence over Corp 1.

(*2*) *Analysis*. Because FX holds only a minority equity interest in Corp 1, is not a party to any arrangement with other equity or other interest holders of Corp 1, does not have sufficient voting power to unilaterally authorize or veto Corp 1's actions or to appoint a majority of Corp 1's directors or officers, and does not otherwise hold any other interest in Corp 1, FX is not treated as having effective control of Corp 1. Accordingly, Corp 1 is not a controlled commercial entity with respect to FX.

(C) *Example 2*—(*1*) *Facts*. The facts are the same as in paragraph (c)(2)(iii)(B) of this section (*Example 1*), except that FX and Corp 1 have an investment agreement in place when FX invests in Corp 1. The investment agreement provides criteria for what types of investments can be made by Corp 1, and provides no voting, operational, managerial, or other rights to FX with respect to Corp 1.

(*2*) *Analysis*. The investment agreement between FX and Corp 1 does not itself, or in combination with the other facts provided in paragraph (c)(2)(iii)(B) of this section (*Example 1*), give FX control of operational, managerial, board-level, or investor-level decisions of Corp 1. Thus, for the reasons stated in paragraph (c)(2)(iii)(B) of this section (*Example 1*), FX is not treated as having effective control of Corp 1. Accordingly, Corp 1 is not a controlled commercial entity with respect to FX.

(D) *Example 3*—(*1*) *Facts*. The facts are the same as in paragraph (c)(2)(iii)(B) of this section (*Example 1*), except that under Corp 1's governing documents, FX is entitled to participate in an investment committee and has the right only to discuss acquisitions and sales of property by Corp 1, but FX has no right to decide or execute such acquisitions or sales and no other rights with respect to Corp 1.

(*2*) *Analysis*. FX's rights arising from the investment committee for Corp 1 are mere consultation rights with respect to managerial decisions of Corp 1. Such rights do not themselves, or in combination with the other facts provided in paragraph (c)(2)(iii)(B) of this section (*Example 1*), give FX control of operational, managerial, board-level, or investor-level decisions of Corp 1. Thus, for the reasons stated in paragraph (c)(2)(iii)(B) of this section (*Example 1*), FX is not treated as having effective control of Corp 1. Accordingly, Corp 1 is not a controlled commercial entity with respect to FX.

(E) *Example 4*—(*1*) *Facts*. Under Corp 1's governing documents, FX is entitled to appoint one out of three directors of Corp 1. That director alone is authorized under Corp 1's governing documents to unilaterally appoint or dismiss the manager, an officer of Corp 1 whose responsibilities are to manage Corp 1's operations. FX does not otherwise have sufficient voting power directly or through any arrangements with holders of equity or holders of other interests in Corp 1 to unilaterally authorize or veto any other Corp 1 action.

(*2*) *Analysis*. FX has, by reason of its equity interest, power that allows it to appoint a director who alone has the power to unilaterally appoint or dismiss Corp 1's manager, which provides FX with control over decisions as to the operations and management of Corp 1. Therefore, FX has effective control of Corp 1. Accordingly, Corp 1 is a controlled commercial entity with respect to FX.

(F) *Example 5*—(*1*) *Facts*. The facts are the same as in paragraph (c)(2)(iii)(E) of this section (*Example 4*), except instead of having the right to unilaterally appoint or dismiss the manager of Corp 1, FX's appointed director alone has rights to unilaterally veto dividend distributions, material capital expenditures, sales of new equity interests in Corp 1, and the operating budget of Corp 1.

(*2*) *Analysis*. The veto rights of FX's appointed director give FX control over decisions as to the operation of Corp 1. Therefore, FX has effective control of Corp 1. Accordingly, Corp 1 is a controlled commercial entity with respect to FX.

(G) *Example 6*—(*1*) *Facts.* Under Corp 1's governing documents, FX is entitled to appoint one out of three directors of Corp 1 and the remaining two directors are appointed by the other unrelated investors. However, one unrelated investor derives significant revenues from FX through other business dealings, and, as a matter of course, causes its appointed director to always vote in the same manner as FX's appointed director on all board decisions. That unrelated investor's and FX's appointed director's votes, when combined, constitute the majority of the Corp 1 board votes. FX does not otherwise have sufficient voting power to unilaterally authorize or veto any other Corp 1 action. FX does not hold any other interest in Corp 1.

(*2*) *Analysis*. FX's significant business relationship with the unrelated investor constitutes an interest in Corp 1 under paragraph (c)(2)(i)(E) of this section. That interest indirectly provides FX, when combined with its equity interest, with the power to control Corp 1's board. Therefore, FX has effective control of Corp 1. Accordingly, Corp 1 is a controlled commercial entity with respect to FX.

(H) *Example 7*—(*1*) *Facts*. Corp 1's business consists primarily of extracting and marketing a mineral located in country C. FC, the government of country C, owns all rights to that mineral and regulates all businesses engaged in its extraction.

(*2*) *Analysis*. FX, by reason of FC's ownership of the mineral rights and the regulatory authority over the mineral's extraction, has the ability to substantially affect Corp 1's business. For purposes of paragraph (c)(2)(i) of this section, FC's ownership of the mineral rights and its regulatory relationship with Corp 1's business constitute FX's interests in Corp 1 under paragraphs (c)(2)(i)(E) and (F) of this section. Those interests indirectly provide FX with the power to control decisions as to the operation and management of Corp 1. Therefore, FX has effective control of Corp 1. Accordingly, Corp 1 is a controlled commercial entity with respect to FX.

(I) *Example 8*—(*1*) *Facts*. FX is a creditor of Corp 1. Under the credit agreement between FX and Corp 1, Corp 1 is subject to restrictions on the type of investments that Corp 1 can make, asset dispositions, levels of future borrowing, and dividend distributions by Corp 1. The credit agreement also provides FX with veto rights over dividend and stock repurchases, additional borrowing, capital expenditures, Corp 1's annual operating budget, and redemption of subordinated debt.

(*2*) *Analysis*. FX's creditor interest, based on the totality of the rights provided to FX by the terms of the credit agreement, provides FX with control over both investor-level and operational decisions of Corp 1. Therefore, FX has effective control of Corp 1. Accordingly, Corp 1 is a controlled commercial entity with respect to FX.

* * * * *

(e) *Applicability date*. * * * Paragraph (c)(2) of this section applies to taxable years beginning on or after [DATE OF PUBLICATION OF FINAL RULE]. * * *

* * * * *

Frank J. Bisignano,
Chief Executive Officer.

(Filed by the Office of the Federal Register December 12, 2025, 8:45 a.m., and published in the issue of the Federal Register for December 15, 2025, 90 FR 57928)

Notice of Proposed Rulemaking

Updating Regulation References to Reflect Reorganizations at the Department of Justice and the Internal Revenue Service

REG-110519-25

AGENCY: Internal Revenue Service (IRS), Alcohol and Tobacco Tax and Trade Bureau (TTB), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would update points of contact within the Department of Justice and the IRS. The proposed regulations are necessary to reflect a reorganization within the Department of Justice to identify new points of contact for matters involving the internal revenue laws. The proposed regulations would also update points of contact at the IRS for adminis-

trative claim submissions from taxpayers seeking civil damages for certain unauthorized collection actions or awards of administrative costs with respect to certain administrative proceedings.

DATES: Written or electronic comments and requests for a public hearing must be received by January 14, 2026.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG-110519-25) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the "Comments and Requests for a Public Hearing" section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted to the IRS's public docket. Send paper submissions to*:* CC:PA:01:PR (REG-110519-25), room 5503, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Shikha K. Patel at (202) 317-6306; concerning submissions of comments or a public hearing, the Publications and Regulations Section at (202) 317-6091 (not toll-free numbers) or by email at *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Authority

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) under sections 6103, 6402, 7430, and 7433 of the Internal Revenue Code (Code) previously issued under sections 6103(q) and 7805(a) of the Code. This document also contains a proposed amendment to the Procedure and Administration Regulations (27 CFR Part 70), which governs taxpayer claims for credit or refund to the Alcohol and Tobacco and Trade Bureau (TTB) for certain excise taxes assessed under the Code. Section 6103(q) authorizes the Secretary of the Treasury or the Secretary's delegate (Secretary) "to prescribe such other regulations as necessary to carry out the provisions of [section 6103]." Section 7805(a) of the Code authorizes the Secretary to "prescribe all needful rules and regulations for the enforcement of [the Code], including all rules and regulations as may be necessary by reason of any alteration of law to internal revenue."

Background

I. *Changes in references to Department of Justice organization*

Civil and criminal litigation relating to the Internal Revenue laws has historically been handled or authorized by the Tax Division of the Department of Justice. The Treasury Department, IRS, and the TTB have been made aware that the Department of Justice has modified its organizational structure to divide the responsibilities of the Tax Division between the Civil Division and Criminal Division of the Department of Justice. References to the Tax Division appear in 26 CFR 301.6103(h)(2)-1 and 301.6402-2, and 27 CFR 70.123.

Section 301.6103(h)(2)-1 of Title 26 of the Code of Federal Regulations (Title 26) regulates the requirements and grounds for disclosures of returns and return information to and by officers and employees of the Department of Justice in Federal grand jury proceedings involving tax administration, including preparation for and investigation of those proceedings. These regulations provide that, pursuant to section 6103(h)(2), such disclosures must be duly authorized by or on behalf of the Assistant Attorney General for the Tax Division of the Department of Justice.

Section 301.6402-2 of Title 26 regulates the requirements, grounds, and form for a taxpayer to file a claim for credit or refund as well as methods of refund. In the event that the refund is based on a claim that has been reduced to judgement, or settled in or as a result of litigation, 26 CFR 301.6402-2 provides that the check is to be mailed to the Department of Justice, Tax Division, which will then deliver the check to the taxpayer or the counsel of record.

Section 70.123 of Title 27 sets forth the requirements, grounds, and form for filing claims for credits or refunds, as well as methods of refunds. It provides that checks in payment of claims which have been reduced to judgment or settled in the course or as a result of litigation, will be drawn in the name of the person or persons entitled to the money and will be sent to the Assistant Attorney General, Tax Division, Department of Justice, for delivery to the taxpayer or the counsel of record in the court proceeding.

II. *Changes in the processing of certain claims at the IRS*

Section 7433 provides for civil damages for certain unauthorized collection actions and was enacted as part of the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647, 102 Stat. 3746 (November 10, 1988). The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Public Law 105-206, 112 Stat. 685 (July 22, 1998), mandated fundamental reorganization of the IRS. Additionally, the RRA 98 amended section 7433(e) to require an exhaustion of administrative remedies. On March 25, 2003, the Treasury Department and the IRS published final regulations (TD 9050) in the **Federal Register** (68 FR 14316) under section 7433 that require, for collection actions that do not relate to section 362 or section 524 of title 11, United States Code (Bankruptcy Code), an administrative claim to first be sent in writing to the "Area Director, Attn: Compliance Technical Support Manager" of the area in which the taxpayer currently resides in order to exhaust administrative remedies. In contrast, for collection actions related to violations of section 362 or section 524 of the Bankruptcy Code, an administrative claim must first be sent to the "Chief, Local Insolvency Unit," for the judicial district in which the bankruptcy petition that is the basis for the asserted automatic stay or discharge violation was filed.

As part of that reorganization mandated by the RRA 98, the IRS shifted from a geographically focused organizational system to one that focuses on specific cat-

egories of taxpayers with similar needs. Since the regulations were published in 2003, there have been numerous changes to which IRS offices are responsible for the processing of these claims. The Internal Revenue Manual (IRM) 1.4.51.2 (June 25, 2025) sets forth the role of processing such claims to the Field Insolvency Manager and the Centralized Insolvency Operation Manager. The Insolvency function is now comprised of two operations, Field Insolvency (FI) and the Centralized Insolvency Operation (CIO). These two operations work together to provide customer service while addressing employee satisfaction in delivering improved business results. Pursuant to IRM 1.4.51.2.5 (2) and (3) (February 12, 2020), the CIO provides initial clerical processing and sends complex issues to FI to work. Addressing administrative claims for damages to the CIO ensures the efficient routing of these claims to the FI office best suited to address those claims. References to Compliance Technical Support appear in 26 CFR 301.7433-1. References to Local Insolvency Units appear in 26 CFR 301.7430-1, 301.7430-2, and 301.7433-2.

Section 301.7430-1(e) of Title 26 defines the manner in which a party seeking damages for actions involving willful violations of the automatic stay under section 362 of the Bankruptcy Code or the discharge provisions under section 524 of the Bankruptcy Code can meet the exhaustion of administrative remedies requirement of section 7433(d)(1). It provides that a party must file an administrative claim for damages or for relief from a violation of section 362 or section 524 of the Bankruptcy Code with the Chief, Local Insolvency Unit, for the judicial district in which the bankruptcy petition that is the basis for the asserted automatic stay or discharge violation was filed. It also refers to actions for damages for willful violation of the automatic stay as section 362(h) claims. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Public Law 109-8, 119 Stat. 23 (April 20, 2005) recodified section 362(h) of the Bankruptcy Code in its entirety at section 362(k)(1) of the Bankruptcy Code.

Section 301.7430-2(c) of Title 26 describes the procedures that a party must follow to recover reasonable administrative costs regarding administrative proceedings within the IRS. It provides that administrative claims with respect to requests for administrative costs incurred in damage actions for violations of section 362 or section 524 of the Bankruptcy Code should be made to the Chief, Local Insolvency Unit.

Section 301.7433-1(e) of Title 26 describes the procedures that a party must follow to file an administrative claim for damages for unauthorized collection actions to fulfill the exhaustion of administrative remedies requirement of section 7433(d)(1). Specifically, an administrative claim for damages shall be sent to the Area Director, Attn: Compliance Technical Support Manager, of the area in which the taxpayer currently resides.

Section 301.7433-2(a) of Title 26 describes the civil cause of action for violation of section 362 or section 524 of the Bankruptcy Code. Section 301.7433-2(a)(2) of Title 26 clarifies that while section 7433 constitutes the exclusive remedy under the Code for violations of section 362 or section 524 of the Bankruptcy Code, such exclusivity does not preclude a cause of action under the Bankruptcy Code relating to willful violations of the stay formerly codified at section 362(h). The BAPCPA recodified this cause of action under section 362(k) of the Bankruptcy Code. Section 301.7433-2(e) of Title 26 describes the procedures that a party must follow to file an administrative claim for damages for violations of section 362 or section 524 of the Bankruptcy Code to fulfill the exhaustion of administrative remedies requirement of section 7433(d)(1). It provides that an administrative claim for damages shall be sent to the Chief, Local Insolvency Unit, for the judicial district in which the taxpayer filed the underlying bankruptcy case giving rise to the alleged violation.

Explanation of Provisions

These proposed regulations would amend 26 CFR 301.6402-2, 301.6103(h)(2)-1, and 27 CFR 70.123 by updating references to the "Assistant Attorney General for the Tax Division of the Department of Justice" to reflect the Assistant Attorneys General who will supervise civil and criminal tax functions after the reorganization of the Department of Justice. Specifically, references in 26 CFR 301.6402-2 and 27 CFR 70.123, which relate to civil matters, would be amended to read "Assistant Attorney General for the Civil Division of the Department of Justice." References in 26 CFR 301.6103(h)(2)-1, which relate to criminal matters, would be amended to read "Assistant Attorney General for the Criminal Division of the Department of Justice." Amending these regulations to reflect the correct point of contact at the Department of Justice will ensure that communications are sent to the appropriate Assistant Attorney General with supervisory authority over the appropriate civil or criminal tax function.

Additionally, these proposed regulations would amend 26 CFR 301.7433-1(e)(1) by updating references to "Area Director, Attn: Compliance Technical Support Manager" to reflect that those matters are currently handled by Collection Advisory Groups. These proposed regulations would amend 26 CFR 301.7430-1(e), 301.7430-2(c)(2), and 301.7433-2(e)(1) by updating references to "Chief, Local Insolvency Unit" to reflect the shift to the Centralized Insolvency Operation. Specifically, the reference in 26 CFR 301.7433-1(e)(1) to "Area Director, Attn: Compliance Technical Support Manager" would be amended to read "Collection Advisory Group of the area in which the taxpayer currently resides." The references in 26 CFR 301.7430-1(e)(1), 301.7430-1(e)(2), 301.7430-2(c)(2), and 301.7433-2(e)(1) to "Chief, Local Insolvency Unit" would be amended to read "Centralized Insolvency Operation." Amending these regulations to reflect the current points of contact within the IRS Collection function will ensure that claim submissions are sent to the appropriate Collection contact.

Finally, these proposed regulations would update references to actions under Bankruptcy Code section 362(h) in 26 CFR 301.7430-1(e)(2) and 301.7433-2(a)(2) to reflect the revision to the Bankruptcy Code under the BAPCPA. Amending these regulations to reflect the current version of the Bankruptcy Code would decrease confusion around application of that title.

Proposed Effective Date

The changes to the organizational structure of the Department of Justice

and the IRS are already in effect. It would be unnecessary and contrary to the public interest for the regulations to continue to reference Department of Justice divisions and IRS business units that have been reorganized as points of contact. To ensure that communications are sent to the appropriate Assistant Attorney General with supervisory authority over the appropriate civil or criminal tax function at the Department of Justice for matters involving the internal revenue laws and that administrative claims submitted from taxpayers seeking civil damages for certain unauthorized collection actions or awards of administrative costs with respect to certain administrative proceedings are sent to the appropriate IRS collection contact, the Treasury Department, the IRS, and TTB find that there is good cause to dispense with a delayed effective date pursuant to 5 U.S.C. 553(d)(3). The regulations under 26 CFR part 301, as proposed, and 27 CFR part 70, as proposed, would be effective as of the date of publication of a Treasury decision adopting these proposed rules with any necessary modifications as final in the **Federal Register**.

Proposed Applicability Date

For proposed applicability dates see 26 CFR 301.6402-2(h), 301.6103(h)(2)-1(c), 301.7430-1(h), 301.7430-2(f), 301.7433-1(i); and 301.7433-2(i).

Special Analyses

I. *Regulatory Planning and Review*

These proposed regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (July 4, 2025) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

II. *Regulatory Flexibility Act*

The Secretary of the Treasury hereby certifies that these proposed regulations would not have a significant economic impact on a substantial number of small entities pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6). The proposed regulations would provide updated points of contact within the Department of Justice and the IRS, and would not impose any new requirements or obligations upon small entities. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act is not required.

III. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. These proposed regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

IV. *Executive Order 13132: Federalism*

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. These proposed regulations do not have federalism implications and do not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

V. *Small Business Administration*

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Request for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are timely submitted to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department, the IRS, and TTB request comments on all aspects of the proposed regulations. Any comments submitted will be available at *https://www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Shikha K. Patel of the Office of Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department participated in the development of the regulations.

Lists of Subjects

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

27 CFR Part 70

Administrative practice and procedure, Claims, Excise taxes, Freedom of information, Penalties, Reporting and recordkeeping requirements, Surety bonds.

Proposed Amendments to the Regulations

Accordingly, the IRS proposes to amend 26 CFR part 301 and the Treasury Department proposes to amend 27 CFR part 70 as follows:

PART 301 – PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for 26 CFR part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805.

Par. 2. Section 301.6402-2 is amended by revising paragraphs (f)(2) and (h) to read as follows:

§ 301.6402-2 Claims for credit or refund.

* * * * *

(f) * * *

(2) Checks in payment of claims which have either been reduced to judgment or settled in the course or as a result of litigation will be drawn in the name of the person or persons entitled to the money and will be sent to the Assistant Attorney General for the Civil Division of the Department of Justice, or such person's designee, for delivery to the taxpayer or the counsel of record in the court proceeding.

* * * * *

(h) *Applicability dates.* This section applies on or after December 15, 2025. For periods before December 15, 2025, see this section as in effect and contained in 26 CFR part 301, revised as of April 1, 2025.

Par. 3. Section 301.6103(h)(2)-1 is amended by revising paragraph (a)(2)(ii) and adding paragraph (c) to read as follows:

§ 301.6103(h)(2)-1 Disclosure of returns and return information (including taxpayer return information) to and by officers and employees of the Department of Justice for use in Federal grand jury proceeding, or in preparation for proceeding or investigation, involving tax administration.

(a) * * *

(2) * * *

(ii) In connection with any Federal grand jury proceeding, or preparation for any proceeding (or with an investigation which may result in such a proceeding), described in paragraph (a)(1) of this section which also involves enforcement of a specific Federal criminal statute other than one described in paragraph (a)(1) of this section to which the United States is or may be a party, provided such matter involves or arises out of the particular facts and circumstances giving rise to the proceeding (or investigation) described in paragraph (a)(1) of this section and further provided the tax portion of such proceeding (or investigation) has been duly authorized by or on behalf of the Assistant Attorney General for the Criminal Division of the Department of Justice, pursuant to the request of the Secretary, as a proceeding (or investigation) described in paragraph (a)(1) of this section. If, in the course of a Federal grand jury proceeding, or preparation for a proceeding (or the conduct of an investigation which may result in such a proceeding), described in this paragraph (a)(2)(ii), the tax administration portion thereof is terminated for any reason, any further use or disclosure of such returns or taxpayer return information in such Federal grand jury proceeding, or preparation or investigation, with respect to the remaining portion may be made only pursuant to, and upon the grant of, a court order as provided by section 6103(i)(1)(A), provided, however, that the returns and taxpayer return information may in any event be used for purposes of obtaining the necessary court order.

* * * * *

(c) *Applicability date*. This section applies on or after December 15, 2025. For periods before December 15, 2025, see this section as in effect and contained in 26 CFR part 301, revised as of April 1, 2025.

Par. 4. Section 301.7430-1 is amended by revising paragraphs (e) and (h) to read as follows:

§ 301.7430-1 Exhaustion of administrative remedies.

* * * * *

(e) * * * (1) *Section 7433 claims*. A party has not exhausted administrative remedies within the Internal Revenue Service with respect to asserted violations of the automatic stay under section 362 of title 11, United States Code (Bankruptcy Code) or the provisions under section 524 of the Bankruptcy Code unless it files an administrative claim for damages or for relief from a violation of section 362 or section 524 of the Bankruptcy Code with the Centralized Insolvency Operation or successor function and satisfies the other conditions set forth in § 301.7433-2(d) prior to filing a petition under section 7433.

(2) *Section 362(k) claims*. A party has not exhausted administrative remedies within the Internal Revenue Service with respect to asserted violations of the automatic stay under section 362 of the Bankruptcy Code unless it files an administrative claim for relief from a violation of section 362 of the Bankruptcy Code with the Centralized Insolvency Operation pursuant to § 301.7433-2(e) and satisfies the other conditions set forth in § 301.7433-2(d) prior to filing a petition under section 362(k) (formerly 362(h)) of the Bankruptcy Code.

* * * * *

(h) *Applicability date.* This section applies to court proceedings described in section 7430 filed in a court of the United States (including the Tax Court and the Court of Federal Claims) after December 15, 2025. For such court proceedings on or before December 15, 2025, see this section as in effect and contained in 26 CFR part 301, revised as of April 1, 2025.

Par. 5. Section 301.7430-2 is amended by revising paragraph (c)(2) and adding paragraph (f) to read as follows:

§301.7430-2 Requirements and procedures for recovery of reasonable administrative costs.

* * * * *

(c) * * *

(2) *Where request must be filed*. A request required by paragraph (c)(1) of this section must be filed with the Internal Revenue Service personnel who have jurisdiction over the tax matter underlying the claim for costs, except that requests with respect to administrative proceedings defined by § 301.7430-8(c) should be made to the Centralized Insolvency Operation. However, if those persons are unknown to the taxpayer making the request, the taxpayer may send the request to the Internal Revenue Service office that considered the underlying matter.

* * * * *

(f) *Applicability date*. This section applies on or after December 15, 2025. For periods before December 165, 2025, see this section as in effect and contained in 26 CFR part 301, revised as of April 1, 2025.

Par. 6. Section 301.7433-1 is amended by revising paragraphs (e)(1) and (i) to read as follows.

§301.7433-1 Civil cause of action for certain unauthorized collection actions.

* * * * *

(e) * * *

(1) *Manner*. An administrative claim for the lesser of $1,000,000 ($100,000 in the case of negligence) or actual, direct economic damages as defined in paragraph (b) of this section shall be sent in writing to the Collection Advisory Group of the area in which the taxpayer currently resides.

* * * * *

(i) *Applicability dates*. This section applies on or after December 15, 2025. For periods before December 15, 2025, see this section as in effect and contained in 26 CFR part 301, revised as of April 1, 2025.

Par. 7. Section 301.7433-2 is amended by revising paragraphs (a)(2), (e)(1), and (i) to read as follows.

§ 301.7433-2 Civil cause of action for violation of section 362 or 524 of the Bankruptcy Code.

(a) * * *

(2) An action under this section constitutes the exclusive remedy under the Internal Revenue Code for violations of sections 362 and 524 of title 11, United States Code (Bankruptcy Code). In addition, taxpayers injured by violations of section 362 of the Bankruptcy Code may maintain actions under section 362(k) (formerly section 362(h)) of the Bankruptcy Code (relating to an individual injured by a willful violation of the stay). However, any administrative or litigation costs in connection with an action under section 362(k) (formerly section 362(h)) may be awarded, if at all, only under section 7430 of the Internal Revenue Code.

* * * * *

(e) * * * (1) *Manner*. An administrative claim for the lesser of $1,000,000 or actual, direct economic damages as defined in paragraph (b) of this section shall be sent in writing to the Centralized Insolvency Operation.

* * * * *

(i) *Applicability date*. This section is applicable to actions taken by Internal Revenue Service officials after December 15, 2025. For actions taken by Internal Revenue Service officials on or before December 15, 2025, see this section as in effect and contained in 26 CFR part 301, revised as of April 1, 2025.

PART 70 – PROCEDURE AND ADMINISTRATION

Par. 8. The authority citation for 27 CFR part 70 continues to read in part as follows:

Authority: 5 U.S.C. 301 and 552; 26 U.S.C. 4181, 4182, 5123, 5203, 5207, 5275, 5367, 5415, 5504, 5555, 5684(a), 5741, 5761(b), 5802, 6020, 6021, 6064, 6102, 6109, 6155, 6159, 6201, 6203, 6204, 6301, 6303, 6311, 6313, 6314, 6321, 6323, 6325, 6326, 6331-6343, 6401-6404, 6407, 6416, 6423, 6501-6503, 6511, 6513, 6514, 6532, 6601, 6602, 6611, 6621, 6622, 6651, 6653, 6656-6658, 6665, 6671, 6672, 6701, 6723, 6801, 6862, 6863, 6901, 7011, 7101, 7102, 7121, 7122, 7207, 7209, 7214, 7304, 7401, 7403, 7406, 7423, 7424, 7425, 7426, 7429, 7430, 7432, 7502, 7503, 7505, 7506, 7513, 7601-7606, 7608-7610, 7622, 7623, 7653, 7805.

Par. 9. Section 70.123 is amended by revising paragraph (e)(2) to read as follows:

§ 70.123 Claims for credit or refund.

* * * * *

(e) * * *

(2) Checks in payment of claims which have either been reduced to judgment or settled in the course or as a result of litigation will be drawn in the name of the person or persons entitled to the money and will be sent to the Assistant Attorney General for the Civil Division of the Department of Justice, or such person's designee, for delivery to the taxpayer or the counsel of record in the court proceeding.

Frank J. Bisignano,
Chief Executive Officer.

Approved: October 14, 2025

Kenneth J. Kies,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register December 12, 2025, 8:45 a.m., and published in the issue of the Federal Register for December 15, 2025, 90 FR 57937)

Notice of Proposed Rulemaking

Relief From Joint and Several Liability

REG-132251-11; REG-134219-08

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Withdrawal of notices of proposed rulemaking.

SUMMARY: This document withdraws two notices of proposed rulemaking regarding relief from joint and several tax liability and relief from Federal income tax liability resulting from the operation of State community property laws. The proposed regulations would have affected married individuals who filed joint returns and later seek relief from joint and several liability.

DATES: As of December 15, 2025, the notices of proposed rulemaking that were published in the ***Federal Register*** on August 13, 2013 (78 FR 49242) and November 20, 2015 (80 FR 72649), are withdrawn.

FOR FURTHER INFORMATION CONTACT: Mark Shurtliff at (202) 317–6845 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 13, 2013, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG-132251-11) in the ***Federal Register*** (78 FR 49242) that proposed guidance for taxpayers on when and how to request relief from joint

and several liability under section 6015 of the Internal Revenue Code (Code) and relief from the operation of State community property law under section 66 of the Code (2013 proposed regulations). In addition, on November 20, 2015, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-134219-08) in the ***Federal Register*** (80 FR 72649) that reflected changes to section 6015 made by the Tax Relief and Health Care Act of 2006, Public Law 109-432, 120 Stat. 2922, 3061 (December 20, 2006), as well as changes in the law arising from litigation (2015 proposed regulations).

The Treasury Department and the IRS have determined it appropriate to withdraw the 2013 proposed regulations and the 2015 proposed regulations at this time to focus time and resources on other matters. Additionally, in light of the volume and breadth of scope of the comments received in response to the 2013 proposed regulations and the 2015 proposed regulations, the Treasury Department and the IRS have determined that further consideration of the proposed rules contained in the notices of proposed rulemaking is warranted. Moreover, due to the amount of time that has passed since the notices of proposed rulemaking were published, the Treasury Department and the IRS do not intend to publish final rules without again providing additional notice of the proposed rules and requesting public comments. For these reasons, the Treasury Department and the IRS are withdrawing the 2013 proposed regulations and the 2015 proposed regulations.

The withdrawal of the 2013 proposed regulations and the 2015 proposed regulations does not limit the ability of the Treasury Department and the IRS to publish new regulatory proposals regarding the areas addressed by the withdrawn notices of proposed rulemaking, including new proposals that may be substantially identical or similar to those described therein, and the Treasury Department and the IRS may propose new rules in this regard in a future rulemaking, as appropriate. In addition, the withdrawal of these notices of proposed rulemaking does not affect the ongoing application of existing statutory and regulatory requirements or the responsibility to faithfully administer the statutory requirements the proposed rules would have implemented if finalized. Finally, should the Treasury Department and the IRS decide in the future to move forward with rulemaking in this area, such rulemaking would take into account statutory changes that have been made, as well as changes in the law arising from litigation, since the 2013 proposed regulations and the 2015 proposed regulations were published.

Drafting Information

The principal author of this notice is Mark Shurtliff of the Office of Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department and the IRS participated in its development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Withdrawal of Proposed Amendments to the Regulations

Under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG-132251-11) that was published in the ***Federal Register*** on August 13, 2013 (78 FR 49242), and the notice of proposed rulemaking (REG-134219-08) that was published in the ***Federal Register*** on November 20, 2015 (80 FR 72649), are withdrawn.

Frank J. Bisignano,
Chief Executive Officer.

(Filed by the Office of the Federal Register December 12, 2025, 8:45 a.m., and published in the issue of the Federal Register for December 15, 2025, 90 FR 57937)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List[1]

Bulletin 2026–3

Notices:

Proposed Regulations:

Revenue Procedures:

Revenue Rulings:

Treasury Decisions:

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2025–27 through 2025–52 is in Internal Revenue Bulletin 2024–52, dated December 22, 2024.

Finding List of Current Actions on Previously Published Items[1]

Bulletin 2026–3

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2025–27 through 2025–52 is in Internal Revenue Bulletin 2024–52, dated December 22, 2024.

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We Welcome Comments About the Internal Revenue Bulletin

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