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February 27, 2023

Douglas O'Donnell
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Proposed Regulations under Sections 897 and 892

Dear Acting Commissioner O'Donnell:

Enclosed are comments on Proposed Regulations under Sections 897 and 892 regarding issues affecting real estate. These comments are submitted on behalf of the Section of Taxation and have not been reviewed or approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

C. Wells Hall, III
Chair, Section of Taxation

Enclosure

cc: Hon. Lily Batchelder, Assistant Secretary (Tax Policy), Department of the Treasury
Michael Plowgian, Deputy Assistant Secretary (International Tax Affairs), (Tax Policy), Department of the Treasury
Thomas West, Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
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AMERICAN BAR ASSOCIATION

SECTION OF TAXATION

Comments on Proposed Regulations under Sections 897 and 892 Regarding Issues Affecting Real Estate

These comments (the "**Comments**") are submitted on behalf of the American Bar Association Section of Taxation (the "**Section**") and have not been reviewed or approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Chris Mangin and Jason Smyczek of the Real Estate Committee. Substantial contributions were made by Paige Anderson, Maddie Brown, David Friedline, Nick Galatas, Xenia Garofalo, Peter Genz, Shiukay Hung, Kevin Jones, Mark Kirshenbaum, Alex Marcellesi, Chris McLoon, Arsalan Memon, Ana O'Brien, and Hasnain Valika. The Comments have been reviewed by Mark Van Deusen of the Real Estate Committee, Gary Huffman of the Section's Committee on Government Submissions, Michael Desmond, Chair of the Committee on Government Submissions for the Section, and Lisa Zarlenga, Vice-Chair of Government Relations for the Section.

Although members of the Section may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section's diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

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Date: February 27, 2023

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EXECUTIVE SUMMARY

I. Prop. Treas. Reg. § 1.897-1

Gain or loss of a nonresident alien individual or foreign corporation from the disposition of an interest in a domestically controlled "qualified investment entity"[1] ("**QIE**") is not subject to tax under section 897(a) (the "**DC-QIE Exception**").[2] A QIE is considered "domestically controlled" if, at all times during the testing period,[3] (the "**DC-QIE Testing Period**") less than 50% of the value of the stock was held "directly or indirectly" by foreign persons.[4] While the Code does not define "directly or indirectly" for purposes of section 897, existing regulations provide that the actual owners of stock, as determined under Treas. Reg. § 1.857-8, are taken into account to make this determination.[5]

On December 29, 2022 (the "**Issuance Date**"), the U.S. Department of the Treasury ("**Treasury**") and the Internal Revenue Service (the "**Service**") published proposed regulations under sections 892 (the "**Proposed Section 892 Regulations**") and 897 (the "**Proposed Section 897 Regulations**" and, together with the Proposed Section 892 Regulations, the "**Proposed Regulations**").[6] Instead of taking into account actual owners of stock in determining whether a QIE is domestically controlled, the Proposed Section 897 Regulations apply a look-through approach to QIE interests actually owned by certain entities. For example, foreign owners of certain foreign-owned domestic corporations (as defined in the Proposed Section 897 Regulations, "**FODCs**") are considered to own "directly or indirectly" stock of a QIE in making the domestically controlled determination (the "**Corporate Look-Through Rule**").[7] The Proposed Section 897 Regulations would apply to transactions occurring on or after the date final regulations issued under section 897 (the "**Final Section 897 Regulations**") are published in the Federal Register (the "**Publication Date**").

We commend Treasury and the Service for their thoughtful consideration of the interpretation of "indirectly" and the treatment of certain persons as foreign persons. However, we have concerns about the Corporate Look-Through Rule, which we discuss below. Specifically, we recommend that:

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[1] As defined in I.R.C. § 897(h)(4)(A). Unless otherwise indicated, references to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "**Code**") and all "Treas. Reg. §" references are to the Treasury Regulations promulgated under the Code, as in effect (or, in the case of proposed regulations which remain outstanding, as proposed) as of the date of these Comments.
[2] I.R.C. §§ 897(a)(1), (h)(2).
[3] The "testing period" is the shortest of (i) the five-year period ending on the date of the disposition or (ii) the period in which the QIE was in existence. I.R.C. § 897(h)(4)(D).
[4] I.R.C. § 897(h)(4)(B).
[5] Treas. Reg. § 1.897-1(c)(2)(i).
[6] 87 Fed. Reg. 80,097 (Dec. 29, 2022).
[7] Prop. Treas. Reg. § 1.897-1(c)(3)(iii)(B).

1. The Final Section 897 Regulations withdraw the Corporate Look-Through Rule and instead reaffirm the conclusions of PLR 200923001[8] (the "**2009 Private Letter Ruling**") regarding domestic control.

2. If the Corporate Look-Through Rule is not withdrawn, the Final Section 897 Regulations should amend the application of the Corporate Look-Through Rule set forth in the Proposed Section 897 Regulations in one or more of the following ways:

   a. Provide an exception to the Corporate Look-Through Rule if a non-public domestic C corporation owns ten percent or less of the QIE.

   b. Consider only 25% or greater non-look-though foreign owners of an FODC as the direct or indirect foreign owners of the QIE's stock. For this purpose, a non-public domestic C corporation would be an FODC only if at least one foreign person that is a non-look-through person holds, directly or indirectly, 25% or more of the fair market value of the corporation's outstanding stock.

   c. Apply the Corporate Look-Through Rule with respect to a non-public domestic C corporation with foreign ownership only if a foreign person or a foreign related party holds direct *and* substantial indirect interests in a QIE through such non-public domestic C corporation.

   d. Provide an exception to the Corporate Look-Through Rule for a non-public domestic C corporation with substantial business activities.

   e. Provide guidance (such as a model certification) as to the manner in which a domestic C corporation that owns shares in a QIE may certify to the QIE that it may be treated as a domestic person (*i.e.*, a non-look-through domestic corporation) for purposes of the Corporate Look-Through Rule.

3. If the Corporate Look-Through Rule is not withdrawn, we recommend that Treasury and the Service take the following actions with respect to the Publication Date:

   a. Clarify that the Corporate Look-Through Rule will not be applied to challenge (as referenced in the Preamble to the Proposed Regulations (the "**Preamble**")) whether a QIE qualified for the DC-QIE Exception during any DC-QIE Testing Period (or portion thereof) prior to the Publication Date.

[8] PLR 200923001 (Feb. 26, 2009).

b. Provide in the Final Section 897 Regulations for a transition relief provision that would indefinitely exempt from the Corporate Look-Through Rule QIEs that were established prior to the Issuance Date.

c. Alternatively, or in addition to, our recommendation immediately above, include in the Final Section 897 Regulations an exemption for existing foreign investors in existing QIEs to the extent of their existing ownership and capital commitments to the QIE (including indirect capital commitments) as of the Issuance Date.

d. If Treasury and the Service do not provide transition relief as recommended above, the Final Section 897 Regulations should provide that the Corporate Look-Through Rule will apply only on a fully prospective basis from no less than 120 days after the Publication Date, with no application to any DC-QIE Testing Period (or portion thereof) prior to the Publication Date.

II. Prop. Treas. Reg. § 1.892-5

Section 892(a)(1) provides that certain income received by a foreign government is excluded from gross income and exempt from federal income tax. This exemption, however, does not apply to income received directly or indirectly from commercial activities, such as income (i) derived from the conduct of any commercial activity (whether within or outside the United States), (ii) received by a controlled commercial entity[9] ("**CCE**") or received (directly or indirectly) from a CCE, or (iii) derived from the disposition of any interest in a CCE.[10]

To qualify as a CCE, the entity must be engaged in commercial activities (whether within or outside of the United States).[11] For this purpose, Temp. Treas. Reg. § 1.892-5T(b)(1) provides that a U.S. real property holding corporation[12] ("**USRPHC**") (or a foreign corporation that would be a USRPHC if it was a domestic corporation) is treated as engaged in commercial activity (the "**Deeming Rule**").

The Proposed Section 892 Regulations reiterate the Deeming Rule, while also providing two notable exceptions to the Deeming Rule (restated as Prop. Treas. Reg. § 1.892-5(b)(1)(ii)). The first exception is for a foreign corporation that is a "qualified foreign pension fund"[13] ("**QFPF**") or a "qualified controlled entity" [14] ("**QCE**") that is considered a qualified holder under Treas. Reg. § 1.897(l)-1(d) (a "**Qualified Holder**").

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[9] As defined in I.R.C. § 892(a)(2)(B). *See also* Temp. Treas. Reg. § 1.892-5T(a), 53 Fed. Reg. 24,060, 24,064 (June 27, 1988).
[10] I.R.C. § 892(a)(2)(A).
[11] I.R.C. § 892(a)(2)(B). The entity must also meet one of the two ownership requirements under I.R.C. § 892(a)(2)(B)(i), (ii). *See also* Temp. Treas. Reg. § 1.892-5T(a).
[12] As defined in I.R.C. § 897(c)(2).
[13] As defined in Treas. Reg. § 1.897(l)-1(e)(10).
[14] As defined in Treas. Reg. § 1.897(l)-1(e)(9). A "qualified controlled entity" is an entity that is wholly owned by one or more QFPFs.

The second exception is for a USRPHC that is a USRPHC solely by reason of its direct and indirect ownership interest in one or more other corporations not controlled by the foreign government (as determined under Temp. Treas. Reg. § 1.892-5T(a)) (the "**Portfolio Exception**"). If an exception applies, the corporation will not be considered to be engaged in commercial activity and therefore will not be a CCE.

We commend Treasury and the Service on proposing these exceptions to the Deeming Rule that are consistent with the policy of section 892. Even with these helpful exceptions, however, in cases where a foreign government invests in U.S. real estate through a controlled entity that owns interests in lower-tier USRPHCs, the Deeming Rule will cause any income (including income from sources other than the USRPHCs) derived from the controlled entity to not be exempt under section 892 (unless the controlled entity is itself a USRPHC solely as a result of owning interests in other USRPHCs not controlled by the foreign government). In such a case, we see no policy rationale for penalizing the foreign government with respect to other (non-USRPHC) income of the controlled entity through which it is investing. Consequently, we recommend that final regulations issued under section 892 (the "**Final Section 892 Regulations**"):

1. Withdraw the Deeming Rule of Temp. Treas. Reg. § 1.892-5(b)(1) in its entirety.

2. If the Deeming Rule is not withdrawn in its entirety:

    a. Finalize Prop. Treas. Reg. § 1.892-5(b)(1)(ii)(A) as written to provide that a Qualified Holder will not be treated as engaged in commercial activity or as a CCE solely as a result of being a USRPHC.

    b. Amend Prop. Treas. Reg. § 1.892-5(b)(1) to apply solely to a corporation that *would be* a USRPHC if the references in section 897(c)(2) to U.S. real property interests[15] ("**USRPIs**") were replaced by references to USRPIs described in section 897(c)(1)(A)(i).

    c. Provide a rule under Prop. Treas. Reg. § 1.892-5(b)(1)(ii)(B) that disregards USRPIs (other than interests in USRPHCs) that, in the aggregate, represent a de minimis value of all USRPIs held by the corporation (*e.g.*, ten percent or less).

3. Provide that gain arising from the disposition of a partnership interest is exempt under section 892 to the extent such gain is attributable to assets that, if sold directly by the foreign government, would be exempt from section 892.

[15] Within the meaning of I.R.C. § 897(c)(1)(a).

4. Confirm that customary side letter provisions, such as consent rights as part of a limited partners' advisory committee or consent rights over major decisions and "extraordinary events," will not cause a partnership interest to fail to qualify for the limited partner exception under Prop. Treas. Reg. § 1.892-5(d)(5)(iii)(A).

DISCUSSION

I. Prop. Treas. Reg. § 1.897-1

A. Introduction

The Proposed Section 897 Regulations address the determination of whether a QIE is "domestically controlled," and therefore eligible for an exemption from tax under the Foreign Investment in Real Property Tax Act of 1980 ("**FIRPTA**"). A QIE includes any (i) real estate investment trust ("**REIT**") within the meaning of section 856(a) and (ii) any regulated investment company ("**RIC**") within the meaning of section 851(a), which is a USRPHC or which would be a USRPHC if the exceptions in section 897(c)(3) or section 897(h)(2) did not apply to interests in any such REIT or RIC.[16]

1. Background

Section 897(a)(1) provides that gain or loss of a nonresident alien individual or a foreign corporation from the disposition of a USRPI is taken into account as taxable income as if the nonresident alien individual or the foreign corporation were engaged in a trade or business within the United States[17] ("**USTOB**") during the taxable year and such gain or loss were effectively connected with such trade or business. A USRPI is presumed to include any interest in a U.S. corporation unless the taxpayer establishes that the corporation was not a USRPHC at any time during the five-year period ending on the date of the disposition.[18] A corporation meets the definition of a USRPHC if the fair market value of its USRPIs equals at least 50% of the fair market value of the corporation's USRPIs, its interest in real property located outside the United States, and any other of its assets used in a trade or business.[19]

Section 897(h)(2) provides that a USRPI does *not* include an interest in a QIE that qualifies under the DC-QIE Exception. Accordingly, gain or loss on the disposition of stock in a domestically controlled QIE, such as a REIT, is not subject to section 897(a).[20] A QIE is domestically controlled if less than 50% of the value of its stock is held "directly or indirectly" by foreign persons at all times during the DC-QIE Testing Period.[21] Notably, the focus of the statute is on the applicable DC-QIE Testing Period,

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[16] I.R.C. § 897(h)(4)(A).
[17] As defined in I.R.C. § 864(c).
[18] I.R.C. § 897(c)(1)(a)(ii). A foreign person can establish that the stock of a domestic corporation is not a USRPI by requesting and obtaining a statement from the corporation that certifies under penalties of perjury that the corporation's stock does not constitute a USRPI. The foreign person must obtain the statement from the domestic corporation on or before the date of the transfer. In addition, the domestic corporation must send a copy of such statement to the Service within 30 days after it is provided to the foreign person.
[19] I.R.C. § 897(c)(2). In addition to interests in USRPHCs, most direct interests in U.S. real property such as land, improvements on land, buildings, and other "inherently permanent structures" are USRPIs.
[20] Other than as provided in I.R.C. § 897(h)(1).
[21] I.R.C. § 897(h)(4)(B).

which is based on the period of the QIE's existence, rather than the relevant foreign shareholder's ownership period.

The practical effect of the DC-QIE Exception is that up to 49.99% of a QIE's shares can be owned directly by foreign persons without the sale of those shares being subject to tax under FIRPTA. Income and gain from the other 50.01% of the shares held by domestic owners will generally be subject to U.S. federal income tax at regular corporate and individual rates, as applicable. Certain domestic owners that are non-taxable entities (*e.g.*, tax-exempt organizations) may not be subject to U.S. federal income tax.

2. Overview of the Proposed Section 897 Regulations

The Proposed Section 897 Regulations provide guidance as to whether stock of a QIE is held "*directly or indirectly*" by foreign persons for purposes of determining whether a QIE is domestically controlled. Specifically, the Proposed Section 897 Regulations provide that the following non-publicly traded entities should be "looked through" for purposes of applying the DC-QIE Exception:

- Domestic and foreign partnerships;
- REITs;
- RICs; and
- FODCs (*i.e.*, domestic C corporations if 25% or more of the fair market value of the corporation's stock is owned, directly or indirectly, by foreign persons).[22]

With respect to C corporations, the Preamble provides that Treasury and the Service considered "alternatives for the rule that defines a domestically controlled QIE, including one alternative that generally would treat all domestic C corporations as non-look through persons" but ultimately decided that the Corporate Look-Through Rule "best serves the purposes of the DC-QIE Exception while also taking into account 'indirect' ownership of QIE stock by foreign persons in determining whether a QIE is domestically controlled."[23] The Preamble further provides that the purpose of this special rule for FODCs is to "prevent the use of intermediary domestic C corporations by foreign investors to create domestically controlled QIEs that could exempt from the application of section 897 QIE stock held directly by those or other foreign investors."[24]

The Proposed Section 897 Regulations also provide that a QFPF is treated as a foreign person in determining whether a QIE is domestically controlled.[25] While section 897(l) treats a QFPF as neither a nonresident alien individual nor a foreign corporation for purposes of section 897, it does not explicitly state that a QFPF or a QCE is not

[22] Prop. Treas. Reg. § 1.897-1(c)(3)(ii).
[23] Preamble to Prop. Treas. Reg. § 1.897-1, 87 Fed. Reg. at 80,104.
[24] *Id*.
[25] Prop. Treas. Reg. § 1.897-1(c)(3)(iv)(A).

treated as a foreign person for purposes of the separate ownership test of the DC-QIE Exception. The Proposed Section 897 Regulations provide clarification:

> Because section 897(l) already specifically excludes QIEs from the application of section 897(a), treating them as not being a foreign person for purposes of the DC-QIE Exception would serve only to benefit other foreign investors in the same QIE. Nothing in the statute or legislative history indicates that majority ownership of a QIE by a QFPF or QCE should allow other investors to avoid section 897, and such treatment does not follow from the policy of either section 897(l) or the DC-QIE Exception as expressed in the legislative history of those provisions.[26]

Accordingly, the Proposed Section 897 Regulations provide that QFPFs (including any part of a QFPF) and QCEs are foreign persons for purposes of the DC-QIE Exception.[27]

3. Publication Date

The Proposed Section 897 Regulations apply to transactions occurring on or after the Publication Date. However, the Preamble provides that the rules applicable for determining whether a QIE is domestically controlled may be relevant for determining QIE ownership during periods prior to the Publication Date. Specifically, the Proposed Section 897 Regulations are relevant to the extent the DC-QIE Testing Period for a transaction that occurs after the Publication Date includes periods before the Publication Date. Because the DC-QIE Testing Period is generally the five-year period ending on the date of the disposition, the Proposed Section 897 Regulations, if published as the Final Section 897 Regulations, will have retroactive effect (*i.e.*, a taxpayer selling or otherwise disposing of domestically controlled QIE interests would need to prove domestically controlled QIE status under the Final Section 897 Regulations for the five years prior to the date of such sale or other disposition).

In addition, the Preamble notes that the Service may challenge positions contrary to the domestically controlled QIE determination and the foreign ownership percentage determination provided under the Proposed Section 897 Regulations[28] before the Publication Date.

B. The DC-QIE Exception and the Meaning of "Directly or Indirectly"

Neither the Code nor the original legislative history of the enactment of the DC-QIE Exception provide explicit guidance or rules for determining whether stock is held "directly or indirectly" by foreign persons. However, as further described below, current regulatory and administrative guidance provides insight. Additionally, more

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[26] Preamble to Prop. Treas. Reg. § 1.897-1, 87 Fed. Reg. at 80,104.
[27] Prop. Treas. Reg. § 1.897-1(c)(3)(iv)(A). The Section is generally in agreement with Treasury and the Service as to the characterization of QFPFs and QCEs as foreign persons for purposes of the DC-QIE Exception and therefore these Comments will not further address this particular portion of the Proposed Section 897 Regulations.
[28] Prop. Treas. Reg. § 1.897-1(c)(3), (4).

recent legislative history and the actions of Congress provide insight into Congressional intent with respect to the DC-QIE Exception.

1. Actual Owner Rule

a. Treas. Reg. § 1.857-8

Treas. Reg. § 1.897-1(c)(2)(i) currently provides that for purposes of determining whether a REIT is domestically controlled, "the actual owners of stock, as determined under Treas. Reg. § 1.857-8, must be taken into account" (the "**Actual Owner Rule**"). Treas. Reg. § 1.857-8 provides:

> The actual owner of stock of a real estate investment trust is the person who is required to include in gross income in his return the dividends received on the stock. Generally, such person is the shareholder of record of the real estate investment trust. However, where the shareholder of record is not the actual owner of the stock, the stockholding record of the real estate investment trust may not disclose the actual ownership of such stock. Accordingly, the real estate investment trust shall demand written statements from shareholders of record disclosing the actual owners of stock as required in paragraph (d) of this section.[29]

The Actual Owner Rule was promulgated on December 31, 1984. For over 38 years, the Actual Owner Rule was the primary guidance regarding whether stock of a QIE is "held directly or indirectly" by foreign persons for purposes of section 897(h)(4)(B). Although the Preamble states that the Actual Owner Rule "is only intended to ensure the beneficial owner of stock is taken into account when different from the shareholder of record," [30] there may be another, more supportable, interpretation of the intent of the Actual Owner Rule.

In 1985, Treasury and the Service were faced with a similar issue relating to Treas. Reg. § 1.897-1(c)(2)(iii), which deals with the exception from FIRPTA taxation of gains from the sale of shares in a publicly traded REIT (the "**Publicly Traded Exception**").[31] In response to a comment received on proposed regulations concerning the possible liability of brokers or transfer agents, Treasury and the Service clarified Treas. Reg. § 1.897-1(c)(2)(iii) such that it uses a "beneficial ownership" standard to determine if a shareholder owns more than five percent of a regularly traded class of

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[29] Treas. Reg. § 1.857-8(b). Paragraph (d) refers to statements to be demanded from shareholders of a REIT.

[30] Preamble to Prop. Treas. Reg. § 1.897-1, 87 Fed. Reg. at 80,101.

[31] Generally, the Publicly Traded Exception provides that gain from the sale of REIT stock, and capital gain distributions on REIT stock, will not be subject to FIRPTA with respect to a foreign stockholder if (i) the applicable class of stock is "regularly traded on an established securities market in the United States" within the meaning of Treas. Reg. § 1.897-1(m) and Temp. Treas. Reg. § 1.897-9T(d)(2) and (ii) the foreign stockholder did not own more than ten percent of that class of stock at any time during the one-year period preceding the sale or distribution, as applicable. I.R.C. § 897(c)(3), (k)(1).

interests.[32] Specifically, Treas. Reg. § 1.897-1(c)(2)(iii) provides that the standard is "a person who beneficially owned" the class of interests. It is noteworthy that the term "beneficial ownership" is used in Treas. Reg. § 1.897-1(c)(2)(iii), but not in Treas. Reg. § 1.897-1(c)(2)(i). If the purpose of the Actual Owner Rule was merely to distinguish between nominee ownership and beneficial ownership, seemingly Treasury and the Service would have used a similar beneficial ownership standard in Treas. Reg. § 1.897-1(c)(2)(i), but did not. This absence suggests that Treasury and the Service did not intend to apply the beneficial ownership standard to Treas. Reg. § 1.897-1(c)(2)(i).

Consequently, in applying the Actual Owner Rule for the past four decades, taxpayers and practitioners often interpreted a C corporation as the "actual owner" for purposes of the DC-QIE Exception because C corporations are fully taxable on any distributions from a QIE.[33] Practitioners and taxpayers viewed this interpretation as reasonable, particularly in light of the fact that analyzing domestic C corporations as separate and distinct taxpayers from their shareholders has long been a feature of the U.S. tax system.[34] This position is further supported by the Service's conclusion in the 2009 Private Letter Ruling and recent legislative history, as more thoroughly described in Sections I.B.1.b. and I.B.2 below.[35]

In contrast, the determination of whether a domestic partnership is an "actual owner" under the Actual Owner Rule is less clear. Domestic partnerships technically report dividends on Form 1065, *U.S. Return of Partnership Income*, but unlike domestic C corporations they are not themselves taxable on QIE distributions.[36] The Preamble, in discussing the need for a look-through rule generally, describes an example whereby foreign investors use a domestic partnership to qualify a REIT for the DC-QIE Exception. Notwithstanding the illustration contained in the Preamble, tax practitioners have, almost universally, advised taxpayers that because partnerships do not pay tax on QIE

[32] *See* Discussion of Comments and Changes to Proposed Regulations Published November 3, 1983, 49 Fed. Reg. 50,689 (Dec. 31, 1984). The Protecting Americans from Tax Hikes Act of 2015 (the "**PATH Act**") increased the ownership limitation in the Publicly Traded Exception to ten percent for regularly traded REIT stock, but maintained the five percent ownership limitation for non-REIT corporations. See Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, § 322(a)(1), 129 Stat. 2242. Treas. Reg. § 1.897-1(c)(2)(iii) has not been amended to reflect the differing ownership limits for REITs and non-REIT corporations.

[33] *See* I.R.C. § 11.

[34] *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 438–39 (1943) (holding that a corporation will be treated as a separate and distinct taxpayer from its sole shareholder if it has a business purpose or any business activity). Minimal business activity, including acting as a holding company, is sufficient to meet the *Moline Properties* standard. *See Britt v. United States*, 431 F.2d 227, 237 (5th Cir. 1970) ("Business activity is required for recognition of the corporation as a separate taxable entity; the activity may be minimal."); *see also* FSA 200122007 (Feb. 13, 2001) (holding that the fact that a corporation is a holding company is sufficient to meet the business activity test set forth in *Moline Properties*).

[35] *See* PLR 200923001.

[36] *See* I.R.C. § 701.

distributions they cannot be treated as an actual owner.[37] A contrary position would enable foreign persons to merely choose to form a domestic partnership rather than a foreign partnership to hold shares of a QIE and cause the QIE to be domestically controlled without any other tax consequences.[38] While we appreciate Treasury and the Service clarifying that a domestic partnership (as well as a foreign partnership) should be treated as an aggregate for purposes of the DC-QIE Exception, we do not believe that the Proposed Section 897 Regulations' extension of this principle to domestic C corporations in the form of the Corporate Look-Through Rule is warranted.

b. 2009 Private Letter Ruling

The 2009 Private Letter Ruling, noted above, interprets the Actual Owner Rule and indicates that for purposes of the DC-QIE Exception: (a) domestic C corporations are treated as domestic shareholders irrespective of foreign ownership of such C corporations; and (b) pass-through entities will be looked through. Specifically, in the 2009 Private Letter Ruling, the Service concluded that because the shareholders in question were fully taxable domestic C corporations, and not REITs, RICs, hybrid entities, conduits, disregarded entities, or other look-through entities, the domestic C corporations should be treated as domestic holders for purposes of the DC-QIE Exception.[39] Although a private letter ruling may not be used or cited as precedent by taxpayers,[40] the persuasive reasoning in the 2009 Private Letter Ruling was widely adopted by taxpayers and practitioners. In addition, it is significant that the 2009 Private Letter Ruling was cited in the legislative history to the PATH Act, as well as by the Joint Committee on Taxation (in each case, without criticism), which suggests that Congress arguably agrees with the conclusion of the 2009 Private Letter Ruling, as discussed further below under Section 1.B.2.[41]

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[37] *See* Preamble to Prop. Treas. Reg. § 1.897-1, 87 Fed. Reg. at 80,101. The Preamble asserts that, without the proposed look-through rules, a U.S. REIT, the stock of which is held 49% by nonresident alien individuals and 51% by a domestic partnership, which is in turn owned in equal parts by two foreign corporations, would qualify for the DC-QIE Exception because taxpayers in such cases may point to the literal language of Treas. Reg. § 1.897-1(c)(2)(i) (and its reference to the Actual Owner Rule) and take the position that the partnership is the actual owner of such REIT stock because the partnership will include in gross income on its income tax return the dividends received from such REIT. We are aware of only very isolated instances in which tax practitioners advised taxpayers to take the position that a domestic partnership with foreign partners should be treated as "good" domestic ownership for purposes of the DC-QIE Exception.

[38] *See* NYSBA Tax Section, *Report on the Changes to FIRPTA under the Protecting Americans from Tax Hikes Act of 2015* 27 (2015), available at https://nysba.org/NYSBA/Sections/Tax/Tax%20Section%20Reports/Tax%20Reports%202016/1354%20Report.pdf.

[39] *See* PLR 200923001.

[40] I.R.C. § 6110(k)(3).

[41] *See* S. Rep. No. 114-25, at 6 (2015); Staff of the Joint Committee on Taxation, JCS–1–16, *General Explanation of Tax Legislation Enacted in 2015*, 279 n. 959 (2016) (the "**2016 Bluebook**").

2. Congressional Intent

a. DC-QIE Exception Lacks Explicit Constructive Ownership Rules

Congress has not expressly provided for the application of any constructive ownership rules for a C corporation under the DC-QIE Exception, in contrast to other parts of section 897, and elsewhere in the Code. Specifically, constructive ownership rules, applying modified section 318 attribution rules, are expressly provided for when determining: (i) the availability of the Publicly Traded Exception,[42] (ii) when determining whether and when to look through lower-tier subsidiaries of a C corporation in testing for USRPHC status,[43] (iii) the eligibility of a shareholder to make an election for a publicly traded foreign corporation to be treated as a domestic C corporation,[44] and (iv) the application of section 897 to certain interests in REITs.[45] Courts, including the Supreme Court, have long held that where Congress includes specific language in a section of a statute but omits that language in another, that such omission should be read as a purposeful exclusion.[46]

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[42] *See* I.R.C. § 897(c)(3) as set forth in I.R.C. § 897(c)(6)(C).
[43] *See* I.R.C. § 897(c)(5) as set forth in I.R.C. § 897(c)(6)(C).
[44] *See* I.R.C. § 897(i)(3).
[45] *See* I.R.C. § 897(k)(1) (modifying the constructive ownership rules of section 897(c)(6)(C) in the context of a disposition of stock in a REIT); *see also* I.R.C. § 897(k)(2)(E) (applying the constructive ownership rules of 897(c)(6)(C) to section 897(k)(2)(B)(i) when determining a qualified shareholder and section 897(k)(2)(D) when determining an applicable investor).
[46] *See BFP v. Resolution Tr. Corp.*, 511 U.S. 531, 537 (1994) (comparing the meaning of "fair market value" between Bankruptcy Code (11 U.S.C.) sections 346, 522, and 548 and observing, "It is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another."); *see also, e.g.*, *Kucana v. Holder*, 558 U.S. 233, 250 (2010) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposefully in the disparate inclusion or exclusion."); *Nken v. Holder*, 556 U.S. 418, 430 (2009) (same); *United States v. Jordan*, 915 F.2d 622, 628 (11th Cir. 1990) ("Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposefully in the disparate inclusion or exclusion.") (quoting *Rodriguez v. United States*, 480 U.S. 522, 525 (1987) (per curiam)); *Aaron Rents, Inc. v. United States*, 462 F. Supp. 65, 70 (N.D. Ga. 1978) (commenting on a difference between sections 46 and 48 and observing, "Congress obviously knows how to write the rule both ways, and unless we assume the most casual draftsmanship, we can only conclude that the distinction has been made intentionally."); *Smith v. Commissioner*, 151 T.C. 41, 56 (2018) ("Where Congress knows how to say something but chooses not to, its silence is controlling.") (citing *CBS, Inc. v. PrimeTime 24 Joint Venture*, 245 F.3d 1217, 1226 (11th Cir. 2001)).

Moreover, Code sections frequently refer to (or otherwise include concepts of) "direct or indirect" ownership and include specific constructive ownership rules[47] or other rules of attribution[48] for purposes of making such determination. Thus, where the phrase "direct or indirect" ownership appears without any constructive ownership concept or rules of attribution provided, we believe that such omission by Congress should ordinarily be presumed to be intentional and constructive ownership rules should not be read to apply.

For example, in *Brown v. Commissioner*, the Tax Court, using this logic, declined to apply section 318 in the context of determining whether there was constructive ownership between a husband and wife's individual retirement accounts, because "section 318 applies to 'those provisions of this subchapter to which the rules contained in this section are expressly made applicable.'"[49] The Fourth Circuit has also previously ruled that constructive ownership rules and rules of attribution do not apply to Code sections which lack explicit references to these sections, even if the Code section contains the phrase "direct or indirect." In *Mitchell v. Commissioner*, the Fourth Circuit

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[47] *See, e.g.*, I.R.C. §§ 267(c) (providing constructive ownership rules to determine direct and indirect ownership of stock), 269B (referencing sections 958(a)(2), 958(a)(3), and 318(a)(4) for purposes of determining whether a corporation is directly or indirectly foreign owned), 318 (providing constructive ownership rules to determine direct and indirect ownership of stock), 460 (cross referencing the constructive ownership rules of section 1563), 544 (providing constructive ownership rules to be used in certain parts of sections 542 and 543 to determine direct or indirect ownership of stock to determine whether a corporation is a personal holding company), 707 (cross referencing the constructive ownership rules of section 267(c) to determine direct or indirect ownership of a partnership interest), 856(d)(5) (entitled "constructive ownership of stock" and applying modified section 318 attribution rule to determine direct or indirect ownership of a corporation or partnership for purposes of certain REIT requirements), 881(b)(3)(B) (entitled "Indirect Ownership Rules" and applying modified section 318 stock attribution rules for purposes of determining whether a U.S. territory corporation is directly or indirectly 25% foreign-owned; stating this also applies for purposes of section 884), 958(b) (entitled "Constructive Ownership" and cross referencing the rules of section 318 for purposes of section 954(d) (relating to indirect ownership of stock of a corporation)), 956(c)(2) (same), 957 (same), 1239 (applying modified section 267 constructive ownership rules to determine direct or indirect ownership of stock for purposes of determining whether an entity is a "controlled entity"), 1246 [repealed] (cross referencing both sections 958 and 318 to determine direct or indirect ownership of a foreign investment company), 1563(e) (entitled "constructive ownership" and listing specific rules of attribution, which apply to direct or indirect ownership of stock of a corporation), 4946(a)(4) (cross referencing section 267), 4975 (applying modified section 267 constructive ownership rules to determine direct or indirect ownership of stock for purposes of determining whether an entity is a "disqualified person" for purposes of a prohibited transaction rule), 6038 (cross referencing the constructive ownership rules of section 267(c) other than section 267(c)(3) for purposes of determining direct or indirect ownership of a partnership).

[48] *See, e.g.*, I.R.C. §§ 424(d) (entitled "Attribution of Stock Ownership" providing certain attribution rules with respect to direct or indirect ownership of stock for purposes of applying certain limitations under sections 422(b)(6) and 423(b)(3)), 448(d)(2)(B) (specifying what indirect ownership entails), 831(b)(2)(B)(iv)(III) (entitled "Indirect interest" and defining it), 883 (providing stock owned directly or indirectly by an entity will be attributed to such entity's holders for purposes of determining ownership of foreign corporations), 953 (cross referencing section 883 to determine indirect ownership of a corporation), 958(a) (entitled "Direct and Indirect Ownership" and providing an attribution rule for purposes of Subpart F other than section 960), 2031 (cross referencing the attribution rules of section 2057(e)(3) prior to its repeal for purposes of determining whether a decedent's gross estate directly or indirectly owns an entity), 4946(d)(1) (including rules of attribution for purposes of determining "disqualified persons" based on direct or indirect ownership of entities).

[49] T.C. Summ. Op. 2008-56 (2008).

considered whether former section 1239 (which contained the phrase "directly or indirectly" but had not yet been amended to cross reference section 267) imported beneficial ownership rules.[50] The Fourth Circuit, citing sections 267 and 707, held that the lack of any specific beneficial ownership rules in section 1239 meant that such rules did not apply to section 1239. The Fourth Circuit concluded:

> Thus, as these sections illustrate, the [Code] is specific whenever tax consequences depend upon the equitable ownership of stock, as contrasted to its legal ownership. The failure to specify in section 1239 that beneficial ownership is to be included in computing the 80% limit strongly indicates that the beneficial ownership of stock is not to be counted.[51]

While the above referenced cases do not involve the validity of Treasury Regulations seeking to impose constructive ownership, they nevertheless support the proposition that Code sections that do not specifically contain or cross reference constructive ownership rules should not be interpreted to implicitly contain such rules.

Similarly, the Service has previously declined to interpret the phrase "direct or indirect" to apply constructive ownership rules where such rules are not specifically referenced. For example, in TAM 200733024, a foreign corporation argued that the look-through rule of section 1297(c), which requires the foreign corporation to own "directly or indirectly" more than 25% of another corporation, applied with respect to its ownership of another corporation.[52] The taxpayer argued that the phrase "owns, directly or indirectly" incorporated constructive ownership rules, and thus that an individual shareholder's ownership of stock in such other corporation should be attributed to the foreign corporation. The Service rejected this argument, stating:

> Section 1297(c), by its terms, applies only to stock owned "directly or indirectly" by the foreign corporation that is being tested for PFIC status. "Direct or indirect" ownership does not include constructive ownership. When Congress intends constructive ownership rules to apply, it will expressly so state. For example, section 318 provides that, under certain circumstances, stock "directly or indirectly" owned by one person will be considered to be owned by another person.[53]

b. Congress Considered and Did Not Adopt Look-Through Rules

Congress has previously considered, but did not adopt, the application of a look-through rule for C corporations under the DC-QIE Exception. The Senate Committee on Finance, in a 2013 discussion draft that served as a precursor to the PATH Act[54] (the "**Discussion Draft**"), proposed to apply the family attribution rules of section

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[50] *Mitchell v. Commissioner,* 300 F.2d 533, 536 (4th Cir. 1962).
[51] *Id.*
[52] TAM 200733024 (Oct. 26, 2006).
[53] *Id.*
[54] Pub. L. No. 114-113, § 322(b)(1)(A).

318, and to treat stock owned by a corporation as owned by persons with a 50% or greater interest in the corporation for purposes of the DC-QIE Exception.[55] These provisions were not included in the PATH Act. The PATH Act did, however, enact specific look-through rules with respect to the application of the DC-QIE Exception where a QIE owns an interest in another QIE.[56] Critically, if a domestic C corporation look-through rule already existed due to the presence of the word "indirectly" in the statute, the specific look-through rule created by Congress for privately held parent QIEs was wholly unnecessary.[57]

In discussing the 2009 Private Letter Ruling, Congress acknowledged that the law did not provide for looking through C corporations generally but declined to enact a separate look-through rule for C corporations. The description of present law in the Senate Report on the Real Estate and Jobs Act of 2015 (the "**Senate Report**") described both the Actual Owner Rule and the Service's position expressed in the 2009 Private Letter Ruling that "'directly or indirectly' for this purpose [in section 897(h)(4)(B)] does not require looking through corporate entities that, in the facts of the ruling, were represented to be fully taxable domestic corporations for U.S. federal income tax purposes."[58] There is no indication of Congress's disapproval of the position in the 2009 Private Letter Ruling, even though Congress had the opportunity to override this position. Contrast this with another provision in the PATH Act relating to section 897(h) intended specifically to replace AM 2008-003:[59]

> The provision is intended to override in certain cases one of the conclusions reached in AM 2008-003. Specifically, the provision contains special rules with respect to certain distributions that are treated as a sale or exchange of REIT stock under section 301(c)(3), 302, or 331 with respect to a qualified shareholder. Any such amounts attributable to an applicable investor are ineligible for the FIRPTA exception for qualified shareholders, and thus are subject to FIRPTA. Any such amounts attributable to other investors are treated as a dividend received from a REIT for purposes of U.S. dividend withholding tax and the application of income tax treaties, notwithstanding their general treatment under the Code.[60]

In sum, the legislative history discussed above strongly supports the view that the absence of explicit constructive ownership rules for domestic C corporations for purposes

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[55] *See* Staff of the Joint Committee on Taxation, JCX-15-13, *Technical Explanation of the Senate Committee on Finance Chairman's Staff Discussion Draft of Provisions to Reform International Business Taxation*, 84 (2013). The Discussion Draft contained many provisions that ultimately were enacted in the PATH Act.

[56] *See* I.R.C. § 897(h)(4)(E).

[57] REITs and RICs are domestic corporations for U.S. tax purposes subject to special rules. *See* I.R.C. §§ 851(a)(3), 856(a)(3). They are nonetheless corporations to which an implied look-through rule in the original statute by reason of the word "indirectly" would have applied without additional Congressional action to supply constructive ownership rules for parent QIEs in the PATH Act.

[58] S. Rep. No. 114-25, at 6. The Real Estate and Jobs Act of 2015 ultimately became the PATH Act.

[59] AM 2008-003 (Feb. 15, 2008).

[60] 2016 Bluebook, at 281.

of the DC-QIE Exception means that the Code should not be read as implicitly containing such rules.

c. Presumption That Congress Acts Intentionally

Courts have repeatedly held that "Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another."[61] The Preamble recognized this general principle in its explanation of why it would be contrary to congressional intent to treat QFPFs and QCEs as domestic persons for purposes of the DC-QIE Exception:

> There is no indication that Congress intended for section 897(l) to provide that QFPFs and QCEs are not treated as foreign persons for purposes of applying the DC-QIE Exception to other foreign persons that are neither QFPFs nor QCEs. As originally enacted in the PATH Act, section 897(l) provided that section 897 did not apply to USRPIs held, and REIT distributions received, by a QFPF and a QCE but did not alter the status of the QFPF or QCE. As a result, as originally enacted section 897(l) turned off the application of section 897(a) to the QFPF or QCE.
>
> In the same legislation, Congress also amended the rules in the DC-QIE Exception…. Certain amendments to the DC-QIE Exception deem ownership in a QIE as ownership by a United States or foreign person depending on whether certain conditions are met. See section 897(h)(4)(E)(i), 897(h)(4)(E)(ii). *These amendments demonstrate that Congress knows how to directly identify the deemed classification of investors as foreign persons or United States persons and did so in one part of the PATH Act through amendments to the DC-QIE Exception. Congress could have made a similar modification to the DC-QIE Exception for QFPFs and QCEs in the same legislation but did not do so*.[62]

Accordingly, we believe that, had Congress intended for the PATH Act to include the Corporate Look-Through Rule, it would have explicitly modified the look-through rule to include C corporations in the manner that it did so for QIEs.

d. Conclusion

We believe that the Corporate Look-Through Rule is inconsistent with the Congressional intent underlying the DC-QIE Exception in the case of a domestic C corporation shareholder. In sum, in the legislative history of the PATH Act, (i) the 2009 Private Letter Ruling is discussed without disapproval; (ii) Congress specifically indicated an intent to overturn a separate FIRPTA-related administrative pronouncement; and (iii) the only change to the provisions related to the definition of "domestically controlled qualified investment entity" were with respect to tiered QIEs, despite prior

[61] *See supra* note 47.
[62] Preamble to Prop. Treas. Reg. § 1.897-1, 87 Fed. Reg. at 80,099 (emphasis added).

consideration of more robust look-through rules in the Discussion Draft. If Congress had intended to provide for the application of the stock constructive ownership rules for a C corporation for purposes of the DC-QIE Exception, or otherwise provide a look-through rule, it likely would have done so at the same time it had provided for such treatment of tiered QIEs.

3. Market Impact of Proposed 897 Regulations

The use of privately held REITs as a vehicle to hold U.S. real estate is commonplace in the real estate industry. Many real estate funds, both closed and open ended, own their U.S. real estate holdings through one or more subsidiary REITs. To facilitate access to capital from taxable foreign investors, the REIT's ownership is often structured to qualify for the DC-QIE Exception. Typically, foreign investors will negotiate for representations or covenants from the fund sponsor that the REIT is, and will remain, domestically controlled, to pave the way for a potential nontaxable exit in the event that the exit can be structured in the form of a REIT share sale.

Historically, in determining a REIT's compliance with the DC-QIE Exception, fund sponsors and their tax advisors have, for the reasons articulated in Sections I.B.1 and 2 of these Comments, reasonably assumed that regular domestic C corporation investors residing in the REIT's chain of ownership are domestic owners and not subject to any look-through rule, even where there is significant foreign ownership of such C corporation.[63]

Against this backdrop, the Corporate Look-Through Rule will disrupt many existing domestically controlled REIT structures. For existing REITs that fail to qualify for the DC-QIE Exception due to one or more FODCs in their ownership structure, the only recourse to avoid application of this rule is a mid-stream ownership change. Restructuring ownership, however, will be a practical impossibility in all but the most unusual of circumstances. Moreover, even if some form of restructuring could be accomplished, a post-Publication Date sale of REIT shares may nevertheless be FIRPTA-"tainted" for up to five years after the Publication Date because the Corporate Look-Through Rule would be effective for the portion of the DC-QIE Testing Period that precedes the Publication Date. The only other alternative is to try to arrange an expedited sale ahead of the Publication Date. Even assuming a buyer could be found, and a sale negotiated and closed, before the Proposed Section 897 Regulations are finalized, such sales under duress are unattractive options.

The Corporate Look-Through Rule also presents complications for potential buyers of existing private REITs that fail to qualify as domestically controlled due to the Corporate Look-Through Rule. If a buyer seeks to qualify the acquired REIT as

[63] Such C corporations may be newly organized, or they may be pre-existing, such as domestic insurance companies with significant foreign ownership, domestic subsidiaries of multinational corporations, and other pre-existing corporations with varying degrees of foreign ownership that have substantial other assets and business activities. Some may be widely held, but not necessarily publicly held within the meaning of Prop. Treas. Reg. § 1.897-1(c)(3)(v)(G) (if publicly held, they would not be looked through regardless of the degree of foreign ownership).

domestically controlled going forward, it will not only have to generate a compliant post-acquisition ownership structure, but also will have to live with the fact that the pre-acquisition failure to be domestically controlled (due to the Corporate Look-Through Rule) gives the REIT a five-year "hangover" period when it will not be able to meet the DC-QIE Exception.

For new REIT investments, fund sponsors will find it far more difficult to assemble a mix of investors that will permit the investee REITs to be domestically controlled. If the DC-QIE Exception is not available, taxable foreign capital sources may look elsewhere for higher yielding investments.

Further, complying with the Proposed Section 897 Regulations will present new compliance and diligence burdens. Fund sponsors will need to (i) determine the chain of upper-tier entities (both domestic and foreign) in the REIT's ownership structure, (ii) classify each such entity as a look-through person or non-look-through person, (iii) determine the ownership structure of each entity that is determined to be a look-through person, (iv) determine the ultimate owners that are non-look-through persons and their status as domestic or foreign persons, and (v) determine the "proportionate interest" in the REIT of each non-look-through person, piercing through the tiers of entities. For each non-public domestic C corporation in the chain of ownership, the sponsor will need to determine if it qualifies as an FODC, requiring a determination of whether non-look-through foreign persons ultimately own 25% or more of the value of such corporation's shares. In complex ownership structures, this may be extremely difficult, if not impossible, particularly if the domestic C corporation is widely held (but not publicly held under Treas. Reg. § 1.897-1(c)(3)(v)(G)) and/or there are look-through entities above the C corporation that will require a determination of each passthrough owner's "proportionate interest" therein. The REIT's visibility into upper-tier changes in the ownership structure subsequent to the initial determination of domestically controlled status may be limited, and its ability to control such change events even more so.

C. Recommendations

We recommend that the Corporate Look-Through Rule be withdrawn and that any Final Section 897 Regulations reaffirm the conclusions of the 2009 Private Letter Ruling. If Treasury and the Service nevertheless determine to retain the Corporate Look-Through Rule, we alternatively recommend that any Final Section 897 Regulations provide the modifications to Prop. Treas. Reg. § 1.897-1(c)(3) described in Sections I.C.2 and I.C.3 below.

1. Withdrawal of the Corporate Look-Through Rule

As discussed above, for almost four decades the only regulatory guidance regarding whether stock of a QIE was "held directly or indirectly" by foreign persons was the Actual Owner Rule.[64] Although we agree with Treasury and the Service's conclusion that a look-though approach is appropriate when stock of a QIE is held by a domestic (or

[64] Treas. Reg. § 1.897-1(c)(2)(i); *see also* PLR 200923001 (applying Treas. Reg. § 1.857-8 rather than looking through an FODC).

foreign) partnership, we do not believe that Congress intended for the look-though approach to apply in the manner of the Corporate Look-Through Rule.[65] No statutory constructive ownership rules apply for purposes of the DC-QIE Exception to impute ownership of QIE stock to direct or indirect owners of a domestic corporation that holds the stock of the QIE. In fact, Congress specifically amended section 897 in the PATH Act to expressly provide a set of look-through rules for QIEs[66] while declining to adopt a look-through for C corporations — the Senate Report accompanying the PATH Act describes the holding under the 2009 Private Letter Ruling in its explanation of current law.[67] Accordingly, we believe that the appropriate conclusion is that Congress believed at the time that no look through rule applied under current law, or arguably ought to apply, to domestic corporations for purposes of the DC-QIE Exception.

Additionally, as previously described, implementing the Corporate Look-Through Rule, as written, is likely to have a chilling effect on foreign investment in U.S. real estate markets. For these reasons, we respectfully recommend that the Corporate Look-Through Rule be withdrawn and that any Final Section 897 Regulations reaffirm the conclusions of the 2009 Private Letter Ruling.

2. Modifications of the Corporate Look-Through Rule

If the Corporate Look-Through Rule is not withdrawn, we recommend certain modifications to the rule. The recommendations below should not be read as altering our principal recommendation that the Corporate Look-Through Rule should be withdrawn, as it is inconsistent with current law and Congressional intent and is disruptive to U.S. real estate markets. Rather, the recommendations that follow are included in the spirit of constructive input and in an attempt to mitigate the harshest consequences of the Corporate Look-Through Rule's broad approach.

The Preamble indicates that Treasury and the Service concluded that a look-though approach serves the purposes of the DC-QIE Exception while also taking into account "indirect" ownership by foreign persons in determining whether a QIE is domestically controlled under section 897(h)(4)(B).[68] Treasury and the Service also noted that a complete look-through approach is inappropriate due to both the policy underlying section 897(h)(4) and administrability concerns.[69] We agree that a complete look-through approach would be inappropriate. Notably, the Preamble also provides that the Corporate Look-Through Rule would prevent the use of intermediary domestic C corporations by foreign investors to create a domestically controlled QIE that could allow those or other foreign investors to apply the DC-QIE Exception with respect to stock directly held in the QIE.[70] This language suggests that Treasury and the Service may be

[65] Preamble to Prop. Treas. Reg. § 1.897-1, 87 Fed. Reg. at 80,101.
[66] I.R.C. § 897(h)(4)(E).
[67] S. Rep. No. 114-25, at 6.
[68] Preamble to Prop. Treas. Reg. § 1.897-1, 87 Fed. Reg. at 80,104.
[69] *Id*. at 80,101.
[70] *Id.* at 80,102.

concerned that this type of structuring constitutes illegitimate planning within the context of the DC-QIE Exception (the "**Illegitimate Planning Concern**").

Although the Corporate Look-Through Rule achieves the results that Treasury and the Service intended in that it addresses the Illegitimate Planning Concern, we respectfully submit that the approach is overly broad.

Determining whether a non-public domestic C corporation is "foreign-owned" to ultimately apply the look-though approach will be administratively burdensome because all foreign owners are counted towards the 25% threshold, no matter how small their interest in the domestic corporation may be. We believe that collecting all indirect foreign ownership information to properly determine whether the DC-QIE Exception applies will often not be possible and will be challenging for taxpayers and the Service to verify and administer. Moreover, it may be impractical to compel non-public domestic C corporations to provide ownership information to a QIE or other relevant party that wishes to determine whether the DC-QIE Exception applies. Lastly, including certain foreign-parented non-public domestic C corporations with substantial U.S. business activity may inappropriately prevent foreign investors in QIEs from applying the DC-QIE Exception. We note that foreign investors will often hold FIRPTA assets or other investments generating income that is effectively connected with a USTOB through a domestic C corporation to legitimately avoid the added costs and complexities of being subject to direct U.S. taxation and filing U.S. tax returns.

Accordingly, we recommend that Treasury and the Service amend the definition of an FODC in one or more of the manners discussed below. Importantly, we believe that the Corporate Look-Through Rule, as amended to incorporate any of the alternatives recommended below, would address the Illegitimate Planning Concern.

a. The Corporate Look-Through Rule Does Not Apply to a Non-Public Domestic C Corporation that Owns Ten Percent or Less of the QIE

We believe that a non-public domestic C corporation that owns ten percent or less of a QIE should be treated as a non-look-though person. To prevent the use of multiple non-public domestic C corporations to circumvent this ten percent limitation, the constructive ownership rules provided under section 318(a) should expressly apply for purposes of making this determination. This recommendation uses the same ownership limitation as the Publicly Traded Exception from FIRPTA applicable to a REIT.[71] This exception would also be more administrable than the proposed Corporate Look-Through Rule for taxpayers and the Service to apply.

We also believe this recommendation would address the Illegitimate Planning Concern. Specifically, this recommendation acknowledges that (i) taxpayers are free to choose to structure their investments as they wish and (ii) unrelated third parties have unbiased, and potentially competing, agendas. That is, generally, a foreign person would

[71] I.R.C. § 897(k)(1).

not structure an investment through a taxable domestic C corporation so that an unrelated foreign person may apply the DC-QIE Exception—generally, both foreign investors would equally want to apply the DC-QIE Exception to the extent available.

The following example illustrates the application of this recommendation.

Example 1.

Facts. USR is a QIE, five percent of the stock of which is held by USCo, a non-public domestic C corporation, 50% of the stock of which is held by a public domestic C corporation, and 45% of the stock of which is held by nonresident alien individuals. FC1, a foreign corporation, holds 30% of the stock of USCo. FC2, a foreign corporation, holds 25% of the stock of USCo. Y, a nonresident alien individual, holds five percent of the stock of USCo. The remaining 40% of the stock of USCo is held by U.S. individuals. After application of section 318(a) none of the USR stock is determined to be attributed to USCo.

Analysis. Because USCo actually and constructively holds less than ten percent of USR, USCo is a non-look-though person. Foreign persons therefore hold directly or indirectly 45% of the stock of USR. In this case, USR is a domestically controlled QIE.

b. Only 25% or Greater Foreign Owners Taken Into Account

Ascertaining the identity and ownership percentage of each foreign owner of a non-public domestic C corporation may be administratively burdensome to taxpayers and the Service. To address this concern, we recommend that a non-public domestic C corporation be treated as a look-through person only if there is at least one foreign person that is a non-look-through person that holds, directly or indirectly,[72] 25% or more of the fair market value of the corporation's outstanding stock, and that, in such a case, only direct or indirect 25% or greater foreign owners that are non-look-through persons are considered the direct or indirect foreign owners of the QIE's stock for purposes of Prop. Treas. Reg. § 1.897-1(c)(3)(ii) and (iii)(B). For this purpose, all other owners (domestic or foreign) of the FODC would be considered domestic direct or indirect holders of the QIE's stock. We believe that this standard, while providing improved administrability, would also address the Illegitimate Planning Concern. Specifically, it would limit the ability of a single significant foreign investor (or a few significant foreign investors) to form a non-public domestic C corporation to avail themselves of the DC-QIE Exception.

We believe identifying 25% or greater foreign owners is an administrable standard because domestic corporations must currently identify 25% or greater foreign shareholders to determine if Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or Foreign Corporation Engaged in a U.S. Trade or Business*, must be

[72] Determined based on the constructive ownership rules under section 318(a).

filed. Subject to certain exceptions, Form 5472 must be filed if the domestic corporation had a "reportable transaction" with a foreign related party, which includes a direct or indirect 25% foreign shareholder.[73]

The following examples illustrates the application of this recommendation.

Example 2.

Facts. USR is a QIE, 75% of the stock of which is held by USCo, a non-public domestic C corporation, and 25% of the stock of which is held by nonresident alien individuals. FC1, a foreign corporation, holds 30% of the stock of USCo. FC2, a foreign corporation, holds 25% of the stock of USCo. Y, a nonresident alien individual, holds five percent of the stock of USCo. The remaining 40% of the stock of USCo is held by U.S. individuals.

Analysis. Because FC1 and FC2 are each non-look-though persons under Prop. Treas. Reg. § 1.897-1(c)(3)(v)(D) and each own 25% or more of the fair market value of USCo, the indirect ownership of FC1 and FC2 is taken into account in determining the domestically controlled status of USR. Accordingly, 22.5% of the stock of USR is considered as held directly or indirectly by FC1 (30% × 75%) and 18.75% of the stock of USR is considered as held directly or indirectly by FC2 (25% x 75%). Foreign persons therefore hold directly or indirectly 66.25% of the stock of USR (25% of the stock of USR held directly by nonresident alien individuals, who are foreign persons and non-look-through persons, plus the 22.5% and 18.75% held indirectly by FC1 and FC2, respectively). In this case, USR is not a domestically controlled QIE.

Example 3.

Facts. The facts are the same as Example 2, except FC2 owns 20% of the stock of USCo and the U.S. individuals own 45% of the stock of USCo.

Analysis. Because FC1 is a non-look-though person under Prop. Treas. Reg. § 1.897-1(c)(3)(v)(D) and owns 25% or more of the fair market value of USCo, 22.5% of the stock of USR is considered as held directly or indirectly by FC1 (30% × 75%). FC2 is treated as a domestic owner because it owns less than 25% of the value of USCo. Foreign persons therefore hold directly or indirectly 47.5% of the stock of USR (25% of the stock of USR held directly by nonresident alien individuals, who are foreign persons and non-look-through persons plus the 22.5% held indirectly by FC1). In this case, USR is a domestically controlled QIE.

[73] *See Instructions for Form 5472* (Rev. Jan. 2023).

c. Indirect Ownership Taken Into Account Only if the Foreign Person Has Direct Ownership in QIE

As an alternative to the previous recommendation, we recommend applying the Corporate Look-Through Rule with respect to a non-public domestic C corporation with foreign ownership only if a foreign person or a foreign related party holds both a direct interest in the QIE *and* a substantial indirect interest (for example, ten percent) in the QIE through such non-public domestic C corporation. We believe this recommendation addresses the Illegitimate Planning Concern. Specifically, similar to our first recommendation, this recommendation acknowledges that (i) taxpayers are free to choose to structure their investments as they wish and (ii) unrelated third parties have unbiased, and potentially competing, agendas. That is, generally, a foreign person would not structure an investment through a taxable domestic C corporation so that an unrelated foreign person may apply the DC-QIE Exception.

The following examples illustrates the application of this recommendation.

Example 4.

Facts. USR is a QIE, 51% of the stock of which is held by USCo, a non-public domestic C corporation, 45% of the stock of which is held by FC1, a foreign corporation, and four percent of the stock of which is held by nonresident alien individuals. FC1 also holds 25% of the stock of USCo. FC2, a foreign corporation, holds 50% of the stock of USCo and the remaining 25% of the stock of USCo is held by U.S. individuals. None of the nonresident alien individuals own, directly or indirectly, an interest in FC1 or FC2. Lastly, none of FC1, FC2, the nonresident alien individuals, and the U.S. individuals are related to each other within the meaning of section 267(b).

Analysis. Because FC1 is a non-look-though person under Prop. Treas. Reg. § 1.897-1(c)(3)(v)(D) and owns a direct and indirect interest in USR, both of FC1's interests are taken into account in determining whether USR is a domestically controlled QIE. With respect to FC1's indirect interest, 12.75% of the stock of USR is considered as held directly by FC1 (25% × 51%). Because FC2 does not own a direct interest in USR, FC2's interest in USCo is not taken into account. Foreign persons therefore hold directly or indirectly 61.75% of the stock of USR (four percent of the stock of USR held directly by nonresident alien individuals, who are foreign persons and non-look-through persons, plus the 57.75% of the stock of USR held directly and indirectly by FC1 (45% plus 12.75%)). In this case, USR is not a domestically controlled QIE.

Example 5.

Facts. The facts are the same as Example 4, however FC1 does not hold any stock of USCo and FC3, a foreign corporation unrelated to FC1, holds

25% of the stock of USCo. The nonresident alien individuals are not related to FC3.

Analysis. Because FC1 and the nonresident alien individuals are non-look-though persons under Prop. Treas. Reg. § 1.897-1(c)(3)(v)(D) and do not own any indirect interests in USR, only FC1's and the nonresident alien individuals' direct interests are taken into account in determining whether USR is a domestically controlled QIE. Because FC2 and FC3 do not own a direct interest in USR, FC2's and FC3's interests in USCo are not taken into account. Further, because the look-through approach does not apply, USCo is wholly considered a non-look-though person. Foreign persons therefore hold directly or indirectly 49% of the stock of USR (four percent of the stock of USR held directly by nonresident alien individuals plus the 45% of the stock of USR held directly by FC1). In this case, USR is a domestically controlled QIE.

d. Exception for a Non-Public Domestic C Corporation with Substantial Business Activities

In certain circumstances, an FODC that is actively engaged in a USTOB may also make investments in QIEs. In the case of such a business with "boots on the ground," we suggest that an exception from the definition of FODC would be appropriate when the corporation can demonstrate that it is not a mere shell for its foreign owners to invest in QIEs. This exception would treat the FODC as a non-look-though person. This exception could apply whenever the non-public domestic corporation (or a member of its affiliated group) would be treated as engaging in the conduct of a USTOB were it a foreign corporation.[74] Additionally, this exception could further be limited to situations in which the value of the QIE's stock is less than a certain percentage of the affiliated group's total assets (for example, ten percent), or if the value of the stock of all QIEs represents less than a certain threshold of the total assets of the affiliated group (for example, 50%). Such a limitation would be an administrable method of distinguishing FODCs that have substantial business activities other than investing in QIEs from those that may have been formed solely to avail the foreign owners of the DC-QIE Exception.

The following example illustrates the application of this recommendation.

Example 6.

Facts. USR is a QIE, 75% of the stock of which is held by USCo, a non-public domestic C corporation, and 25% of the stock of which is held by nonresident alien individuals. FC1, a foreign corporation, holds all of

[74] *Cf.* I.R.C. § 199A(c)(3)(A) (The term "qualified items of income, gain, deduction, and loss" means items of income, gain, deduction, and loss to the extent such items are (i) effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting "qualified trade or business (within the meaning of section 199A)" for "nonresident alien individual or a foreign corporation" or for "a foreign corporation" each place it appears), and (ii) included or allowed in determining taxable income for the taxable year.).

the stock of USCo. The nonresident alien individuals that hold stock of USR own no interest in FC1. USCo is a holding company that owns two subsidiaries. One subsidiary owns and operates hotels, and the other subsidiary provides hotel management services to third parties. USCo, through its subsidiaries, would be treated as engaged in a USTOB if it were a foreign corporation. Additionally, USR represents five percent of the value of the USCo affiliated group assets, and USR and all other QIEs held by USCo's affiliated group represent 30% of the affiliated group's assets.

Analysis. Because (1) USCo would be treated as engaged in a USTOB if it were a foreign corporation, (2) USR represents less than ten percent of the USCo affiliated group's assets, and (3) USR and all other QIEs held by USCo's affiliated group represent less than 50% of the affiliated group's assets, USCo is not a look-through person. Foreign persons therefore hold directly or indirectly 25% of the stock of USR (25% of the stock of USR held directly by nonresident alien individuals). In this case, USR is a domestically controlled QIE.

e. Withholding and Documentation Considerations

A domestic C corporation is generally able to verify its treatment as a U.S. person for the withholding tax rules in chapter 3 of the Code using Form W-9, *Request for Taxpayer Identification Number and Certification*. While the section 1445 regulations do not currently explicitly provide that Form W-9 may be used for certifying that a QIE shareholder is a U.S. person for purposes of the domestic control test, under the interpretation of the law in the 2009 Private Letter Ruling, we believe that it would have been reasonable for a RIC or REIT to rely on Form W-9 provided by a domestic C corporation for purposes of determining whether it is a QIE. Therefore, to the extent that the Final Section 897 Regulations apply any mechanical test for determining whether a domestic C corporation is treated as a foreign person, we recommend the Service issue guidance (such as a model certification, which, for example, could be in the form of a revised Form W-9) as to the manner in which a domestic C corporation that owns shares in a RIC or REIT may certify to the RIC or REIT that it is not an FODC for purposes of a QIE determination.

3. Recommendations with Respect to Publication Date

If the Corporate Look-Through Rule is not withdrawn, Treasury and the Service should consider the following recommendations with respect to the Publication Date.

a. No Application of the Corporate Look-Through Rule Prior to Publication Date

The Preamble states that the Service may challenge positions contrary to the domestically controlled QIE determination and the foreign ownership percentage determination provided under the Proposed Section 897 Regulations before the issuance

of the Final Section 897 Regulations. We believe that Treasury and the Service should clarify that the Corporate Look-Through Rule will not be applied to challenge whether a QIE qualified for the DC-QIE Exception during any DC-QIE Testing Period (or portion thereof) prior to the Publication Date.

As discussed earlier in these Comments, the Corporate Look-Through Rule would represent a departure from the widely-understood interpretation of the Code, existing Treasury Regulations, and the Service's own administrative position with respect to domestic C corporation owners of QIEs. Consequently, we do not believe it would be appropriate for the Service to challenge existing structures involving domestic C corporations based on Corporate Look-Through Rule (or any other broader interpretation of "indirect" ownership). Further, because Treasury is relying on its general authority under section 7805 in issuing the Proposed Section 897 Regulations, retroactive application of the Corporate Look-Through Rule may be subject to challenge as violating the prohibition on retroactive Treasury Regulations under section 7805(b).[75] We also note that, regardless of the merits of the Corporate Look-Through Rule generally, the 25% standard for FODCs utilized in the Proposed Section 897 Regulations is not an interpretation of existing authorities that reasonable tax practitioners would have deduced on their own.

Accordingly, should the Final Section 897 Regulations maintain any form of a corporate look-through rule, we recommend that the preamble indicate that the intended scope of the transactions the government may challenge are limited to structures other than those involving domestic C corporation shareholders (*e.g.*, QFPF or domestic partnership shareholders, or transactions subject to existing anti-abuse doctrines).

b. Transition Relief for QIEs

Final Section 897 Regulations should contain a transition relief provision that would indefinitely exempt from the Corporate Look-Through Rule QIEs that were established prior to the Issuance Date.

As noted earlier in these Comments, significant foreign capital has been invested in QIE structures based on reasonable interpretations of the law with respect the DC-QIE Exception. Absent transition relief, existing foreign investors in QIEs who believed, based on a reasonable interpretation of the Code, the legislative history, the Treasury Regulations, and the Service's own administrative position with respect to domestic C corporation owners of QIEs, that they had invested in a domestically controlled QIE would, in order avoid unexpected and un-bargained for tax on sale, either (i) have to sell their interest in the QIE prior to the Publication Date (if possible) or (ii) be required to continue to own their interest in the QIE for at least five years after the point of time, if any, that the QIE's ownership could be restructured to comply with the Proposed Section 897 Regulations. Any such rush to exit U.S. real estate investments or need for QIEs to

[75] *See* I.R.C. § 7085(b), which, with narrow exceptions not applicable in this case, prohibits retroactive Treasury Regulations. We note that Treasury is relying on its general authority under section 7085 in issuing the Proposed Section 897 Regulations.

restructure their ownership is likely to cause material disruption to U.S. real estate investment.

Due to these concerns, if Final Section 897 Regulations retain the Corporate Look-Through Rule, we recommend that such regulations include transition relief for QIEs that were in existence on the Issuance Date. We do not believe that the transition relief should be time-limited. While a time-limited transition provision could provide some relief, any such limit would nevertheless ultimately require many foreign investors to dispose of their interests in QIEs, or for such QIEs to restructure their ownership, in transactions which could be economically distorting and harmful to both U.S. and foreign investors.

One potential model for transition relief is the rule for certain foreign business entities in Treas. Reg. § 301.7701-2(d). Very generally, under that rule, a foreign entity that had a reasonable basis (within the meaning of section 6662) for its entity classification on the date of the proposed "check-the-box" regulations is able to retain that classification subject to certain termination rules.[76] That rule appropriately balances an entity's reasonable reliance on then existing authorities without providing an indefinite period upon which the entity can maintain its classification for tax purposes. Accordingly, considering the significant amount of authority[77] for taking the position that domestic C corporations were not looked through under the law prior to the Proposed Section 897 Regulations, a similar transition rule in this case balances reasonable taxpayer expectations with the government's interests in implementing the policy underlying the Proposed Section 897 Regulations.

c. Transition Relief for Existing Foreign Investors in QIEs

Alternatively, or in addition to, our recommendation in Section I.C.3.b. above, Final Section 897 Regulations could exempt existing foreign investors in existing QIEs to the extent of their existing ownership and capital commitments to the QIE (including indirect capital commitments) as of the Issuance Date.

Such a provision would permit foreign persons that made investments in QIEs based on a reasonable interpretation of the law prior to the issuance of the Proposed Section 897 Regulations to not be subject to the Corporate Look-Through Rule, but any new investments by foreign investors after the Issuance Date would be subject to the Final Section 897 Regulations. We note, however, that this approach would be more complex to administer as compared to a general transition rule, as it could result a single QIE being domestically controlled with respect to certain foreign investors and not with respect to others. In addition, the adoption of such limited relief would limit the availability of new capital to the QIE as existing foreign investors would be limited in the ability to contribute capital beyond their existing commitments.

[76] Treas. Reg. § 301.7701-2(d)(1).
[77] *See*, *e.g.*, the Actual Owner Rule.

d. Application Prospectively from at Least 120 Days After the Publication Date

If Treasury and the Service do not provide transition relief as recommended above, we recommend that Final Section 897 Regulations specify that the Corporate Look-Through Rule would apply only on a fully prospective basis no sooner than 120 days after the Publication Date. Specifically, the Corporate Look-Through Rule would not apply to any DC-QIE Testing Period (or portion thereof) prior to such date. For those QIEs that are in a position to undertake ownership restructurings to attempt compliance with the Proposed Section 897 Regulations, fully prospective application would permit them to do so in a way that does not punish their foreign investors who reasonably believed they had invested in a domestically controlled QIE. However, this alternative, similar to a time-limited transition period, would nevertheless result in disruption in the markets as foreign investors hasten to restructure or dispose of their investments in U.S. real estate. Fully prospective application, with a delay in effectiveness, will not eliminate this concern, but could help ameliorate the effects. Even if Treasury and the Service do not the delay the effectiveness of the Corporate Look-Through Rule, we still recommend, that Final Section 897 Regulations apply only on a fully prospective basis, with no application to any DC-QIE Testing Period (or portion thereof) prior to the Publication Date.

II. Prop. Treas. Reg. § 1.892-5

A. Introduction

The Proposed Section 892 Regulations address U.S. federal income tax considerations related to foreign governments that invest in U.S. real estate. The Proposed Section 892 Regulations would also modify Treas. Reg. § 1.892-5 and Temp. Treas. Reg. § 1.892-5T. The Proposed Section 892 Regulations reiterate the Deeming Rule, which is discussed further in Section II.B.2 of these Comments.[78] As described in more detail below, the Proposed Section 892 Regulations would also narrow the scope of the Deeming Rule by providing that:

- a QFPF will not be treated as engaged in commercial activity solely as a result of being a USRPHC; and
- a controlled entity of a foreign government that is a USRPHC solely by reason of owning interests in lower-tier USRPHCs not controlled by such foreign government will not be treated as engaged in commercial activity.

[78] Temp. Treas. Reg. § 1.892-5T(b)(1); Prop. Treas. Reg. § 1.892-5(b)(1).

B. Background

Section 892(a) excludes from gross income certain income of foreign governments. Income excluded from gross income under section 892(a) is exempt from taxation for purposes of Subtitle A of the Code.[79]

The types of income that are excluded under section 892(a)(1) are as follows:

- Investments in the United States in:
  - Stocks, bonds, or other domestic securities owned by a foreign government;
  - Financial instruments held in execution of governmental financial or monetary policy;[80] and
- Interest on deposits in banks in the United States of moneys belonging to a foreign government.

The income referenced above includes gains from the sale of stock in a domestic corporation, even if that gain would otherwise be subject to tax under section 897.[81]

For purposes of section 892, a "foreign government" means only the integral parts or controlled entities of a foreign government.[82] An "integral part" is any person, body of persons, organization, agency, bureau, fund, instrumentality, or other body, however designated, that constitutes a governing authority of a foreign country.[83] If any earnings of the governing authority inure to the benefit of a private person, that authority shall not be treated as an integral part of the foreign government for purposes of section 892.

A "controlled entity" of a foreign government (a "**CE**") means any entity that is separate in form from a foreign sovereign or otherwise constitutes a separate juridical entity if it satisfies all of the following requirements:

- it is wholly owned and controlled by the foreign sovereign directly or indirectly through one or more controlled entities;
- it is organized under the laws of the foreign sovereign by which owned;

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[79] I.R.C. § 892(a)(1) (flush language).
[80] Section 895 applies similar conditions to excluding income of foreign central banks. Congress enacted section 895 as a supplement to section 892. *See* S. Rep. No. 87-163, at 2-3 (1961) ("This exemption will accord foreign central banks of issue which are separately incorporated the same exemption with respect to holdings of U.S. Government obligations as now exists where these obligations are held directly by the foreign government itself.").
[81] Temp. Treas. Reg. § 1.892-3T(b), *Example 1* (gain from sale of stock in a USRPHC is exempt from tax under section 892 where the foreign government owned 12% of the stock of that corporation). The income also includes dividends from publicly traded stock in corporations in which, in each case, the foreign government owns less than 50% of stock in that corporation, interest on bonds issued by non-controlled entities and on interest bearing bank deposits in non-controlled entities, and income from commodity futures contracts that are held in execution of governmental financial or monetary policy.
[82] Temp. Treas. Reg. § 1.892-2T(a)(1).
[83] Temp. Treas. Reg. § 1.892-2T(a)(2).

- its net earnings are credited to its own account or to accounts of the foreign sovereign, with no portion of its income inuring to the benefit of any private person; and
- its assets vest in the foreign sovereign upon dissolution.[84]

The exemption under section 892(a)(1) will not apply if the foreign government receives income from conducting "commercial activity."[85] "Commercial activity" includes 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.[86] Certain activities that are conducted with a view to producing income or gain are, however, specifically excluded from this definition. For example, investing in assets generating income defined in section 892(a)(1) is specifically excluded from activities constituting "commercial activity."[87] In addition, holding net leases or land that is not producing income (other than on its sale or from an investment in net leases) is not a "commercial activity."[88] Unless an activity is among the excluded activities listed in Temp. Treas. Reg. § 1.892-4T(c), that activity may be a commercial activity for purposes of section 892 even if it does not constitute the conduct of a USTOB under section 864(b).[89]

In addition, sections 892(a)(2)(A)(ii) and (iii) provide that the exemption under section 892(a)(1) will not apply to any income (i) received by a CCE, (ii) received directly or indirectly from a CCE, or (iii) derived from the disposition of any interest in a CCE. A CCE is any entity[90] engaged in commercial activity in which the foreign government holds (directly or indirectly) any interest which (by vote or value) is 50% or more of the total of such interests in that entity, or holds (directly or indirectly) any other interest that entity that provides the foreign government with "effective control" of that entity.[91] For purposes of determining "control," any interest in an entity owned directly or indirectly by an integral part or controlled entity of a foreign government is treated as actually owned by such foreign government.[92]

A foreign government may have "effective practical control" of an entity for purposes of section 892(a)(2)(B) "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."[93] The regulations describe, as an example, a case in which a foreign government owns a small equity interest (by value or voting power) in an entity but is

[84] Temp. Treas. Reg. § 1.892-2T(a)(3).
[85] I.R.C. § 892(a)(2)(A)(i).
[86] Temp. Treas. Reg. § 1.892-4T(b).
[87] Temp. Treas. Reg. § 1.892-4T(c)(1).
[88] *Id.*
[89] *Id.*
[90] An "entity" for purposes of section 892(a)(2)(B) includes a corporation, a partnership, a trust (including a pension trust described in Temp. Treas. Reg. § 1.892-2T(c)), and an estate. Treas. Reg. § 1.892-5(a).
[91] Temp. Treas. Reg. § 1.892-5T(c)(2).
[92] Temp. Treas. Reg. § 1.892-5T(c)(1)(i).
[93] Treas. Reg. § 1.892-5T(c)(2).

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."[94]

As noted above in Section II of the Executive Summary, the Deeming Rule provides that a corporation that is a USRPHC is treated as engaged in commercial activity for purposes of section 892(a)(2)(B).[95] In addition, a foreign corporation that would be a USRPHC if it were a domestic corporation is also treated as engaged in commercial activity for purposes of section 892(a)(2)(B).[96] Accordingly, if a foreign government has interests in either such corporation and meets the control requirements of section 892(a)(2)(B)(i) or (ii), the corporation will be a CCE for purposes of section 892(a)(2)(B).

The tax consequences under section 892 to a foreign government holding interests in a CCE are significant. Moreover, those consequences differ significantly from those applying if the foreign government itself is treated as engaging in commercial activity alone. A foreign government can generally exclude all income that is defined as excludable in section 892(a)(1) and Temp. Treas. Reg. § 1.892-3T, even if the foreign government is engaged in commercial activity.[97] In other words, income from the commercial activity will not cause the foreign government to lose the section 892 exemption for its section 892(a)(1) income.

In contrast, the income of a CCE of a foreign government, and any gain derived by the foreign government from selling an interest in that CCE, is not exempt from U.S. federal income taxation under section 892(a)(1), regardless of whether any of that income is described in Temp. Treas. Reg. § 1.892-3T. Consequently, even if the CCE derives 99% of its income from investments described in section 892(a)(1) and Temp. Treas. Reg. § 1.892-3T, and only one percent of its income is received from commercial activity,[98] none of the CCE's income will be exempt under section 892. This has been referred to as the "all or nothing rule."[99]

Significantly, "separately organized pension trusts" (as defined in Temp. Treas. Reg. § 1.892-2T(c)) are treated differently under the "all or nothing rule." If the pension trust solely earns income that would not be treated as unrelated business taxable income if the pension trust were a "qualified trust" under section 401(a), even if the pension trust

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[94] *Id*.
[95] Temp. Treas. Reg. § 1.892-5T(b)(1).
[96] *Id*.
[97] Temp. Treas. Reg. § 1.892-4T(a).
[98] The commercial activity includes any commercial activity, wherever conducted. So, for example, if a CCE generates one percent of its income from operating a hotdog stand in a foreign country and 99% of its income from equity securities in the United States, none of the CCE's income will be exempt from tax under section 892. *See* Kenneth Wood, et al., *Sovereign Wealth Funds: Benefits and Burdens of the Sovereign Immunity from Tax under § 892,* 39 Tax Mgm't Int'l 79 (2008) ("The logic underlying this loss of all tax benefits because of activity without any U.S. nexus is difficult to explain.").
[99] *See* NYSBA Tax Section, *Report on the Tax Exemption for Foreign Sovereigns Under Section 892 of the Internal Revenue Code* 21 (2008) (citing Robert A. Bergquist, *U.S. Taxation of Foreign Governments and Their Controlled Entities*, 39 Tax Notes (TA) 115, 130 (1988)), available at https://nysba.org/app/uploads/2020/03/1157-Report.pdf.

is a CCE, the part of its income that is defined under Temp. Treas. Reg. § 1.892-3T can still qualify for the section 892 exemption.[100]

C. Overview of the Proposed Section 892 Regulations

1. The QFPF Exception

The Proposed Section 892 Regulations provide that a Qualified Holder will not be treated as engaged in commercial activity or as a CCE solely as a result of being a USRPHC (the "**QFPF Exception**").[101] A Qualified Holder is a QFPF (including a part of a QFPF) or a QCE, in each case, that is exempt from FIRPTA.[102]

As noted in the Preamble, comments to the Treasury Regulations proposed under section 897(l) in 2019 (the "**2019 Proposed QFPF Regulations**")[103] identified an inconsistency between, on the one hand, the exemption from FIRPTA enjoyed by QFPFs and QCEs under section 897(l) and, on the other hand, the treatment of QFPFs and QCEs that are USRPHCs as CCEs under the Deeming Rule for purposes of section 892.[104] Because QFPFs and QCEs are exempt from U.S. federal income tax under FIRPTA, there does not seem to be any policy rationale for a rule requiring them to monitor their ownership of USRPIs to avoid CCE status and preserve their eligibility for the section 892 exemption with respect to their other income.

2. The Portfolio Exception

The Proposed Section 892 Regulations also provide, pursuant to the Portfolio Exception, that a corporation that is a USRPHC "solely by reason of its direct or indirect interest in one or more corporations that are not controlled by the foreign government," as determined under Temp. Treas. Reg. § 1.892-5T(a), will not be treated as engaged in commercial activity relative to such foreign government and will not be treated as a CCE of such foreign government.[105]

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[100] Temp. Treas. Reg. § 1.892-5T(b)(3).
[101] Prop. Treas. Reg. § 1.892-5(b)(1)(ii)(A).
[102] Treas. Reg. § 1.897(l)-1(d)(1).
[103] Prop. Treas. Reg. § 1.897(l), 84 Fed. Reg. 26,605 (June 7, 2019). The 2019 Proposed QFPF Regulations were finalized on December 29, 2022. *See* 87 Fed. Reg. 80.042 (Dec. 29, 2022).
[104] Preamble to Prop. Treas. Reg. § 1.892-5, 87 Fed. Reg. 80,097, 80,099 (Dec. 29, 2022).
[105] Prop. Reg. § 1.892-5(b)(1)(ii)(B). Note that under the Deeming Rule, as revised to incorporate the Portfolio Exception, an entity may be engaged in commercial activity relative to one foreign government even though that entity may not be engaged in commercial activity relative to another foreign government. This would cause additional complexity for sponsors of funds or joint ventures with several foreign government investors.

3. Publication Date

The Proposed Section 892 Regulations would apply to taxable years ending on or after the Issuance Date.[106] Taxpayers, however, may rely on the Proposed Section 892 Regulations until Final Section 892 Regulations are issued.[107]

On December 29, 2022, Treasury and the Service also published a notice reopening the comment period for proposed Treasury Regulations under Section 892 that were issued in 2011 (the "**2011 Proposed Regulations**").[108] The comment period is re-opened until February 27, 2023.[109] As further discussed below in Section II.E., the Section previously submitted comments to the 2011 Proposed Regulations on January 30, 2012 (the "**2012 Comments**").[110]

D. Recommendations on Proposed Section 892 Regulations

We appreciate Treasury and the Service's efforts to narrow the scope of the Deeming Rule through the QFPF Exception and the Portfolio Exception. Although we welcome these revisions, we make the following recommendations due to continuing concerns with the Deeming Rule.

1. Withdrawal of the Deeming Rule in its Entirety

Consistent with our 2012 Comments, we recommend that the Deeming Rule be eliminated.[111] We do not believe that a CE should be a CCE merely because it holds an interest in a lower-tier USRPHC.[112] The Proposed Section 892 Regulations and the Portfolio Exception they contain indicate that Treasury and the Service agree with this recommendation in cases in which the applicable foreign government does not "control" the lower-tier USRPHC within the meaning of Temp. Treas. Reg. § 1.892-5T(a).

Our reasons for this recommendation are threefold. First, in a scenario in which a foreign government invests in a lower-tier USRPHC through a CE and controls the lower-tier USRPHC within the meaning of Temp. Treas. Reg. § 1.892-5T(a), the lower-tier USRPHC would be a CCE of the foreign government (unless this lower-tier USRPHC is itself a USRPHC solely as a result of owning interests in other USRPHCs not controlled by the foreign government).[113] As a result, neither income received by or from the lower-tier USRPHC nor gain derived from the disposition of an interest in the lower-tier USRPHC would be eligible for exemption under section 892.[114]

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[106] Preamble to Prop. Treas. Reg. § 1.892-5, 87 Fed. Reg. at 80,103.
[107] *Id.*
[108] *Id*. at 80,108.
[109] *Id.* at 80,109.
[110] ABA Tax Section, *Comments on Proposed Regulations Issued Under Section 892* (2012), available at https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/013012comments.pdf.
[111] *Id.* at 20.
[112] *Id.*
[113] I.R.C. § 892(a)(2)(B)(i); Prop. Treas. Reg. § 1.892-5(b)(1)(i).
[114] I.R.C. § 892(a)(2)(A)(ii)-(iii).

There does not appear to be a clear policy rationale for applying the Deeming Rule and making the CE through which the foreign government is investing in the lower-tier USRPHC a CCE when income derived from the lower-tier USRPHC would not be exempt under section 892 in the first place. The application of the Deeming Rule in this scenario is also antithetical to the rule that "commercial activities of a subsidiary controlled entity are not attributed to its parent."[115]

Second, control of a lower-tier USRPHC is a poor proxy for control of the underlying USRPIs or actual commercial activity. Consider a situation in which a CE of a foreign government (CE1) is a USRPHC as a result of owning 100% of a lower-tier entity (CE2) that is itself a USRPHC as a result of owning an interest in an entity that is classified as a partnership for U.S. federal income tax purposes, holds direct USRPIs, and is engaged in commercial activity. Assume that CE2 owns a minority interest in the partnership and that this interest is a "limited partner" interest in the partnership within the meaning Prop. Treas. Reg. § 1.892-5(d)(5)(iii)(B).

In this case, the LP Exception described in more detail below in Section II.E. would apply, and commercial activities of the partnership would not be attributed to CE2. But the Deeming Rule would nonetheless cause CE2 to be a CCE of the foreign government. Additionally, the Portfolio Exception would not apply to save CE1 from CCE status—it would be treated as engaged in commercial activity since it is a USRPHC as a result of owning interests in a USRPHC controlled by the foreign government. We do not believe this is an appropriate result.

Third, the simple example provided in the Preamble masks the complexity that would inevitably be involved in applying to Portfolio Exception to structures commonly used by foreign governments to invest in U.S. real estate. In the example, the foreign government controls a USRPHC whose only assets are minority interests in REITs.[116] Consider a case in which FA, a foreign government enters into a joint venture with FB, another foreign government and RD, a domestic real estate developer. FA invests through CE3, a wholly owned CE. CE3, FB, and RD form JV, an entity classified as partnership, with CE3 and FB each contributing 45% of the capital and RD contributing the remaining ten percent. JV invests in U.S. real estate through a REIT that is not domestically controlled and is a USRPHC. Daily operations of JV and the REIT are managed by RD (as general partner of JV) and by a manager appointed by the REIT's board, respectively. CE3 and FB are entitled to consent rights over a number of "major decisions" under the operating agreement of the JV, including approval of the annual business plan. Each of CE3 and FB is also entitled to designate two of the REIT's five directors. RD has developed a close relationship with FA over the course of several joint ventures in the past but has never transacted with FB before.

It would be extremely difficult, if not impossible, to determine with any degree of confidence whether FA controls the REIT within the meaning of Temp. Treas. Reg. § 1.892-5T(a). There is no guidance or regulatory example addressing investment

[115] Temp. Treas. Reg. § 1.892-5T(d)(2)(i).
[116] Preamble to Prop. Treas. Reg. § 1.892-5, 87 Fed. Reg. at 80,099.

structures of the kind described above, despite their common use by foreign governments to invest in U.S. real estate. There are no authorities, in particular, regarding what "effective practical control" might mean in such structures. Although the Portfolio Exception narrows the scope of the Deeming Rule on paper, it is unlikely to make a practical difference to foreign governments in many situations, particularly as foreign governments are typically conservative and seek to avoid any risk of losing their exemption under section 892. For the reasons described above, we recommend that the Deeming Rule be withdrawn in its entirety.

2. Recommendations if Deeming Rule is not Withdrawn

As noted above, our primary recommendation is that the Deeming Rule be withdrawn in its entirety. In the event Treasury and the Service are not inclined to withdraw the Deeming Rule, we make the following recommendations.

a. Finalize the QFPF Exception

The QFPF Exception contained in the Proposed Section 892 Regulations provides welcome relief and certainty to QFPFs and QCEs that are integral parts or controlled entities of foreign governments. We recommend finalizing the QFPF Exception as written.

b. Modification of the Deeming Rule

In addition to our recommendation directly above, consistent with our 2012 Comments, we also recommend that the Deeming Rule be modified to apply solely to CEs that would be USRPHCs if the references in section 897(c)(2) to USRPIs were replaced by references to USRPIs described in section 897(c)(1)(A)(i).[117]

c. Addition of De Minimis Exception to the Portfolio Exception

We believe that the Portfolio Exception could be improved with a de minimis exception to the requirement that the CE 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. We recommend that a de minimis amount of USRPIs that are other than minority interests in corporations be disregarded in determining whether the CE is a CCE.

The following example illustrates this recommendation.

Example 7.

Facts. A, a CE of foreign government X, holds minority interests in REITs that collectively are worth $1 billion. A also holds a minority

[117] *Id.* As we noted in note 52 to the 2012 Comments, "the rules of section 897(c)(5) would be retained so that it would still be possible to 'look through' stock of a controlled USRPHC to the underlying USRPIs described in section 897(c)(l)(A)(i)."

limited partnership interest in P, a partnership that holds U.S. real property. A's proportionate share of P's real property is worth $90 million.[118] Assume that A holds no other assets except the minority interests in the REITs and the limited partnership interest in P.

Analysis. Under the Proposed Section 892 Regulations, A would be a CCE, even though the value of its interest in P is less than ten percent[119] of the value of A's interests in all USRPIs. But for that limited partnership interest in P, A would not be a CCE.

We believe that, for purposes of the Portfolio Exception, USRPIs held by the CE other than as a result of a direct or indirect ownership interest in one or more other corporations that are not controlled by the foreign government should be disregarded if they collectively represent a de minimis value of all USRPIs held by that CE (*e.g.*, ten percent or less of the value of all such USRPIs). Such a rule would prevent a CE from inadvertently losing the benefit of the Portfolio Exception because of a small amount of other USRPIs, provided that those USRPIs in value represent a de minimis share of all of the USRPIs held by that CE.

E. Adoption of the 2011 Proposed Regulations

As described in the 2012 Comments, the 2011 Proposed Regulations would supplement or modify existing temporary Treasury Regulations under section 892 by (i) permitting certain inadvertent commercial activities to be disregarded in determining whether a CE is a CCE, (ii) adopting an annual test for CCE status, (iii) providing additional guidance as to what activities constitute the conduct of commercial activities, and (iv) providing an exception to the rule that commercial activities of a partnership are attributed to its partners when a foreign government's interest in the partnership is a limited partner interest (the "**LP Exception**").[120]

The 2011 Proposed Regulations would take effect as of the date of publication of the Treasury decision adopting them as final regulations.[121] The preamble to the 2011 Proposed Regulations notes that taxpayers may rely on the 2011 Proposed Regulations until final Treasury Regulations are issued.[122] As noted above, the comment period for the 2011 Proposed Regulations has been re-opened until February 27, 2023.

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[118] Under section 864(c)(4)(B) and Treas. Reg. § 1.897-2(e)(2), subject to certain exceptions, a corporation that holds a partnership interest is treated as holding a proportionate share of the assets held by that partnership for purposes of determining whether that corporation is a USRPHC. Further, the proportionate ownership rule is applied successively upward through a chain of ownership. So, in this example, for purposes of section 897(c)(4)(B), A is treated as owning a proportionate share of P's assets.

[119] The actual percentage is 8.25% (*i.e.*, $90,000,000 ÷ $1,090,000,000).

[120] ABA Tax Section, *Comments on Proposed Regulations Issued Under Section 892*, *supra* note 110, at 11-12.

[121] Prop. Treas. Reg. § 1.892-4(f), -5(e).

[122] Preamble to Prop. Treas. Reg. §§ 1.892, 76 Fed. Reg. 68,119, 68,121 (Nov. 3, 2011).

Our 2012 Comments remain applicable.[123] Although we generally reiterate our 2012 Comments, we would like to draw particular attention to two issues relating to the treatment of partnerships under section 892 that remain important to taxpayers, and supplement our 2012 Comments. The first is the treatment of sales of partnership interests. The second is the LP Exception.

1. Modification of the 2011 Proposed Regulations with respect to Sale of Partnership Interests

Under temporary regulations issued in 1988, gain derived from the sale of a partnership interest is not exempt under section 892 because interests in partnerships (other than publicly traded partnerships) are not "securities" within the meaning of the Temporary Regulations under section 892.[124] Our 2012 Comments noted that it was improper for this rule to treat a partnership that owns interests in a USRPHC as an entity when section 897(g) adopts an aggregate approach for purposes of applying FIRPTA.[125]

Our recommendation was, and remains, that the 2011 Proposed Regulations be modified to provide that gain arising from the disposition of a partnership interest is exempt under section 892 to the extent such gain is attributable to assets that, if sold directly by the foreign government, would be exempt from section 892.[126] Gain from the sale of an interest in a partnership whose sole asset is stock of a USRPHC, for instance, should be exempt under section 892 if the USRPHC is not a CCE of the applicable foreign government, as gain from a sale of the USRPHC's stock directly by the foreign government would be exempt.[127] This recommendation is further buttressed by the adoption of the aggregate treatment for a sale of a partnership interest in section 864(c)(8), as well as the adoption of Treas. Reg. § 1.897-7(c) implementing section 897(g),[128] both of which occurred subsequent to our 2012 Comments.

As further discussed below, the 2011 Proposed Regulations also reiterate the general rule, previously found in the temporary Treasury Regulations issued in 1988, that commercial activities of a partnership are attributed to its partners for purposes of section 892, subject to certain exceptions, including the LP Exception (the "**Partnership**

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[123] ABA Tax Section, *Comments on Proposed Regulations Issued Under Section 892*, *supra* note 110.
[124] Temp. Treas. Reg. § 1.892-3T(a)(3).
[125] ABA Tax Section, *Comments on Proposed Regulations Issued Under Section 892*, *supra* note 110 at 25.
[126] *Id.*
[127] I.R.C. § 892(a)(1)(A)(i); Temp. Treas. Reg. § 1.892-3T(a)(1).
[128] Section 864(c)(8) was enacted in 2017 as part of the Tax Cuts and Jobs Act and generally provides that if a foreign person owns, directly or indirectly, an interest in a partnership that is engaged in a USTOB, any gain or loss on the sale or other disposition of that partnership interest (or any portion thereof) will be treated as effectively connected with the conduct of that USTOB amount up to an amount equal to the portion of the foreign person's distributive share of gain that would have been effectively connected income had the partnership sold all of its assets at fair market value on the same date as the disposition of the partnership interest. Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017). Treas. Reg. § 1.897-7(c) was finalized in November 2020 and provides that, if a partnership holding USRPIs is subject to both sections 864(c)(8) and 897(g) because it is engaged in the conduct of a USTOB without regard to section 897, upon a foreign person's sale or other disposition of an interest in that partnership, the amount of the foreign persons effectively connected gain or loss is determined under section 864(c)(8) and not under section 897(g). 85 Fed. Reg. 70,958, 70,971 (Nov. 6, 2020).

Deeming Rule").[129] In so doing, the 2011 Proposed Regulations confirm that Treasury and the Service believe it appropriate to treat partnerships as aggregates for some purposes under section 892. In our view, aggregate treatment should be extended to sales of partnership interests, and we can discern no clear policy rationale for treating partnerships as entities for purposes of determining whether gain from sales of interests therein is exempt under section 892.

2. Clarification of the LP Exception

The 2011 Proposed Regulations introduced two exceptions to the Partnership Deeming Rule, including the LP Exception. Under the LP Exception, an entity not otherwise engaged in commercial activities will not be deemed to be engaged in commercial activities solely because it holds "an interest as a limited partner in a limited partnership" (a "**Qualifying LP Interest**").[130]

For an interest in an entity classified as a partnership for U.S. federal income tax purposes to be a Qualifying LP Interest, its holder must 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."[131]

Consent rights in the case of "extraordinary events" will not cause an interest to fail to qualify as a Qualifying LP Interest.[132] Extraordinary events include the "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."[133]

As noted in our 2012 Comments, it is unclear whether membership in a limited partners' advisory committee with certain consent rights over "non-extraordinary events" but without influence over the vast majority of management decisions or day-to-day operations of the partnership may cause an interest to fail to be a Qualifying LP Interest. Accordingly, we reiterate our recommendation that the 2011 Proposed Regulations be modified to provide that typical consent rights as part of a limited partners' advisory committee or customary consent rights over major decisions, in each case, with respect to relatively infrequent, key decisions outside day-to-day management, will not cause a partnership interest to fail to be a Qualifying LP Interest.[134]

Likewise, we reiterate our recommendation that Treasury and the Service confirm that customary side letter provisions will not cause a partnership interest to fail to be a

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[129] Prop. Treas. Reg. § 1.892-5(d)(5)(i); Temp. Treas. Reg. § 1.892-5T(d)(3).
[130] Prop. Treas. Reg. § 1.892-5(d)(5)(iii)(A).
[131] Prop. Treas. Reg. § 1.892-5(d)(5)(iii)(B).
[132] *Id.*
[133] *Id.*
[134] ABA Tax Section, *Comments on Proposed Regulations Issued Under Section 892*, *supra* note 110, at 23.

Qualifying LP Interest.[135] We also encourage Treasury and the Service to include examples operationalizing the LP Exception. We note that the examples included in the 2011 Proposed Regulations assume without further detail or analysis that the applicable foreign government has (or does not have) "the authority to participate in the management and conduct" of the partnership's business.[136]

[135] *Id.* We also repeat our recommendation that Temp. Treas. Reg. § 1.892-5T(d)(3) be amended to take the LP Exception into account or otherwise withdrawn.
[136] Prop. Treas. Reg. § 1.892-5(d)(5)(iv).