Airspace Designations and Reporting Points, dated August 19, 2022, and effective September 15, 2022, is amended as follows:

Paragraph 6010(a) Domestic VOR Federal Airways.

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V–50 [Amended]

From St Joseph, MO; to Kirksville, MO. From Spinner, IL; Adders, IL; Terre Haute, IN; Brickyard, IN; to Dayton, OH.

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V–52 [Amended]

From Des Moines, IA; to Ottumwa, IA. From St Louis, MO; Troy, IL; INT Troy 099° and Pocket City, IN, 311° radials; to Pocket City.

* * * * *

V–63 [Amended]

From Razorback, AR; Springfield, MO; to Hallsville, MO. From Burlington, IA; Moline, IL; to Davenport, IA. From Janesville, WI; Badger, WI; to Oshkosh, WI. From Rhinelander, WI; to Houghton, MI.

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V–582 [Removed]

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V–586 [Amended]

From Peoria, IL; Pontiac, IL; to Joliet, IL.

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Issued in Washington, DC, on December 23, 2022.

Scott M. Rosenbloom,

Manager, Airspace Rules and Regulations.

[FR Doc. 2022–28328 Filed 12–28–22; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–100442–22]

RIN 1545–BQ36

Guidance on the Foreign Government Income Exemption and the Definition of Domestically Controlled Qualified Investment Entities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the treatment of certain entities, including qualified foreign pension funds, for purposes of the exemption from taxation afforded to foreign governments (the ''proposed regulations''). The proposed regulations also address the determination of whether a qualified investment entity is domestically controlled, including the treatment of qualified foreign pension funds for this purpose.

DATES: Written or electronic comments and requests for a public hearing must be received by February 27, 2023.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–100442–22) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury and the IRS will publish for public availability any comments submitted electronically and comments submitted on paper to its public docket. Send hard copy submissions to: CC:PA:LPD:PR (REG–100442–22), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning § 1.892–5, Joel Deuth at (202) 317–6938; concerning § 1.897–1, Arielle Borsos at (202) 317–6937; concerning submissions of comments or requests for a public hearing, Regina Johnson at (202) 317–5177 (not toll-free numbers) or *publichearings@irs.gov.*

SUPPLEMENTARY INFORMATION:

Background

I. Section 892

Section 892(a)(1) of the Internal Revenue Code (the ''Code'') exempts from U.S. taxation certain income derived by a foreign government. This exemption, however, does not apply to income that is (1) derived from the conduct of a commercial activity (whether within or outside the United States), (2) received by a controlled commercial entity or received (directly or indirectly) from a controlled commercial entity, or (3) derived from the disposition of an interest in a controlled commercial entity. Section 892(a)(2)(A).

Section 892(a)(2)(B) provides that for purposes of section 892(a)(2)(A), a controlled commercial entity is any entity engaged in commercial activities (whether within or outside the United States) and in which a foreign government holds (directly or indirectly) interests according to specified thresholds. The term ''entity'' in section 892(a)(2)(B) means a corporation, a partnership, a trust, and an estate. *See* § 1.892–5(a)(3).

A United States real property holding corporation (''USRPHC''), as defined in section 897(c)(2), or a foreign corporation that would be a USRPHC if it was a United States corporation, is treated as engaged in commercial activity and, therefore, is a controlled commercial entity if a foreign government meets certain ownership or control thresholds with respect to that USRPHC or foreign corporation. § 1.892–5T(b)(1).

II. Section 897

Section 897(a)(1) provides that gain or loss of a nonresident alien individual or foreign corporation from the disposition of a United States real property interest (''USRPI'') is taken into account under section 871(b)(1) or 882(a)(1), as applicable, as if the nonresident alien individual or foreign corporation were engaged in a trade or business within the United States during the taxable year and such gain or loss were effectively connected with that trade or business.

Subject to certain exceptions, section 897(c)(1)(A) defines a USRPI as an interest in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the Virgin Islands, and any interest (other than solely as a creditor) in any domestic corporation unless the taxpayer establishes that such corporation was at no time a USRPHC during the period set forth in section 897(c)(1)(A)(ii) (generally, the five-year period ending on the date of the disposition of the interest). Under section 897(c)(2), a USRPHC is generally any corporation if the fair market value of its USRPIs equals or exceeds 50 percent of the aggregate fair market value of its USRPIs, its interests in real property located outside the United States, plus any other of its assets that are used or held for use in a trade or business.

Section 897(h)(1) provides that any distribution by a qualified investment entity (''QIE'') to a nonresident alien individual, a foreign corporation, or other QIE, to the extent attributable to gain from sales or exchanges by the QIE of USRPIs, is treated as gain recognized by such nonresident alien individual, foreign corporation, or other QIE from the sale or exchange of a USRPI, subject to certain exceptions. Section 897(h)(4)(A) defines a QIE as any (i) real estate investment trust (''REIT''), and (ii) any regulated investment company (''RIC'') which is a USRPHC or which would be a USRPHC if the exceptions in section 897(c)(3) and 897(h)(2) did not apply to interests in any REIT or RIC.

Section 897(h)(2) provides that a USRPI does not include an interest in a domestically controlled QIE (''DC–QIE exception''). Accordingly, gain or loss on the disposition of stock in a domestically controlled QIE is not subject to section 897(a) (other than to the extent provided in section 897(h)(1)). Section 897(h)(4)(B) provides that a QIE is domestically controlled if less than 50 percent of the value of its stock is held directly or indirectly by foreign persons at all times during the testing period prescribed in section 897(h)(4)(D) (generally, the five-year period ending on the date of the disposition). The legislative history accompanying the enactment of section 897 indicates that Congress intended for the DC–QIE exception to apply to entities controlled by United States persons. *See* H.R. Conf. Rep. No. 96–1479, at 188 (1980) (''In the case of REITs which are controlled by U.S. persons, sales of the REIT shares by foreign shareholders would not be subject to tax (other than in the case of distribution by the REIT).''). Section 1.897–9T(c) defines ''foreign person'' for purposes of section 897 as a nonresident alien individual (including an individual subject to the provisions of section 877), a foreign corporation (as defined in § 1.897–1(l)), a foreign partnership, a foreign trust, or a foreign estate, as such persons are defined respectively by § 1.871–2 and by section 7701 and the regulations thereunder.[1] Under § 1.897–1(l), the term ''foreign corporation'' generally has the meaning ascribed to it in section 7701(a)(3) and 7701(a)(5) and § 301.7701–5.

Section 897(h)(3) provides that in the case of a domestically controlled QIE, rules similar to those in section 897(d) (which prescribes rules requiring the recognition of gain on the distribution of a USRPI by a foreign corporation) apply to the foreign ownership percentage of any gain. Section 897(h)(4)(C) provides that the term ''foreign ownership percentage'' means the percentage of QIE stock that was held (directly or indirectly) by foreign persons at the time during the testing period (as defined in section 897(h)(4)(D)) during which the direct and indirect ownership of stock by foreign persons was greatest.

Section 1.897–1(c)(2)(i), which was issued when section 897(h) addressed only domestically controlled REITs, defines domestically controlled REITs (rather than QIEs) and otherwise restates the rule in section 897(h)(2).[2] Section 1.897–1(c)(2)(i) does not address the determination of whether stock of a REIT is considered ''held directly or indirectly by foreign persons'' under section 897(h)(4)(B) and provides only that, for purposes of determining the ownership of the REIT's stock, actual ownership under § 1.857–8 must be taken into account. Section 1.857–8(b) states that the actual owner of stock of a REIT is the person who is required to include in gross income in his return the dividends received on the stock and is generally the shareholder of record of the REIT.

Section 897(h)(4)(E), which was added to the Code in section 322(b)(1)(A) of the Protecting Americans from Tax Hikes Act of 2015, Public Law 114–113, div. Q (the ''PATH Act''), provides special ownership rules for determining the holder of QIE stock under section 897(h)(4)(B) and 897(h)(4)(C). Section 897(h)(4)(E)(i) states that, in the case of any class of stock of the QIE that is regularly traded on an established securities market in the United States (''U.S. publicly traded QIE stock''), a person holding less than five percent of such class of stock at all times during the testing period is treated as a United States person unless the QIE has actual knowledge that such person is not a United States person. Section 897(h)(4)(E)(ii) provides that any stock in the QIE held by another QIE (i) any class of stock of which is regularly traded on an established securities market, or (ii) which is a RIC that issues redeemable securities within the meaning of section 2 of the Investment Company Act of 1940 (an entity described in (i) or (ii), a ''public QIE'') is treated as held by a foreign person, except that if the public QIE is domestically controlled (determined after the application of section 897(h)(4)(E)), such stock is treated as held by a United States person. Finally, section 897(h)(4)(E)(iii) provides that any stock in the QIE held by a QIE that is not a public QIE (''non-public QIE'') is only treated as held by a United States person in proportion to the stock of the non-public QIE that is (or is treated under section 897(h)(4)(E)(ii) or 897(h)(4)(E)(iii) as) held by a United States person.

Section 897(l) provides an exception to the application of section 897(a) for certain foreign pension funds and their wholly owned subsidiaries. Section 897(l) was added to the Code in section 323(a) of the PATH Act. As originally enacted, section 897(l)(1) provided that section 897 does not apply to any USRPI held directly (or indirectly through one or more partnerships) by, or to any distribution received from a REIT by, a qualified foreign pension fund (''QFPF'') or any entity all of the interests of which are held by a QFPF. Congress later made several technical amendments to section 897(l) in section 101(q) of the Tax Technical Corrections Act of 2018, Public Law 115–141, div. U (the ''Technical Corrections Act''). As amended in the Technical Corrections Act, section 897(l) provides that neither a QFPF nor an entity all the interests of which are held by a QFPF is treated as a nonresident alien individual or foreign corporation for purposes of section 897. Section 897(l)(3) provides the Secretary with the authority to ''prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.''

On June 7, 2019, the Department of the Treasury (''Treasury Department'') and the IRS published proposed regulations in the **Federal Register** (84 FR 26605) (the ''2019 proposed regulations'') under sections 897(l), 1441, 1445 and 1446. The 2019 proposed regulations contained rules relating to qualification for the exception under section 897(l), as well as rules relating to withholding requirements under sections 1441, 1445 and 1446, for dispositions of USRPIs by, and distributions described in section 897(h) received by, QFPFs and entities that are wholly owned by one or more QFPFs (''qualified controlled entities,'' or ''QCEs''). The 2019 proposed regulations are finalized in the Final Rules section of this issue of the **Federal Register**.

Explanation of Provisions

I. Coordination of Exemption Under Section 897(l) With Section 892

The exemption from U.S. taxation provided to foreign governments by section 892 does not apply to income derived from the conduct of a commercial activity, or income received by a controlled commercial entity or received (directly or indirectly) from a controlled commercial entity. Section 1.892–4T(a). Section 1.892–5T(b)(1) treats a USRPHC (or a foreign corporation that would be a USRPHC if it was a United States corporation) as engaged in commercial activity and, therefore, a controlled commercial entity if it is controlled by a foreign government pursuant to § 1.892–5T(a).

[1] Section 1.897–9T(a) provides that § 1.897–9T(c) (the definition of ''foreign person'') would appear as § 1.897–1(k) if and when § 1.897–9T is adopted as a final regulation.

[2] Section 897(h) did not apply to RICs when the regulations were finalized. Section 411 of the American Jobs Creation Act of 2004, Public Law 108–357 (2004), amended section 897(h) to apply to certain RICs in addition to REITs and introduced the term QIE to include such entities.

A QFPF would be a controlled commercial entity for section 892 purposes if it qualified as a USRPHC within the meaning of § 1.892–5T(b)(1) and if it were controlled by a foreign government pursuant to § 1.892–5T(a). In such case, none of the income, including, for example, from investments in the United States in stocks or securities, received by the foreign government from that QFPF would be eligible for the section 892 exemption. A comment to the 2019 proposed regulations noted that § 1.892–5T(b)(1) incentivizes a government-controlled QFPF to reduce its USRPIs to preserve the exemption provided by section 892. In addition, the comment noted that § 1.892–5T(b)(1) may necessitate that such a QFPF monitor its USRPIs for section 892 purposes despite being exempt from the application of section 897(a). The comment recommended that a QFPF and a QCE be excluded from the application of § 1.892–5T(b)(1) or that § 1.892–5T(b)(1) be withdrawn.

Although these proposed regulations do not withdraw the rule entirely, the Treasury Department and the IRS agree that the rule in § 1.892–5T(b)(1) should not apply to a QFPF or a QCE, and these proposed regulations therefore adopt that recommendation. Proposed § 1.892–5(b)(1)(ii)(A). In addition, the proposed regulations exclude certain other USRPHCs from the application of § 1.892–5T(b)(1). Proposed § 1.892–5(b)(1)(ii)(B). Excluding certain other USRPHCs from the application of § 1.892–5T(b)(1) is consistent with the policy of section 892 with respect to deemed commercial activities. For example, in general, a foreign government under section 892 currently is not treated as engaging in commercial activities by reason of investing in stocks, bonds, and other securities. § 1.892–4T(c)(1)(i).[3] The proposed regulations add another category by excluding from the application of § 1.892–5T(b)(1) a corporation that is a USRPHC solely by reason of its direct or indirect ownership interest in one or more other corporations that are not controlled by the foreign government. Thus, for example, if a foreign government controls a USRPHC whose only assets are minority interests in REITs, the proposed regulations would not treat that corporation as a controlled commercial entity pursuant to § 1.892–5T(b)(1). The changes to § 1.892–5T(b)(1) made by the proposed regulations do not affect the analysis of whether the income itself is exempt from U.S. taxation under section 892.[4]

The proposed regulations also clarify § 1.892–5T(b)(1) by replacing the phrase ''or a foreign corporation that would be a United States real property holding corporation if it was a United States corporation'' with ''which may include a foreign corporation'' when referencing section 897(c)(2) to define a USRPHC. Proposed § 1.892–5(b)(1)(i). Section 897(c)(2) defines a USRPHC as including ''any corporation'', whether domestic or foreign.[5] Thus, the phrase ''or a foreign corporation that would be a United States real property holding corporation if it was a United States corporation'' when referencing the definition in section 897(c)(2) is unnecessary.

II. Effect of Section 897(l) on DC–QIE Exception

A comment received in response to the 2019 proposed regulations recommended that regulations clarify that a QFPF is treated as a domestic person for purposes of the DC–QIE exception. The comment reasoned that section 897(l)(1) states that a QFPF shall not be treated as a nonresident alien individual or foreign corporation for purposes of all of section 897, which includes the DC–QIE exception. The comment also noted that such a rule would be easily administrable for open-ended investment funds and would provide certainty to such funds and their investors that section 897(a) would not apply to the disposition of interests in open-ended investment funds which have QFPFs as significant investors. Another comment, however, stated that it is not clear that the intent behind section 897(l) was to provide that a QIE is domestically controlled if it is majority owned by QFPFs, as there was no indication that Congress intended that result. The comment recommended that regulations provide how QFPFs are to be treated for purposes of the DC–QIE exception but did not recommend a specific result.

Section 897(a) generally applies with respect to the gain or loss of ''a nonresident alien individual or a foreign corporation.'' In addition, section 897(h)(1) applies to any distribution by a QIE to a nonresident alien individual or a foreign corporation (or other QIE). Section 897(l) provides that, for purposes of section 897, a QFPF shall not be treated as ''a nonresident alien individual or a foreign corporation.'' The reference to ''a nonresident alien individual or a foreign corporation'' in section 897(l) therefore is consistent with the same class of persons subject to tax under section 897(a) and 897(h)(1). Thus, under the statute, when a QFPF disposes of a USRPI, section 897(a) does not apply to any gain or loss from the disposition because section 897(l) treats the QFPF as neither a nonresident alien individual nor a foreign corporation. Similarly, when a QFPF receives a distribution from a QIE that is attributable to gain from the sale or exchange of a USRPI, the look-through rule under section 897(h)(1), and the general rule under section 897(a) do not apply because section 897(l) treats the QFPF as neither a nonresident alien individual nor a foreign corporation.

In contrast, the ownership test in section 897(h)(4)(B) for the DC–QIE exception (which predates the enactment of section 897(l)) uses the term ''foreign persons'' and not ''nonresident individuals or foreign corporations.'' The DC–QIE exception applies to scenarios where a nonresident alien individual or foreign corporation disposes of stock in a QIE, but because the QIE is less than 50 percent owned by ''foreign persons,'' the stock disposed of is not considered a USRPI. Although section 897(l) provides that a QFPF is not treated as a nonresident alien individual or a foreign corporation for purposes of section 897, it does not expressly provide that a QFPF or QCE is not treated as a foreign person for purposes of the separate ownership test 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

[3] Regulations proposed under section 892 in 2011 would also extend the policy embodied by § 1.892–4T(c)(1)(i) with respect to deemed commercial activities by providing that investments in financial instruments will not be treated as commercial activities for purposes of section 892, irrespective of whether such financial instruments are held in the execution of governmental financial or monetary policy. *See* proposed § 1.892–4(e)(1)(i). *See also* proposed §§ 1.892–4(e)(1)(iv) and 1.892–5(d)(5)(iii), which provide relief from being treated as engaged in certain deemed commercial activities.

[4] *See,* for example, proposed § 1.892–4(e)(1)(iv), which provides that gain derived from a disposition of a USRPI defined in section 897(c)(1)(A)(i) will not qualify for exemption from taxation under section 892 even though a disposition (including a deemed disposition under section 897(h)(1)) of a USRPI, by itself, does not constitute the conduct of a commercial activity.

[5] In contrast, section 897(c)(1)(A)(ii) defines a USRPI by reference to an interest in a USRPHC that is a domestic corporation.

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. *See* PATH Act secs. 133 and 322.[6] 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.

The Technical Corrections Act modified the language of section 897(l). In particular, the modified language specifies that a QFPF and a QCE are not treated as nonresident alien individuals or foreign corporations for purposes of section 897. The Joint Committee on Taxation explanation of the technical correction for section 897(l) states that the revised language was merely intended to clarify the language specifying which entities qualified for the benefit provided by the new subsection. *See* STAFF OF THE JOINT COMM. ON TAX'N, General Explanation of Tax Legislation Enacted in the 115th Congress (JCS–2–19) (General Explanation) 145 (2019) (''2019 General Explanation''). Although the 2019 General Explanation does not specify the technical error with the PATH Act language that was corrected by the 2018 amendment, when comparing the technical correction to the PATH Act formulation, the correction clearly allows a QFPF and QCE to jointly own a USRPI and qualify for section 897(l) with respect to their partial interests in it, whereas the PATH Act formulation used ''or'' between QFPF and QCE, which suggested that all of the USRPI had to be owned by a single entity. Additionally, the change clarified that the exception applied to distributions from all QIEs and not just REITs. Lastly, by shifting the focus of section 897(l) from applying to the USRPI in the PATH Act formulation (''[T]his section shall not apply to any United States real property interest held by . . .'') to instead applying to the QFPF in the Technical Corrections Act formulation (''[F]or purposes of this section, a qualified foreign pension fund shall not be treated as . . .''), the technical correction aligned the section 897(l) exception with the operative provision in section 897(a), which modifies the tax treatment of the entity receiving income via disposition or distribution (the QFPF or QCE), not the tax treatment of the USRPI itself.

Ultimately, as a technical correction, the modification to section 897(l) cannot expand on the policy Congress intended to enact in the PATH Act. A technical correction is a change that clarifies existing law, such as through correcting errors, rather than one that fundamentally or substantively changes the law. *See Fed. Nat'l Mortgage Assoc.* v. *United States,* 56 Fed. Cl. 228, 234, 237 (2003), *rev'd and remanded on other grounds,* 379 F.3d 1303 (Fed. Cir. 2004) (''Congress turns to technical corrections when it wishes to clarify existing law or repair a scrivener's error, rather than to change the substantive meaning of the statute. . . . [A] technical correction that merely restores the rule Congress intended to enact cannot be construed as a fundamental change in the operation of the statute.''); STAFF OF THE JOINT COMM. ON TAX'N, Overview of Revenue Estimating Procedures and Methodologies Used by the Staff of the Joint Committee on Taxation (JCX–1–05) 33 (2005) (describing a technical correction as ''legislation that is designed to correct errors in existing law in order to fully implement the intended policies of previously enacted legislation'' and a change that ''conforms to and does not alter the intent'' of the underlying legislation). Both the PATH Act General Explanation and the 2019 General Explanation make clear that the intent of section 897(l), as originally enacted and as corrected, was to provide that ''in determining the U.S. income tax of a qualified foreign pension fund, section 897 does not apply.'' *See* 2019 General Explanation, at 145. This intent was also clear in the original language of section 897(l) and could not have been expanded by the modifications in the Technical Corrections Act. Additionally, because section 897(l) already specifically excludes QFPF and QCEs 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. Further, if Congress had intended for a QFPF to not be treated as a ''foreign person,'' which is a different and broader characterization beyond section 897(l)'s treatment as not ''a nonresident alien individual or a foreign corporation,'' which is needed to turn off section 897(a) as to the QFPF or QCE, Congress presumably would have expressly provided for that result. Cf. section 1445(f)(3)(B) (solely for purposes of section 1445, providing that an entity that is exempt under section 897(l) is not a foreign person) and section 897(h)(4)(E) (as discussed, treating certain QIE investors as foreign persons (even if in fact a domestic corporation)).

Accordingly, proposed § 1.897–1(c)(3)(iv)(A) provides that a QFPF (including any part of a QFPF) or a QCE is a foreign person for purposes of the DC–QIE exception. *See* parts III and IV of this Explanation of Provisions for a discussion of the definition of domestically controlled QIE in proposed § 1.897–1(c)(3). The IRS may challenge contrary positions before the issuance of any final regulations regarding the treatment of a QFPF or QCE for purposes of the DC–QIE exception.

The proposed regulations make related changes to the definitions provided in § 1.897–1. Proposed § 1.897–1(k) and (l) revise the definition of ''foreign person'' (as provided in § 1.897–9T(c)) and ''foreign corporation'' to remove references that are no longer applicable and to add cross references to the rule in proposed § 1.897–1(c)(3)(iv)(A).

III. QIE Stock Held Directly or Indirectly Under Section 897(h)(4)(B)

A. Overview

The proposed regulations provide guidance for determining whether stock of a QIE is considered ''held directly or indirectly'' by foreign persons for determining whether a QIE is domestically controlled under section 897(h)(4)(B). The proposed regulations define stock that is held ''indirectly'' by taking into account stock of the QIE held through certain entities under a limited ''look-through'' approach. The look-through approach balances the policies of the DC–QIE exception with the requirement in section 897(h)(4)(B) to take into account ''indirect'' ownership of QIE stock by foreign persons in determining whether a QIE is domestically controlled. It is also

[6] Those amendments did not relate to the new rules in section 897(l) and are described separately in the Joint Committee on Taxation's General Explanation. *See* STAFF OF THE JOINT COMM. ON TAX'N, General Explanation of Tax Legislation Enacted in 2015 (JCS–1–16) (General Explanation) 155, 280–83 (2016) (''PATH Act General Explanation'').

intended to prevent the use of intermediary entities to achieve results contrary to the purposes of the DC–QIE exception.

Questions have arisen as to whether the reference to stock held ''indirectly'' in section 897(h)(4)(B) could be interpreted to require looking through all entities, including, for example, all domestic and foreign corporations, to determine the extent to which the ultimate individual shareholders of a QIE are foreign or domestic. In its broadest sense, the statute refers to stock held ''indirectly'' by foreign persons, which could encompass ownership by a foreign individual through multiple tiers of entities of any type. However, the Treasury Department and the IRS have concluded that the term ''indirectly'' should not be interpreted so broadly given the policy underlying section 897(h)(4). Section 897(h)(4)(B) indicates that the determination of whether a QIE is domestically controlled looks to ownership of QIE stock by ''foreign persons,'' not just individuals. In addition, such a broad interpretation of ''indirectly'' mandating the look-through of all entity types, including through multiple tiers of entities, would likely be difficult for taxpayers to comply with, and for the IRS to administer, particularly with respect to publicly traded entities.

Notwithstanding that a complete look-through approach is inappropriate, the Treasury Department and the IRS are issuing proposed § 1.897–1(c)(3) based on the conclusion that a look-through approach in determining ''indirect'' ownership of a QIE should still apply in specified circumstances to QIE stock held by intermediary entities. The proposed regulations thus address the treatment of QIE stock held by certain intermediary entities, such as domestic partnerships. For example, assume USR, a REIT, holds a USRPI as its sole asset. Nonresident alien individuals hold 49 percent of USR's single class of stock. PRS, a domestic partnership 50 percent of the interests of which are held by each of two foreign corporations, holds the remaining 51 percent of the USR stock. If USR stock is disposed of, taxpayers may assert that the stock is not a USRPI under the DC–QIE exception, and therefore not subject to section 897(a), because PRS is a United States person and, consequently, foreign persons could be viewed as directly or indirectly holding less than 50 percent of USR's stock by value. Taxpayers may assert this position even though, taking into account the USR stock held by the foreign corporations through their interests in PRS, foreign persons hold directly or indirectly all of USR's outstanding stock. In support of this position, taxpayers may point to § 1.897–1(c)(2)(i) and its reference to § 1.857–8 as suggesting that the inclusion of the dividends received on QIE stock in gross income on a domestic partnership's tax return, without regard to stock held indirectly by another person, establishes the partnership not only as the actual owner of QIE stock but, as a result of such actual ownership, as the only relevant person for determining whether a QIE is domestically controlled. Taxpayers may take this position even though the determination of actual ownership pursuant to § 1.857–8 is only intended to ensure the beneficial owner of stock is taken into account when different from the shareholder of record, and § 1.897–1(c)(2)(i) does not state or otherwise suggest that the actual owners of QIE stock as determined under § 1.857–8 are the only relevant persons for determining whether a QIE is domestically controlled or provide any guidance on the meaning of ''held directly or indirectly by foreign persons.''

The Treasury Department and the IRS have concluded that the interpretation of the DC–QIE exception described in the preceding paragraph is incorrect because it would permit nonresident alien individuals and foreign corporations to dispose of USRPIs held indirectly through certain intermediate entities, such as domestic partnerships, to avoid taxation under section 897(a). To prevent this result, entities such as partnerships that are generally not subject to U.S. Federal income tax should not, subject to certain limited exceptions, be treated as holders of QIE stock for purposes of determining whether a QIE is domestically controlled. This type of look-through analysis is consistent with section 897(h)(4)(B), which references ''indirect'' ownership in determining the shareholders of a QIE that should be taken into account in applying the DC–QIE exception.

B. General Look-Through Approach

Consistent with the reference to stock held ''indirectly'' by foreign persons in section 897(h)(4)(B), the determination of whether a QIE is domestically controlled under the proposed regulations generally applies a ''look-through'' approach to stock of a QIE that is held through certain entities. Thus, in determining whether a QIE is domestically controlled, only a ''non-look-through person'' is treated as holding directly or indirectly stock of a QIE, and stock of a QIE held by or through one or more intervening ''look-through persons'' is treated as held proportionately by the look-through person's ultimate owners that are non-look-through persons. Proposed § 1.897–1(c)(3)(ii)(A) and (B).

Proposed § 1.897–1(c)(3)(ii)(C) provides that stock of a QIE considered held directly or indirectly by a non-look-through person is not considered held directly or indirectly by any other person. Under this rule, for example, if stock of a QIE is held directly or indirectly by a domestic C corporation (that is not a foreign-owned domestic corporation), it is treated as held directly or indirectly only by that domestic C corporation and is not treated as held directly or indirectly by non-look-through shareholders of the domestic C corporation (or any other person).

Subject to a special look-through rule for foreign-owned domestic corporations and the special ownership rules in section 897(h)(4)(E), discussed in parts III.C and III.D of this Explanation of Provisions, respectively, the proposed regulations define a ''non-look-through person'' to include persons such as individuals, ''domestic C corporations'' (defined as a domestic corporation other than an S corporation, a REIT or a RIC) and foreign corporations (including, for the avoidance of doubt, foreign governments pursuant to section 892(a)(3)). Proposed § 1.897–1(c)(3)(v)(D). The definition of a non-look-through person also includes ''nontaxable holders'' (defined to include tax-exempt entities under section 501(a) or the United States, a State, a U.S. territory, an Indian tribal government or any subdivision of the foregoing) because they generally do not have owners to which the look-through approach could apply. For the same reason, the definition of a ''non-look-through person'' includes international organizations (as defined in section 7701(18)). In addition, a non-look-through person includes publicly traded partnerships (domestic or foreign) because it may be difficult to look-through such entities and it is unlikely that these entities could be affirmatively used as intermediary entities to create a domestically controlled QIE. Finally, a non-look-through person includes a QFPF (including any part of a QFPF) or QCE, which ensures that such entities are taken into account as foreign persons for purposes of section 897(h)(4)(B) as provided under proposed § 1.897–1(c)(3)(iv)(A).

A ''look-through person'' is defined as any person that is not a non-look-through person and includes, for example, a REIT or a RIC (subject to the

special ownership rule in proposed § 1.897–1(c)(3)(iii)(C)), an S corporation, a non-publicly traded partnership (domestic or foreign), and a trust (domestic or foreign). Proposed § 1.897–1(c)(3)(v)(C).

C. Special Look-Through Rule for Foreign-Owned Domestic Corporations

Even though domestic C corporations are generally treated as non-look-through persons, the Treasury Department and the IRS are issuing proposed § 1.897–1(c)(3)(iii)(B) based on the conclusion that a limited look-through approach should apply to non-publicly traded domestic C corporations in which foreign persons hold a meaningful ownership interest. This rule would, for example, 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. In such cases, the ownership of the domestic C corporation by foreign persons should be ascertainable and taken into account in determining the ''indirect'' ownership of the QIE by foreign persons in applying section 897(h)(4)(B).

Accordingly, in determining whether a QIE is domestically controlled, the proposed regulations treat a domestic C corporation whose stock is not regularly traded on an established securities market (''non-public domestic C corporation'') as a look-through person, but only if the non-public domestic C corporation is a foreign-owned domestic corporation. Proposed § 1.897–1(c)(3)(iii)(B). For this purpose, a ''foreign-owned domestic corporation'' is any non-public domestic C corporation if foreign persons hold directly or indirectly 25 percent or more of the fair market value of the corporation's outstanding stock. Proposed § 1.897–1(c)(3)(v)(B). Whether a non-public domestic C corporation is a foreign-owned domestic corporation is determined by, in general, applying the same look-through rules that apply in determining whether a QIE is domestically controlled. Thus, for example, stock of the domestic corporation held by look-through persons would be treated as held directly or indirectly by the look-through person's shareholders, partners, or beneficiaries for this purpose.

D. Special Ownership Rules in Section 897(h)(4)(E)

The proposed regulations incorporate the special ownership rules in section 897(h)(4)(E)(i) and 897(h)(4)(E)(ii). These rules treat a person that holds stock in a QIE as a non-look-through person to the extent required to ensure the treatment of such person as a foreign or United States person as prescribed under section 897(h)(4)(E)(i) and 897(h)(4)(E)(ii). Thus, a person holding less than five percent of U.S. publicly traded QIE stock that section 897(h)(4)(E)(i) deems to be a United States person (absent actual knowledge by the QIE that such person is not a United States person) is treated under the proposed regulations as a non-look-through person with respect to that stock. Proposed § 1.897–1(c)(3)(iii)(A). Stock of a QIE held by a public QIE that, under section 897(h)(4)(E)(ii), is treated as held by a foreign or United States person based on whether the public QIE is a domestically controlled QIE is similarly treated under the proposed regulations as held by a non-look-through person (even though the general definition of a non-look-through person excludes QIEs). Proposed § 1.897–1(c)(3)(iii)(C).

For QIE stock held by a non-public QIE, whose ownership should be more readily ascertainable, the general look-through rules in the proposed regulations are consistent with the approach in section 897(h)(4)(E)(iii) that looks to the proportionate ownership of the non-public QIE to determine the QIE stock held by United States persons.

The rule in proposed § 1.897–1(c)(3)(iii)(A) regarding U.S. publicly traded QIE stock applies notwithstanding any other provision under proposed § 1.897–1(c)(3) (rules regarding domestically controlled QIEs). Thus, for example, a QFPF that holds less than five percent of U.S. publicly traded QIE stock at all times during the testing period (and absent actual knowledge that the person is not a United States person), is treated as a United States person that is a non-look through person with respect to that stock even though the QFPF would otherwise be treated as a foreign person under proposed § 1.897–1(c)(3)(iv)(A). The Treasury Department and the IRS have determined that this priority rule is appropriate due to the administrative and compliance difficulties that could result in determining whether other rules would, absent the application of the U.S publicly traded QIE rule, treat less-than-five-percent holders of U.S. publicly traded QIE stock as foreign persons.

IV. QIE Stock Held Directly or Indirectly Under Section 897(h)(4)(C)

As noted in the Background section of this preamble, section 897(h)(4)(C) provides that the term ''foreign ownership percentage'' means the percentage of QIE stock that was held (directly or indirectly) by foreign persons at the time during the testing period during which the direct and indirect ownership of stock by foreign persons was greatest. The Treasury Department and the IRS have concluded that the determination of QIE stock held ''directly or indirectly'' in section 897(h)(4)(C) should be interpreted in the same manner as such phrase is interpreted in the definition of a domestically controlled QIE in section 897(h)(4)(2). Accordingly, proposed § 1.897–1(c)(4) provides that for purposes of calculating the foreign ownership percentage, the determination of the QIE stock that was held directly or indirectly by foreign persons is made under the rules that apply for purposes of determining whether a QIE is domestically controlled.

V. Other Rules and Modifications

The proposed regulations treat international organizations (as defined in section 7701(18)) as foreign persons for purposes of determining whether a QIE is domestically controlled. Proposed § 1.897–1(c)(3)(iv)(B). Notwithstanding that international organizations are generally not treated as foreign persons for section 897 purposes under § 1.897–9T(e), the Treasury Department and the IRS believe that, for reasons similar to those described in part II of this Explanation of Provisions regarding QFPFs and QCEs, and because international organizations would not otherwise constitute United States persons under section 7701(a)(30), international organizations should be treated as foreign persons in applying the DC–QIE exception.

The proposed regulations do not retain the reference to § 1.857–8 in § 1.897–1(c)(2)(i), which is not necessary given the rules provided in the proposed regulations for determining whether stock of a QIE is considered to be held directly or indirectly. The look-through rules set forth in proposed § 1.897–1(c)(3) apply only with respect to determining whether a QIE is domestically controlled under section 897(h)(4)(B) and do not apply with respect to any other provision, including section 897(c)(3).

Finally, the proposed regulations revise the definition of domestically controlled REIT in § 1.897–1(c)(2)(i) to reflect amendments to section 897(h) made after those regulations were issued that extended the application of section 897(h) to certain RICs. Accordingly, the proposed regulations replace the

definition of ''domestically controlled REIT'' in § 1.897–1(c)(2)(i) by defining a ''domestically controlled QIE'' in proposed § 1.897–1(c)(3).

Applicability Dates

The regulations under section 892 are proposed to apply to taxable years ending on or after December 28, 2022. Taxpayers may rely on the proposed regulations under section 892 until the date of publication of the Treasury decision adopting the regulations as final in the **Federal Register**.

Subject to a special rule for entity classification elections, the regulations under section 897 are proposed to apply to transactions occurring on or after the date these regulations are published as final regulations in the **Federal Register**; however, rules applicable for determining whether a QIE is domestically controlled may be relevant for determining QIE ownership during periods before the date these regulations are published as final regulations in the **Federal Register** to the extent the testing period related to a transaction that occurs after the date these regulations are published as final regulations in the **Federal Register** includes periods before that date. The IRS may challenge positions contrary to proposed § 1.897–1(c)(3) and (4) before the issuance of final regulations relating to the topics addressed in those proposed rules.

Special Analyses

I. Regulatory Planning and Review—Economic Analysis

The Administrator of the Office of Information and Regulatory Affairs (OIRA), Office of Management and Budget, has determined that this proposed rule is not a significant regulatory action, as that term is defined in section 3(f) of Executive Order 12866. Therefore, OIRA has not reviewed this proposed rule pursuant to section 6(a)(3)(A) of Executive Order 12866 and the April 11, 2018, Memorandum of Agreement between the Treasury Department and the Office of Management and Budget (''OMB'').

II. Paperwork Reduction Act

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

III. Regulatory Flexibility Act

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (5 U.S.C. chapter 6) (''RFA'') requires the agency ''to prepare and make available for public comment an initial regulatory flexibility analysis'' that will ''describe the impact of the proposed rule on small entities.'' *See* 5 U.S.C. 603(a). Section 605 of the RFA provides an exception to this requirement if the agency certifies that the proposed rulemaking will not have a significant economic impact on a substantial number of small entities. A small entity is defined as a small business, small nonprofit organization, or small governmental jurisdiction. *See* 5 U.S.C. 601(3) through (6).

The Treasury Department and the IRS do not expect that proposed § 1.892–5(b)(1) will have a significant economic impact on a substantial number of small entities within the meaning of sections 601(3) through 601(6) of the RFA. Proposed § 1.892–5(b)(1) provides guidance regarding whether certain foreign government-controlled entities may be treated as controlled commercial entities within the meaning of section 892. Proposed § 1.892–5(b)(1) does not impose any new costs on these entities. Consequently, the Treasury Department and the IRS do not expect that proposed § 1.892–5(b)(1) will have a significant economic impact on a substantial number of small entities.

Because there is a possibility, however, of significant economic impact on a substantial number of small entities as a result of the rules relating to the treatment of QFPFs and QCEs for purposes of the DC–QIE exception and the definition of a domestically controlled QIE, an initial regulatory flexibility analysis for the proposed regulations is provided below. The Treasury Department and the IRS request comments from the public on the number of small entities that may be impacted and whether that impact will be economically significant.

A. Reasons Why Action Is Being Considered

As discussed in part II of the Explanation of Provisions, there may be some uncertainty as to whether QFPFs and QCEs, which are treated as not ''nonresident alien individuals or foreign corporations'' for purposes of section 897, are treated as foreign persons for purposes of the DC–QIE exception. Treating QFPFs and QCEs as non-foreign investors for purposes of the DC–QIE exception has the potential to expand the effect of section 897(l) to foreign investors who are neither QFPFs nor QCEs (by exempting such investors from tax under section 897(a). These regulations eliminate any uncertainty that taxpayers may have as to the proper classification of QFPFs and QCEs for purposes of the DC–QIE exception by providing that QFPFs and QCEs are treated as foreign persons for purposes of the DC–QIE exception.

As discussed in part III of the Explanation of Provisions, there is uncertainty regarding the determination of whether stock of a QIE is held ''directly or indirectly'' by foreign persons for purposes of the DC–QIE exception. These regulations provide rules to clarify this determination.

B. Objectives of and Legal Basis for the Proposed Regulations

These regulations clarify the treatment of QFPFs and QCEs for two purposes: the first is for purposes of the section 892 exemption from taxation for foreign governments, and the second is the DC–QIE exception. The rules are intended to ensure the following: (1) foreign government-controlled QFPFs (and QCEs) that qualify for the exemption under section 897(l) (and certain other foreign government entities) are not treated as controlled commercial entities for section 892 purposes by reason of qualifying as a USRPHC, and (2) the exemption under section 897(l) does not inappropriately inure to non-QFPFs or non-QCEs by treating QFPFs and QCEs as domestic investors for purposes of the DC–QIE exception. These regulations also clarify whether stock of a QIE is held ''directly or indirectly'' by foreign persons in determining whether the DC–QIE exception applies. The legal basis for these regulations is contained in sections 892(c), 897(l) and 7805.

C. Small Entities to Which These Regulations Will Apply

The regulation relating to the treatment of QFPFs and QCEs for purposes of the DC–QIE exception affects other foreign investors in QIEs. The regulation defining a domestically controlled QIE also affects foreign investors in QIEs. Because an estimate of the number of small businesses affected is not currently feasible, this initial regulatory flexibility analysis assumes that a substantial number of small businesses will be affected. The Treasury Department and the IRS do not expect that these regulations will affect a substantial number of small nonprofit organizations or small governmental jurisdictions.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

These regulations do not impose additional reporting or recordkeeping obligations.

E. Duplicate, Overlapping, or Relevant Federal Rules

The Treasury Department and the IRS are not aware of any Federal rules that duplicate, overlap, or conflict with these regulations.

F. Alternatives Considered

Section 897(a) applies to nonresident alien individuals and foreign corporations, and neither the statute nor prior regulations establish different rules for small entities. Moreover, the DC–QIE exception is measured based on the ownership interests in a QIE, regardless of the size of the investor. Because the DC–QIE exception takes into account all investors, regardless of size, the Treasury Department and the IRS have concluded that the DC–QIE exception should apply uniformly to large and small business entities. The Treasury Department and the IRS did not consider any significant alternative to the rule that provides for the treatment of QFPFs and QCEs under the DC–QIE exception, or for the rule relating to QFPFs, QCEs, or certain other foreign government entities under section 892.

The Treasury Department and the IRS did consider 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 (that is, without the special rule for foreign-owned domestic corporations discussed in part III.C of the Explanation of Provisions section of this preamble). However, the Treasury Department and the IRS concluded that the look-through approach in the proposed rules 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 under section 897(h)(4)(B). As noted in part III.C of the Explanation of Provisions section of this preamble, the purpose of the special rule for foreign-owned domestic corporations 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.

The proposed rules address potential uncertainty under current law and do not impose an additional economic burden. Consequently, the rules represent the approach with the least economic impact.

IV. Section 7805(f)

Pursuant to section 7805(f) of the Code, the proposed regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

V. Unfunded Mandates Reform Act

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

VI. Executive Order 13132: Federalism

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

Comments and Requests for Public Hearing

Before the proposed amendments are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations, including the definitions of look-through person and non-look-through person, and whether special treatment for particular entities, such as cooperatives, may be warranted. Any electronic and paper comments submitted will be made available at *www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020–4, 2020–17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin or Cumulative Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *www.irs.gov.*

Drafting Information

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

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

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

* * * * *

Section 1.897–1 also issued under 26 U.S.C. 897(l)(3).

* * * * *

■ **Par. 2.** Section 1.892–5, as proposed to be amended in 76 FR 68119 (November 3, 2011), is further amended by revising paragraphs (b) through (d) to read as follows:

§ 1.892–5 Controlled commercial entity.

* * * * *

(b) *Entities treated as engaged in commercial activity*—(1) *United States real property holding corporations*—(i) *General rule.* Except as provided in paragraph (b)(1)(ii) of this section, a

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

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

(A) A foreign corporation that is a qualified holder under § 1.897(l)–1(d); or

(B) A corporation that is a United States real property holding corporation, as defined in section 897(c)(2), solely by reason of its direct or indirect ownership interest in one or more other corporations that are not controlled by the foreign government (as determined under § 1.892–5T(a)).

(iii) *Applicability date.* This paragraph (b)(1) applies to taxable years ending on or after December 28, 2022. For rules that apply to taxable years ending before December 28, 2022, *see* § 1.892–5T(b)(1), as contained in 26 CFR part 1, revised as of April 1, 2022.

(b)(2) through (d)(4). For further guidance, *see* § 1.892–5T(b)(2) through (d)(4).

* * * * *

■ **Par. 3.** Section 1.892–5T is amended by revising paragraph (b)(1) to read as follows:

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

* * * * *

(b) * * *

(1)(i) For further guidance, see § 1.892–5(b)(1)(i).

(ii) For further guidance, see § 1.892–5(b)(1)(ii).

* * * * *

■ **Par 4.** Section 1.897–1 is amended by:

■ a. Revising paragraph (a)(2);

■ b. Removing and reserving paragraph (c)(2)(i);

■ c. Adding paragraphs (c)(3) and (4);

■ d. Adding paragraph (k);

■ e. Removing the language ''or section 897(k) and § 1.897–4'' in the second sentence and adding two sentences to the end of paragraph (l); and

■ f. Adding paragraph (n).

The revision and additions read as follows:

§ 1.897–1 Taxation of foreign investment in United States real property interests, definition of terms.

(a) * * *

(2) *Effective date.* Except as otherwise provided in this paragraph (a)(2), the regulations set forth in §§ 1.897–1 through 1.897–4 are effective for transactions occurring after June 18, 1980. Paragraphs (c)(3) and (4), (k), and (l) of this section apply to transactions occurring on or after [the date these regulations are published as final regulations in the **Federal Register**] and transactions occurring before [the date these regulations are published as final regulations in the **Federal Register**] resulting from an entity classification election under § 301.7701–3 of this chapter that was effective on or before [the date these regulations are published as final regulations in the **Federal Register**] but was filed on or after [DATE OF PUBLICATION OF FINAL RULE]. For transactions occurring before [DATE OF PUBLICATION OF FINAL RULE], *see* paragraphs (c)(2)(i) and (l) of this section and § 1.897–9T(c) as in effect and contained in 26 CFR part 1, as revised April 1, 2022.

* * * * *

(c) * * *

(3) *Domestically controlled QIE*—(i) *In general.* An interest in a domestically controlled QIE is not a United States real property interest. A QIE is domestically controlled if foreign persons hold directly or indirectly less than 50 percent of the fair market value of the QIE's outstanding stock at all times during the testing period. For rules that apply to distributions by a QIE (including a domestically controlled QIE) attributable to gain from the sale or exchange of a United States real property interest, *see* section 897(h)(1).

(ii) *Look-through approach for determining QIE stock held directly or indirectly.* The following rules apply for purposes of determining whether a QIE is domestically controlled:

(A) *Non-look-through persons considered holders.* Only a non-look-through person is considered to hold directly or indirectly stock of the QIE.

(B) *Attribution from look-through persons.* Stock of a QIE that, but for the application of paragraph (c)(3)(ii)(A) of this section, would be considered held by a look-through person, is instead considered held directly or indirectly by the look-through person's shareholders, partners, or beneficiaries, as applicable, that are non-look-through persons based on the non-look-through person's proportionate interest in the look-through person. To the extent the shareholders, partners, or beneficiaries, as applicable, of the look-through person are also look-through persons, this paragraph applies to such shareholders, partners, or beneficiaries as if they held, but for the application of paragraph (c)(3)(ii)(A) of this section, their proportionate share of the stock of the QIE.

(C) *No attribution from non-look-through persons.* Stock of a QIE considered held directly or indirectly by a non-look-through person is not considered held directly or indirectly by any other person.

(iii) *Special rules for applying look-through approach*—(A) *Certain holders of U.S. publicly traded QIE stock.* Notwithstanding any other provision of paragraph (c)(3) of this section, a person holding less than five percent of U.S. publicly traded QIE stock at all times during the testing period, determined without regard to paragraph (c)(3)(ii)(A) of this section, is treated as a United States person that is a non-look-through person with respect to that stock, unless the QIE has actual knowledge that such person is not a United States person. For an example illustrating the application of this paragraph (c)(3)(iii)(A), *see* paragraph (c)(3)(vi)(C) of this section.

(B) *Certain foreign-owned domestic C corporations.* A non-public domestic C corporation is treated as a look-through-person if it is a foreign-owned domestic corporation. For an example illustrating the application of this paragraph (c)(3)(iii)(B), *see* paragraph (c)(3)(vi)(B) of this section.

(C) *Public QIEs.* A public QIE is treated as a foreign person that is a non-look-through person. The preceding sentence does not apply, however, if the public QIE is a domestically controlled QIE as defined in paragraph (c)(3) of this section, determined after the application of this paragraph (c)(3)(iii)(C), in which case the public QIE is treated as a United States person that is a non-look-through person. For an example illustrating the application of this paragraph (c)(3)(iii)(C), *see* paragraph (c)(3)(vi)(C) of this section (*Example 3).*

(iv) *Treatment of certain persons as foreign persons*—(A) *Qualified foreign pension fund or qualified controlled entity.* For purposes of paragraph (c)(3) of this section, a qualified foreign pension fund (including any part of a qualified foreign pension fund) or a qualified controlled entity is treated as a foreign person, irrespective of whether the fund or entity qualifies for the exception from section 897 provided in § 1.897(l)– 1(b)(1). For an example illustrating the application of this paragraph (c)(3)(iv)(A), *see* paragraph (c)(3)(vi)(A) of this section (*Example 1). See* also paragraph (k) of this section for a definition of foreign person that applies for purposes of sections 897, 1445, and 6039C.

(B) *International organization.* For purposes of paragraph (c)(3) of this section, an international organization (as defined in section 7701(a)(18)) is treated as a foreign person. *See* § 1.897–

9T(e) regarding the treatment of international organizations under sections 897, 1445, and 6039C, which provides that an international organization is not a foreign person with respect to United States real property interests, and is not subject to sections 897, 1445, and 6039C on the disposition of a United States real property interest.

(v) *Definitions.* The following definitions apply for purposes of paragraph (c)(3) of this section:

(A) A *domestic C corporation* is any domestic corporation other than a regulated investment company (''RIC'') as defined in section 851, a real estate investment trust (''REIT'') as defined in section 856, or an S corporation as defined in section 1361.

(B) A *foreign-owned domestic corporation* is any non-public domestic C corporation if foreign persons hold directly or indirectly 25 percent or more of the fair market value of the non-public domestic C corporation's outstanding stock. For purposes of determining whether a non-public domestic C corporation is a foreign-owned domestic corporation, the rules of paragraphs (c)(3)(ii)(A) through (C) and (c)(3)(iii)(C) of this section apply with the following modifications—

(*1*) In paragraphs (c)(3)(ii)(A) through (C) of this section, treating references to ''QIE'' as references to ''non-public domestic C corporation''; and

(*2*) A non-public domestic C corporation that is a foreign-owned domestic corporation under paragraph (c)(3)(v)(B) of this section is treated as a look-through person for purposes of determining whether any other non-public domestic C corporation is a foreign-owned domestic corporation.

(C) A *look-through person* is any person other than a non-look-through person. Thus, for example, a look-through person includes a RIC, a REIT, an S corporation, a non-publicly traded partnership (domestic or foreign), and a trust (domestic or foreign, whether or not the trust is described in sections 671 through 679). For a special rule that treats certain non-public domestic C corporations as look-through persons, *see* paragraph (c)(3)(iii)(B) of this section.

(D) A *non-look-through person* is an individual, a domestic C corporation (other than a foreign-owned domestic corporation), a nontaxable holder, a foreign corporation (including a foreign government pursuant to section 892(a)(3)), a publicly traded partnership (domestic or foreign), an estate (domestic or foreign), an international organization (as defined in section 7701(a)(18)), a qualified foreign pension fund (including any part of a qualified foreign pension fund), or a qualified controlled entity. For special rules that treat certain holders of QIE stock as non-look-through persons, *see* paragraphs (c)(3)(iii)(A) and (C) of this section.

(E) A *non-public domestic C corporation* is any domestic C corporation that is not a public domestic C corporation.

(F) A *nontaxable holder* is—

(*1*) Any organization that is exempt from taxation by reason of section 501(a);

(*2*) The United States, any State (as defined in section 7701(a)(10)), any territory of the United States, or a political subdivision of any State or any territory of the United States; or

(*3*) Any Indian tribal government (as defined in section 7701(a)(40)) or its subdivision (determined in accordance with section 7871(d)).

(G) A *public domestic C corporation* is a domestic C corporation any class of stock of which is regularly traded on an established securities market within the meaning of §§ 1.897–1(m) and 1.897–9T(d).

(H) A *public QIE* is a QIE any class of stock of which is regularly traded on an established securities market within the meaning of §§ 1.897–1(m) and 1.897–9T(d), or that is a RIC that issues redeemable securities within the meaning of section 2 of the Investment Company Act of 1940.

(I) A *publicly traded partnership* is a partnership any class of interest of which is regularly traded on an established securities market within the meaning of §§ 1.897–1(m) and 1.897–9T(d).

(J) A *qualified controlled entity* has the meaning set forth in § 1.897(l)–1(e)(9).

(K) A *qualified foreign pension fund* has the meaning set forth in § 1.897(l)–1(c).

(L) A *QIE* is a qualified investment entity, as defined in section 897(h)(4)(A).

(M) *Testing period* has the meaning set forth in section 897(h)(4)(D).

(N) *U.S. publicly traded QIE stock* is any class of stock of a QIE that is regularly traded on an established securities market within the meaning of §§ 1.897–1(m) and 1.897–9T(d), but only if the established securities market is in the United States.

(vi) *Examples.* The rules of this paragraph (c)(3) are illustrated by the following examples. It is presumed that each entity has a single class of stock or other ownership interests, that the ownership described existed throughout the relevant testing period and that, unless otherwise stated, a QIE is not a public QIE as defined under paragraph (c)(3)(v)(H) of this section.

(A) *Example 1: QIE stock held by public domestic C corporation*—(*1*) *Facts.* USR is a REIT, 51 percent of the stock of which is held by X, a public domestic C corporation as defined in paragraph (c)(3)(v)(G) of this section, and 49 percent of the stock of which is held by nonresident alien individuals, which are foreign persons as defined in paragraph (k) of this section.

(*2*) *Analysis.* Under paragraph (c)(3)(v)(L) of this section, USR is a QIE. X is a non-look-through person as defined under paragraph (c)(3)(v)(D) of this section. Thus, under paragraph (c)(3)(ii)(A) of this section X is considered as holding directly or indirectly stock of USR for purposes of determining whether USR is a domestically controlled QIE. Under paragraph (c)(3)(ii)(C) of this section, the USR stock held directly or indirectly by X is not considered held directly or indirectly by any other person, including the shareholders of X. Because X is not a foreign person as defined in paragraph (k) of this section and holds directly or indirectly 51 percent of the single class of outstanding stock of USR, foreign persons hold directly or indirectly less than 50 percent of the fair market value of the stock of USR, and USR therefore is a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(*3*) *Alternative facts: QIE stock held by domestic partnership.* The facts are the same as in paragraph (c)(3)(vi)(A)(*1*) of this section (*Example 1*), except that, instead of being a public domestic C corporation, X is a domestic partnership that is not a publicly traded partnership as defined in paragraph (c)(3)(v)(I) of this section. In addition, FC1, a foreign corporation, holds a 50 percent interest in X, and the remaining interests in X are held by U.S. citizens. X is a look-through person as defined in paragraph (c)(3)(v)(C) of this section and, therefore, under paragraph (c)(3)(ii)(A) of this section is not considered as holding directly or indirectly stock of USR for purposes of determining whether USR is a domestically controlled QIE. Under paragraph (c)(3)(ii)(B) of this section, the stock of USR that, but for paragraph (c)(3)(ii)(A) of this section, is considered held by X, a look-through person, is instead considered held proportionately by X's partners that are non-look-through persons. Accordingly, because FC1 and the U.S. citizen partners in X are non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, 25.5 percent of the stock of USR is considered as held directly or indirectly by FC1 (50% × 51%), a foreign person

as defined in paragraph (k) of this section, and 25.5 percent (in the aggregate) of the stock of USR is considered as held directly or indirectly by the U.S. citizen partners in X (50% × 51%), who are not foreign persons as defined in paragraph (k) of this section. Foreign persons therefore hold directly or indirectly 74.5 percent of the stock of USR (49 percent of the stock of USR held directly or indirectly by nonresident alien individuals, who are non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, plus the 25.5 percent held directly or indirectly by FC1), and USR is not a domestically controlled QIE under paragraph (c)(3)(i) of this section. The result described in this paragraph (c)(3)(vi)(A)(*3*) would be the same if, instead of being a domestic partnership, X were a foreign partnership.

(*4*) *Alternative facts: QIE stock held by a qualified foreign pension fund.* The facts are the same as in paragraph (c)(3)(vi)(A)(*3*) of this section (*Example 1*), except that, instead of being a foreign corporation, FC1 is a qualified foreign pension fund. The analysis is the same as in paragraph (c)(3)(vi)(A)(*3*) of this section regarding the treatment of X as a look-through person as defined in paragraph (c)(3)(v)(C) of this section. FC1, a foreign person under paragraph (c)(3)(iv)(A) of this section, is a non-look-through person as defined in paragraph (c)(3)(v)(D) of this section. Because FC1 and the U.S. citizen partners in X are non-look-through persons, 25.5 percent of the stock of USR is considered as held directly or indirectly by FC1 (50% × 51%), and 25.5 percent (in the aggregate) of the stock of USR is considered as held directly or indirectly by the U.S. citizen partners in X (50% × 51%). Foreign persons therefore hold directly or indirectly 74.5 percent of the stock of USR (49 percent of the stock of USR held directly or indirectly by nonresident alien individuals, who are foreign persons and non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, plus the 25.5 percent held directly or indirectly by FC1), and USR is not a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(B) *Example 2: QIE stock held by non-public domestic C corporation that is a foreign-owned domestic corporation*—(*1*) *Facts.* USR is a REIT, 51 percent of the stock of which is held by X, a non-public domestic C corporation as defined in paragraph (c)(3)(v)(E) of this section, and 49 percent of the stock of which is held by nonresident alien individuals, which are foreign persons as defined in paragraph (k) of this section. FC1, a foreign corporation, holds 20 percent of the stock of X, and Y, a nonresident alien individual, holds 5 percent of the stock of X. The remaining 75 percent of the stock of X is held by U.S. citizens.

(*2*) *Analysis.* Under paragraph (c)(3)(v)(L) of this section, USR is a QIE. X is a non-look-through person as defined under paragraph (c)(3)(v)(D) of this section, unless paragraph (c)(3)(iii)(B) of this section applies to treat X as a look-through person because X is a foreign-owned domestic corporation. FC1, Y, and the U.S. citizen shareholders of X are non-look-through persons as defined under paragraph (c)(3)(v)(D) of this section. Under paragraph (c)(3)(v)(B)(*1*) of this section, FC1, Y, and the U.S. citizen shareholders are all considered as holding directly or indirectly stock of X for purposes of determining whether X is a foreign-owned domestic corporation. Under paragraph (c)(3)(v)(B)(*1*) of this section, the stock held directly or indirectly by FC1, Y, and the U.S. citizen shareholders is not considered held directly or indirectly by any other person. Because FC1 and Y, both foreign persons as defined in paragraph (k) of this section, hold directly or indirectly 20 percent and 5 percent of the stock of X, respectively, foreign persons hold directly or indirectly 25 percent of the fair market value of the stock of X, and X is a foreign-owned domestic corporation under paragraph (c)(3)(v)(B) of this section. Accordingly, under paragraph (c)(3)(iii)(B) of this section, X is a look-through person as defined in paragraph (c)(3)(v)(C) of this section and, therefore, under paragraph (c)(3)(ii)(A) of this section is not considered as holding directly or indirectly stock of USR for purposes of determining whether USR is a domestically controlled QIE. Under paragraph (c)(3)(ii)(B) of this section, the stock of USR that, but for paragraph (c)(3)(ii)(A) of this section, is considered held by X, a look-through person, is instead considered held proportionately by X's shareholders that are non-look-through persons. Accordingly, because FC1, Y, and the U.S. citizen shareholders of X are non-look-through persons, 10.2 percent of the stock of USR is considered as held directly or indirectly by FC1 (20% × 51%), 2.55 percent of the stock of USR is considered as held directly or indirectly by Y (50% × 51%), and 38.25 percent (in the aggregate) of the stock of USR is considered as held directly or indirectly by the U.S. citizen shareholders (75% × 51%). Foreign persons therefore hold directly or indirectly 61.75 percent of the stock of USR (49 percent of the stock of USR held directly by nonresident alien individuals, who are foreign persons and non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, plus the 10.2 percent and 2.55 percent held indirectly by FC1 and Y, respectively), and USR is not a domestically controlled QIE under paragraph (c)(3)(i) of this section. The result described in this paragraph (c)(3)(vi)(B)(*2*) would be different if Y were a U.S. citizen instead of a nonresident alien individual, in which case X would be a non-look-through person because it is not a foreign-owned domestic corporation under paragraph (c)(3)(v)(B) of this section and, consequently, USR would be a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(C) *Example 3: QIE stock held by public QIE that is a domestically controlled QIE*—(*1*) *Facts.* USR2 is a REIT, 51 percent of the stock of which is held by USR1, a REIT that is a public QIE as defined in paragraph (c)(3)(v)(H) of this section, and 49 percent of the stock of which is held by nonresident alien individuals, which are foreign persons as defined in paragraph (k) of this section. The stock of USR1 is U.S. publicly traded QIE stock as defined in paragraph (c)(3)(v)(N) of this section. FC1 and FC2, both foreign corporations, each hold 20 percent of the stock of USR1. The remaining 60 percent of the stock of USR1 is held by persons that each hold less than 5 percent of the stock of USR1 and with respect to which USR1 has no actual knowledge that such person is not a United States person (''USR1 small public shareholders'').

(*2*) *Analysis.* Under paragraph (c)(3)(v)(L) of this section, USR2 and USR1 are QIEs. Under paragraph (c)(3)(iii)(A) of this section, each of the USR1 small public shareholders is treated as a United States person that is a non-look-through person. Consequently, under paragraph (c)(3)(i) of this section USR1 is a domestically controlled QIE because FC1 and FC2, each a foreign person as defined in paragraph (k) of this section, together hold directly or indirectly only 40 percent of the stock of USR1 and, thus, foreign persons hold directly or indirectly less than 50 percent of the fair market value of the stock of USR1. In addition, the USR2 stock held by USR1 is treated as held directly or indirectly by a United States person that is a non-look-through person under paragraph (c)(3)(iii)(C) of this section. Because USR1 holds directly or indirectly 51 percent of the stock of USR2, foreign persons hold directly or indirectly less

than 50 percent of the fair market value of the stock of USR2, and USR2 is a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(*3*) *Alternative facts: QIE stock held by public QIE that is not a domestically controlled QIE.* The facts are the same as in paragraph (c)(3)(vi)(C)(*1*) of this section (*Example 3*), except that 25 percent of the stock of USR1 is held by each of FC1 and FC2, with the remaining 50 percent of the stock of USR1 held by the USR1 small public shareholders. Regardless of the treatment of the USR1 small public shareholders, USR1 is not a domestically controlled QIE under paragraph (c)(3)(i) of this section because FC1 and FC2, each a foreign person as defined in paragraph (k) of this section, together hold directly or indirectly 50 percent of the stock of USR1 and, thus, foreign persons do not hold directly or indirectly less than 50 percent of the fair market value of the stock of USR1. In addition, the USR2 stock held by USR1 is treated as held by a foreign person that is a non-look-through person under paragraph (c)(3)(iii)(C) of this section. Because USR1 holds directly or indirectly 51 percent of the stock of USR2, foreign persons do not hold directly or indirectly less than 50 percent of the fair market value of the stock of USR2, and USR2 is not a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(D) *Example 4: QIE stock held by non-public QIE*—(*1*) *Facts.* USR2 is a REIT, 49 percent of the stock of which is held by nonresident alien individuals, and 51 percent of the stock of which is held by USR1, a REIT. U.S. citizens hold 50 percent of the stock of USR1. The remaining 50 percent of the stock of USR1 is held by PRS, a domestic partnership, 50 percent of the interests in which are held by DC, a public domestic C corporation as defined in paragraph (c)(3)(v)(G) of this section, and 50 percent of the interests in which are held by nonresident alien individuals.

(*2*) *Analysis.* Under paragraph (c)(3)(v)(L) of this section, USR2 and USR1 are QIEs. USR1 is not treated as a non-look-through person under paragraph (c)(3)(iii)(C) of this section because USR1 is not a public QIE as defined in paragraph (c)(3)(v)(H) of this section. Each of USR1 and PRS is a look-through person as defined in paragraph (c)(3)(v)(C) of this section that is not treated as holding directly or indirectly stock in USR2 for purposes of determining whether USR2 is a domestically controlled QIE under paragraph (c)(3)(ii)(A) of this section. Under paragraph (c)(3)(ii)(B) of this section, stock of a QIE that would be considered held by a look-through person but for the application of paragraph (c)(3)(ii)(A) of this section is considered held directly or indirectly proportionately by the look-through person's direct or indirect owners that are non-look-through persons. Because the U.S. citizens who hold USR1 stock are non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, those U.S. citizens are treated as holding directly or indirectly 25.5 percent of the stock of USR2 through their USR1 stock interest (50% × 51%) in accordance with paragraph (c)(3)(ii)(A) of this section. Similarly, because DC and the nonresident alien partners in PRS are non-look-through persons, each is treated as holding directly or indirectly the stock of USR2 through its interest in PRS and PRS's interest in USR1. Thus, DC is treated as holding directly or indirectly 12.75 percent of the stock of USR2 (50% × 50% × 51%) and the nonresident alien individual partners, which are foreign persons as defined in paragraph (k) of this section, are treated as directly or indirectly holding a 12.75 percent aggregate interest in the stock of USR2 (50% × 50% × 51%). Foreign persons therefore hold directly or indirectly 63.25 percent of the stock of USR2 (the 49 percent stock in USR2 directly held by nonresident alien individuals, who are foreign persons and non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, plus the 12.75 percent in stock indirectly held by the nonresident alien individual partners in PRS), and USR2 is not a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(4) *Foreign ownership percentage.* For purposes of calculating the foreign ownership percentage under section 897(h)(4)(C), the determination of the QIE stock that was held directly or indirectly by foreign persons is made under the rules of paragraphs (c)(3)(ii) through (vi) of this section.

* * * * *

(k) *Foreign person.* The term *foreign person* means a nonresident alien individual (including an individual subject to the provisions of section 877), a foreign corporation as defined in paragraph (l) of this section, a foreign partnership, a foreign trust or a foreign estate, as such persons are defined by section 7701 and the regulations in this chapter under section 7701. A resident alien individual, including a nonresident alien individual with respect to whom there is in effect an election under section 6013(g) or 6013(h) to be treated as United States resident, is not a foreign person. With respect to the status of foreign governments and international organizations, *see* § 1.897–9T(e). *See* paragraph (c)(3)(iv)(A) of this section regarding the treatment of qualified foreign pension funds and qualified controlled entities as foreign persons for purposes of section 897(h)(4)(B).

(l) * * * For purposes of sections 897 and 6039C, however, the term does not include a foreign corporation with respect to which there is in effect an election under section 897(i) and § 1.897–3 to be treated as a domestic corporation. For purposes of section 897, the term does not include a qualified holder described in § 1.897(l)–1(d); *see* paragraph (c)(3)(iv)(A) of this section regarding the treatment of qualified foreign pension funds and qualified controlled entities as foreign persons for purposes of section 897(h)(4)(B).

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(n) *See* § 1.897–9T(d) for a definition of regularly traded for purposes of sections 897, 1445, and 6039C.

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■ **Par. 5.** Section 1.897–9T is amended by removing and reserving paragraph (c) and adding a sentence after the second sentence of paragraph (e).

The addition reads as follows:

§ 1.897–9T Treatment of certain interest in publicly traded corporations, definition of foreign person, and foreign governments and international organizations (temporary).

* * * * *

(e) * * * *See* § 1.897–1(c)(3)(iv)(B) regarding the treatment of international organizations as foreign persons for purposes of section 897(h)(4)(B). * * *

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Melanie R. Krause,

Acting Deputy Commissioner for Services and Enforcement.

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Income of Foreign Governments and International Organizations; Comment Period Reopening

AGENCY: Internal Revenue Service (IRS), Treasury.