July 2, 2026

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Electronically submitted at www.regulations.gov
CC:PA:01:PR (REG–00349656-26)

RE: Guidance Relating to Income of Foreign Governments and of International Organizations (REG-00349656-26)

Dear Assistant Secretary and Acting Chief Counsel Kies:

On behalf of our members, the American Investment Council (the "AIC") appreciates the opportunity to submit a response to the request for comments in the Notice of Proposed Rulemaking with respect to section 892 of the Internal Revenue Code.[1] As previewed during our April 23, 2026, meeting and our February 13, 2026, comment letter on REG-101952-24 our comments will focus primarily on two issues under the proposed regulations – the proposed expansion of when an acquisition of debt is treated as a commercial activity and the proposed facts and circumstances test for determining effective control. The comments will also discuss transition rules.

Summary

Certain portions of the proposed regulations would prohibit existing practices in this area. In particular, the proposed regulations would adopt a presumption that a debt instrument gives rise to commercial activity income ("CAI") unless it falls within a narrow safe harbor or is considered to not constitute CAI based on a newly proposed facts and circumstances test.

Outside of the debt context, the proposed rules would create uncertainty as to when a foreign sovereign, following standard and widespread industry practices to protect their investments, such as serving on an advisory committee or having the right to veto certain significant action,

[1] Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

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could be deemed to have "effective control" of a business entity.

We appreciate the revised transition rules in the proposed regulations issued on June 1, 2026, but believe that further changes should be made to ensure the new rules do not apply to existing investments and investments that foreign governments are currently contemplating before the final regulations are published.

We respectfully request that Treasury consider reverting to the framework in the 2011 proposed regulations presuming acquiring loans to be an investment activity unless the purchaser is in a banking, financing, or similar business. Otherwise, as set out further below, Treasury should undergird the facts and circumstances test with the principle that income derived from the service of providing loans to customers results in CAI, but income from the investment activity of acquiring loans does not, and expand the safe harbors accordingly.

We also respectfully request Treasury to provide that the key distinction regarding effective control is between management and operations on the one hand, and monitoring and protection of an investment on the other hand. Allowing investors to protect their investments by having general advisory and consultation rights should not constitute effective control. Furthermore, veto rights over certain actions by the entity that are customary for investors and necessary to protect their investment, such as transactions between the business entity and management or other related persons, should not constitute effective control.

Commercial Activity Income

The proposed regulations appear to create a presumption that acquiring debt is a commercial activity by stating that acquiring debt is a commercial activity unless the acquisition meets one of two safe harbors or a facts and circumstances test. The two safe harbors are for registered offerings,[2] and qualified secondary market acquisitions.[3]

We believe the proposed regulations issued by Treasury and the IRS in 2011, as finalized by the 2025 final regulations for investments other than loans, provide a more appropriate framework for determining whether income from loans constitutes CAI. Under that guidance, the presumption is that "investments in stocks, bonds, and other securities (as defined in § 1.892-3T(a)(3)), loans, investments in financial instruments (as defined in § 1.892-3T(a)(4)), and the holding of bank deposits in banks" are not considered commercial activities.[4] The exception is that such activities are considered commercial activities if made by a banking, financing or similar business.[5]

Similarly, the general rule under the 2011 proposed regulations, as finalized by the 2025 final

[2] See Prop. Treas. Reg. § 1.892-4(c)(1)(ii)(B)(1).
[3] See Prop. Treas. Reg. § 1.892-4(c)(1)(ii)(B)(2).
[4] Treas. Reg. § 1.892-4(c)(1)(i). This portion of the final regulations is subject to the other provisions of paragraph (c), of which (c)(1)(ii) is currently reserved, and would be addressed by the proposed regulations as noted above.
[5] See Treas. Reg. § 1.892-4T(c)(1)(iii).

regulations for investments other than loans, is that "[e]ffecting transactions in stocks, bonds, other securities … partnership equity interests, commodities, or financial instruments ... for a foreign government's own account does not constitute commercial activity."[6] The exception is that undertaking such transactions as a dealer determined under the principles of § 1.864-2(c)(2)(iv)(a) does constitute CAI.[7]

The framework adopted in the 2011 proposed regulations is more appropriate for determining when debt instruments give rise to CAI. There is no apparent reason why investments in debt should be treated differently than other types of investments, and the general presumption that making investments is not a commercial activity should also apply to making loans. This is consistent with the treatment of income from debt generally – interest is typically treated as portfolio income, for example as FDAP or investment income. The exception to this general rule is usually when the interest arises in a "banking, financing or similar business", which was the exception set forth in the 2011 proposed regulations.

Similarly, trading for a foreign government's own account should be presumed not to be commercial activity income unless the transactions are undertaken as a dealer determined under the principles of § 1.864-2(c)(2)(iv)(a). This was the framework of the 2011 proposed regulations, and we believe it is the appropriate one. Investing has always been considered to not give rise to CAI, and buying, owning and selling debt securities should not be presumed to be commercial activity.

We recognize that there are inherent factual determinations as to when one's investment activity of making, holding, buying and selling loans could give rise to commercial activity, whether in the nature of a banking, financing, or similar business or that of a dealer. And where there are these types of factual determinations, it is possible for taxpayers and their advisers to reach different legal conclusions, which can lead to a wide range of practices in a particular market. We do not believe that is the case here. While the dollar amounts of foreign direct investment from sovereigns are significant, the number of section 892 eligible entities is relatively small – these are all large, highly sophisticated organizations. And at least with respect to commercial activity (if not more generally), they are profoundly risk averse. Foreign governments and their advisers are particularly careful in this area because crossing the line into commercial activity can turn an 892-eligible entity into a "controlled commercial entity", tainting the entity's entire income as potentially subject to tax. We therefore believe that this is an area that has been operating in a principled manner under the guidance set out in the 2011 proposed regulations (generally finalized in the 2025 final regulations for areas other than loans) and do not believe that extensive further guidance is necessary.

We appreciate that Treasury and the IRS intended to provide more clarity with respect to when the acquisition of debt is considered an investment activity or a commercial activity.[8]

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[6] Treas. Reg. § 1.892-4(c)(2).
[7] See Treas. Reg. § 1.892-4(c)(2).
[8] The preambles to the 2025 proposed and final regulations state that a comment was received with respect to the

However, with respect to loans, the 2025 proposed regulations reverse the framework set out in the 2011 proposed regulations and replace it with a facts and circumstances test that, in our view, removes rather than adds clarity. To the extent more clarity is needed, we believe it would have been appropriate to expand on the 2011 proposed regulations framework with specific examples or safe harbors.

If, beyond the framework of the 2011 proposed regulations (or in lieu of), Treasury and the IRS believe that safe harbors and a facts and circumstances test are appropriate, the facts and circumstances should be explained with an underlying principle. We believe an appropriate principle is that when a lending activity represents a service provided to a customer (such as a customer of a bank or a borrower that seeks to access liquidity from someone in the business of lending), the income from the loan represents income from a commercial activity. In contrast, when the loan simply represents an investment, the income should not be CAI.

Investors engage in a wide variety of activities in order to select and protect their investments. This includes diligence, research and weighing the terms and rights of the instrument. In these cases, there is generally little to no involvement with a potential issuer unless the facts and circumstances change (e.g., where an investment becomes distressed and the investor must engage in discussions to protect its investment). In contrast, activities involving debt that are commercial in nature are customer facing – that is, the person in the business of lending is providing a service to borrowers and potential borrowers. For example, a bank markets itself to the public as receiving deposits and making personal, mortgage, and business loans. Similarly, a bank or other lending business may regularly issue letters of credit to the public, finance foreign exchange transactions, and act as a dealer, market maker or distributor of loans, bonds, notes or other securities for customers rather than investing for its own account. Unless engaged in such commercial activities, acquiring loans should maintain the presumption in the 2011 proposed regulations of being investment activities.

The registered initial offering safe harbor is consistent with this principle, but this principle is not limited to this context. The safe harbor should be expanded to include private offerings, such as Reg S and 144A offerings, widely syndicated loans, and other similar offerings where the buyer has no significant ability to negotiate with the issuer. These debt offerings are not different with regard to commercial activities than registered initial offerings in that the buyer, unless it is in a banking, financing or a similar business, is a mere investor. For example, an offering under Rule 144A is no different than a registered offering except that it may only be offered to "Qualified Institutional Buyers" and therefore does not have to be registered. Similarly, a sovereign participating in a term loan, where the loan is negotiated by a bank and a borrower with the intention that the loan be broadly syndicated to institutional investors (commonly known in the market as a "term loan B") is engaging in investment activity (in contrast to the bank, whose

2011 proposed regulations that "there is uncertainty as to the circumstances in which loan origination is commercial activity," and that the proposed regulations are intended to respond to that comment.

activities are clearly commercial in nature). In all of these cases, the buyer is acting as an investor, not directly negotiating with the issuer.

The regulations should expand the secondary acquisitions safe harbors to include secondary market purchases where the investor is not acting in a dealer capacity and does not negotiate the terms of the loan or such other debt instrument with the borrower. Repos, deferred transaction consideration, and loans embedded in swaps should be safe harbored as well. In all these cases, acquisition of a loan (absent facts and circumstances establishing otherwise) is an investment activity.

Loans made to companies in which the investor already owns or contemporaneously makes an equity investment should not be considered CAI. In these cases, acquiring the loan is associated with the equity investment and does not constitute commercial activity. If Treasury is concerned that taxpayers could manipulate such a rule, an anti-abuse or "de minimis" rule would resolve those concerns. The approach in the proposed regulations, in which the debt acquirer's equity ownership percentage in the debt issuer and the value of the equity relative to the debt are facts and circumstances to be taken into account,[9] but in an unspecified manner, creates significant uncertainty. This uncertainty is further compounded by the example[10] in which the acquisition of $50 million of debt where the acquirer held $80 million of equity (out of $100 million total equity) is not CAI because, amongst other reasons, the debt is not "significant" compared to the equity. We do not believe the example is meant to imply that holding 80% of the equity is necessary to avoid CAI in such circumstances. And it is further unclear whether the relative values of the equity and debt investments are intended to imply that different relative values would give rise to a different result. We respectfully request that Treasury revisit its approach in this context.

Participating in negotiations (including serving on a creditors committee) regarding the terms of a significant modification to a distressed debt instrument, where such debt instrument was not distressed when acquired and was acquired in a transaction that was not commercial activity, should not be considered CAI. In such a case, negotiating the advance of (and advancing) new debt funds to a distressed borrower should also be safe harbored from being CAI, if it is reasonably clear that such advance is being made to protect the initial investment.

In the case of distressed debt, activities such as serving on a creditors committee are necessary to protect investments and do not constitute commercial activity. Example 5 in the 2025 proposed regulations holding that serving on a creditor's committee would lead to a loan being considered commercial activity should be modified. More generally, loan modifications (including "significant modifications" within the meaning of § 1.1001-3), with or without participation in negotiations, should not cause holding loans to be considered commercial activity where there is no new capital being lent to the borrower.

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[9] See Prop. Treas. Reg. § 1.892-4(c)(1)(ii)(C).
[10] See Prop. Treas. Reg. § 1.892-4(c)(1)(ii)(D)(3).

Controlled commercial entity – "effective control"

Under the proposed regulations, "effective control" of an entity means an interest in the entity that results in "control of the operational, managerial, board-level, or investor-level decisions of the entity." However, "mere consultation rights" with regards to these decisions by the entity does not constitute effective control. The key distinction regarding effective control should be between management and operations on the one hand, and monitoring and protection of an investment on the other hand.

In that regard, we agree with a number of the comments Treasury has received: in general, veto, consent, or similar "blocking" rights should not constitute effective control.

There is a fundamental difference between veto power over day-to-day management, such as ordinary budgeting decisions, and veto power over extraordinary actions by management that are inconsistent with the investment agreement.[11] As one foreign sovereign explained in its comments, minority investors, including foreign sovereigns, "routinely negotiate veto rights over non-pro rata dividend distributions, the incurrence of material indebtedness that threatens solvency, material mergers and acquisitions transactions, fundamental business changes, and other transformative events."[12] The regulations should not effectively prohibit minority investors from obtaining customary protections for their investments.

It is common market practice for minority investors to negotiate certain consent, consultation, information, board observer, nomination, and other governance rights designed to protect the value of their investment and ensure appropriate oversight of transactions. These rights are fundamentally different from the ability to direct the day-to-day management or operations of a business. For example, minority investors frequently possess rights relating to significant transactions such as mergers, sales of substantially all assets, amendments to governing documents, issuances of senior securities, related-party transactions, changes in the nature of the business, or other extraordinary actions that could materially affect the value of their investment. Such rights are intended to prevent actions adverse to investors and do not provide the holder with the ability to manage the enterprise.

Similarly, the right to appoint a minority number of directors, designate a board observer, receive information regarding the business, or consult with management regarding significant matters should not, by itself or in combination with customary investor protection rights, result in effective control. The relevant distinction should remain whether the investor has the power to direct the operational and managerial decisions of the business as opposed to possessing customary protections designed to monitor and safeguard its investment.

Minority investors have these rights through different mechanisms in a variety of ownership structures and investment vehicles. Accordingly, the final regulations should clarify that

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[11] See Comment Letter by the New York Bar Tax Association, February 13, 2026,
[12] Comment Letter, Mubadala Investment Company PJSC, February 12, 2026.

customary minority investor protections, whether held directly or indirectly, such as through a co-investment, continuation vehicle or other jointly owned investment, do not constitute effective control of an entity.

One common manner in which investor protections are implemented in the marketplace is for some limited partners to serve on a limited partner advisory committee ("LPAC") that protects the interests of the limited partners but does not have power over management and operations. LPACs typically have veto and consent rights in situations where it would be possible for the interests of the limited partners and the sponsor to diverge (for example, transactions between the entity and the sponsor or a related person or other circumstances that create a potential conflict of interest). The final regulations should make clear that serving on a LPAC should not be deemed to give a limited partner effective control of the entity. Because an LPAC's role is limited per the above, having a single or multiple seats on an LPAC, or even "control" of the LPAC, does not give rise to effective control.

<u>Transition Rules</u>

We appreciate that Treasury issued new proposed regulations with regards to the proposed effective date of final regulations in response to comments submitted to the 2025 proposed regulations. The new proposed regulations generally recognize the principle that investments and structures should be evaluated based on the rules as they existed at the time the foreign government made the relevant investments. Treasury and the IRS stated they do not intend for the final regulations "to apply retroactively to existing foreign government holdings of debt and of interests in entities."[13]

Activities with regards to investments made before the effective date, including where there was a binding contract by such date, should continue to be analyzed under the current law commercial activity and "effective control" standards for the life of the investment. Only investments made after the transition period should be evaluated under the new CAI and controlled commercial entity ("CCE") rules, without impacting the prior investments by such entities that would continue to be evaluated under the existing rules.

Although the new proposed regulations generally implement the principle that if a foreign sovereign investor makes an investment pursuant to an arrangement that was entered into prior to the transition date, any such investment is subject to the existing CAI and CCE rules, more clarification is needed in some circumstances. Thus, Treasury should provide that the modification of a loan acquired before the effective date should continue to be treated under the existing rules. And if a foreign sovereign investor agreed with a sponsor to invest an amount of capital in to-be-funded deals, those deals should be analyzed under the existing CAI and CCE rules, regardless of when funded.

[13] Preamble to the 2026 proposed regulations.

The transition rule should take an approach similar to the "qualified partnership interest" rule in the 2025 final regulations. If a controlled entity eligible for section 892 benefits received income from commercial activities through a qualified partnership interest, the entity would not itself be treated as engaged in commercial activities (eliminating any potential for inadvertent CCE-foot fault) even though the income from the commercial activities would not qualify under section 892.[14] Similarly, if a controlled entity eligible for section 892 benefits were to become a CCE by reason of new rules set forth in final regulations, its pre-existing "old and cold" investments that do not give rise to CAI, should continue to be eligible for section 892 benefits. This transition rule could be coupled with a targeted anti-abuse rule that denies the transition rule for actions taken with the primary purpose of circumventing the new rules.

Thank you in advance for your consideration of our comments. We would be happy to meet at any time to discuss these issues further and answer any questions you might have.

Sincerely,

/s/ Shelby Telle
Deputy General Counsel
American Investment Council

[14] See Treas. Reg. § 1.892-5(d)(5)(iii)(A).