

TaxNewsFlash

United States

No. 2025-350
December 12, 2025

Final and proposed regulations: Income of non-U.S. governments and of international organizations under section 892

The U.S. Treasury Department and IRS today released final regulations and proposed regulations relating to the taxation of income of foreign (non-U.S.) governments and international organizations from investments in the United States.

Final regulations

The [final regulations](#) (T.D. 10042) modify and clarify the rules under section 892 regarding the exemption from U.S. income tax for non-U.S. governments and their controlled entities. The final regulations provide guidance for determining when a non-U.S. government is engaged in commercial activity and when an entity is a controlled commercial entity (CCE).

The final regulations retain the overall approach of prior proposed regulations (2011 and 2022), with certain modifications based on public comments. Key changes include:

- **Definition of commercial activity:** The final regulations broadly define commercial activity as any activity ordinarily conducted for the current or future production of income or gain, even if it does not constitute a "trade or business" under other Code provisions (or would not if it were conducted within the U.S.).
- **Investment exception:** The regulations clarify that investments in stocks, bonds, other securities, partnership equity interests, financial instruments (including derivatives), net leases, non-income-producing real property, and bank deposits are not commercial activities. Trading in such items for a non-U.S. government's own account (not as a dealer) is also not commercial activity.
- **Controlled commercial entities (CCE):** The regulations clarify that an entity is a CCE if a non-U.S. government holds at least 50% interest (by value or voting power) or has effective control over the entity. The term "effective control" is defined in the proposed regulations, as discussed below. In addition, the final regulations limit the rule that treats U.S. real property holding corporations (USRPHCs) as CCEs to domestic corporations, so that a foreign controlled entity is not treated as a CCE solely because of its status as a USRPHC.

- **Partnerships:** Commercial activities of a partnership are generally attributed to partners unless the partner holds a “qualified partnership interest” (passive, limited rights, <50% interest). Attribution rules are clarified for multi-tier partnership structures.
- **Inadvertent commercial activity exception:** Relief is provided for entities that inadvertently conduct commercial activity, provided the activity is promptly cured (within 180 days of discovery), the failure was reasonable, and adequate records are maintained. A safe harbor applies if assets/income from inadvertent commercial activity are ≤5% of total, and written policies/procedures are in place to avoid monitoring the entity’s worldwide activities.

The final regulations generally apply to tax years beginning on or after December 15, 2025. Taxpayers may elect to apply the rules to open prior years, subject to consistency requirements.

Proposed regulations

The [proposed regulations](#) (REG-101952-24) provide additional guidance under section 892, focusing on three key areas:

- **Definition of controlled entity:** The proposed regulations would clarify that partnerships (for U.S. tax purposes) are not “controlled entities” under section 892, even if wholly owned by a single foreign sovereign.
- **Acquisition of debt:** The proposed regulations would clarify that the acquisition of debt is treated as commercial activity unless it is characterized as investment under either of two safe harbors or under a facts-and-circumstances test.
 - **Safe harbors:** Debt acquired in an offering registered under the Securities Act (with unrelated underwriters) or in a qualified secondary market acquisition is treated as investment.
 - **Facts-and-circumstances test:** Other debt acquisitions may qualify as investment if, considering all relevant factors, the expected return is exclusively on capital and not on activities conducted by the acquirer.
- **Definition of effective control:** The proposed regulations would provide expanded guidance on what constitutes “effective control” for purposes of CCE status, including consideration of equity, debt, contractual, regulatory, and business relationship interests that allow control over operational, managerial, board-level, or investor-level decisions.

The proposed regulations are proposed to apply to tax years beginning on or after the date the regulations are finalized. Once finalized, taxpayers may elect to apply the rules excluding partnerships from the definition of controlled entities to open prior years, subject to consistency requirements. Comments on the proposed regulations and requests for a public hearing are due by February 13, 2026.

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