



# Hot Topics in Tax: New Regulations Under Section 892

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**GIBSON DUNN**

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# Today's Panelists



**Kathryn Kelly**

Kathryn Kelly is a partner in the New York office of Gibson Dunn and is a member of the firm's Tax Practice Group. Kathryn represents clients in a broad range of tax matters, including public and private mergers and acquisitions, cross-border transactions, restructurings, and financing transactions.



**Daniel Zygielbaum**

Daniel Zygielbaum is a partner in the Washington, D.C. office of Gibson Dunn. He practices in the firm's Tax Practice Group and is also a member of the firm's REIT Practice Group. Dan's practice focuses on tax planning for investment funds and real estate, including fund formations, continuation fund transactions, GP-stakes deals, fund recapitalizations, fund secondary transactions, REITs, real estate joint ventures, and cross-border real estate investments. He also advises clients on the tax aspects of financings, public and private M&A, joint ventures, and capital markets transactions, and has represented clients in tax audits and Congressional investigations.



**Yara Mansour**

Yara Mansour is an associate in the New York office of Gibson Dunn. She is a member of the firm's Tax Practice Group. Yara received her Juris Doctor and her Master of Laws in Comparative Law from Cornell University in 2010, where she served as an editor for the Cornell International Law Journal and graduated magna cum laude. Yara earned Bachelor of Arts degrees in International Relations and English Literature from Wheaton College in 2007.

# Agenda

- 01 Introduction**
- 02 Proposed Regulations under Section 892 on Effective Control and Debt Acquisitions**
- 03 Final Regulations under Section 892 on Commercial Activities**
- 04 Practical Considerations for Sovereign Wealth Funds and their Investment Partners**

# Introduction

# Background

- Section 892 provides U.S. tax exemption for certain income of foreign governments (e.g., from stocks, bonds, securities)
- Exemption does not apply to:
  - Income from commercial activities
  - Income from or through a controlled commercial entity (CCE)
  - Gain from disposition of a CCE
- December 2025 guidance includes:
  - New Proposed Regulations on effective control and debt investments (introducing major changes)
  - Final Regulations on commercial activities (largely finalizing prior proposals)

# Proposed Regulations under Section 892 on Effective Control and Debt Acquisitions

# Proposed Regulations on Effective Control

- Facts and circumstances analysis of control of:
  - operational
  - managerial,
  - board-level, or
  - investor-level decisions.
- Veto rights over key decisions → may create control
- Consultation rights alone → do not create control
- Interests aggregated across related entities of same government

# Proposed Regulations on Effective Control

- Taxpayer comment letters requested more detailed guidance and observed that veto rights are unlikely to give control except in certain circumstances.
- For example, the right to veto an action may not convey control over the action if another investor also has a veto right.
- On February 20, 2026, a senior IRS official indicated that Treasury and the IRS are carefully considering the comments.

# Proposed Regulations on Debt Investments

- More restrictive framework for whether debt investments constitute commercial activity
- Two new safe harbors:
  - Registered offerings
  - Certain secondary market acquisitions
- Outside safe harbors, facts-and-circumstances test
  - Commercial activity possible where:
    - Investor negotiates or structures debt
    - Particularly where no accompanying equity investment

# Proposed Regulations on Debt Investments

- Taxpayer comment letters:
  - Requested more clarity on differentiating between commercial activity and investment activity.
  - Observed that the Proposed Regulations are inconsistent with market practice and will disadvantage sovereign investors versus other lenders.
- On February 20, 2026, a senior IRS official stated the Proposed Regulations regarding debt acquisitions were not attempting to “write new law.”

# Proposed Regulations Effective Date

- Proposed Regulations generally would be applicable to taxable years beginning after the regulations are finalized.
- Could cause pre-existing investments to lose the benefit of section 892—previously negotiated rights that did not convey “effective control” under longstanding previous guidance could give rise to “effective control” under Proposed Regulations.
- Taxpayer comment letters requested grandfathering of pre-existing investments, on the basis that the Proposed Regulations significantly deviate from prior guidance and market practice.
- On February 20, 2026, a senior IRS official stated that any final regulations would not have retroactive effect.

# Final Regulations under Section 892 on Commercial Activities

# Final Regulations on Commercial Activities

- Commercial Activity Defined
  - No special exclusion for fee income from funds.
  - Selling partnership interests and investing in certain derivatives generally not commercial activity.
- USRPHC rule eliminated for non-U.S. corporations. Removes *per se* commercial activity rule for all non-U.S. corporations.
- Qualified partnership interest exception modified.
- Other Highlights:
  - Inadvertent commercial activity exception retained with longer, 180-day cure period.
  - Annual controlled commercial entity test confirmed with clarifications.
- Effective for tax years beginning on or after December 15, 2025, with elective retroactive application.

# Final Regulations on Commercial Activities: QPI Exception

- Qualified Partnership Interest Exception
  - Applies broadly to partnership interests meeting four conditions:
    - Minority ownership and no effective control (new requirement)
    - Limited liability
    - No authority to contract on partnership's behalf
    - No day-to-day management and operational control rights.
  - Safe harbor for non-managing partner interests of not more than 5 percent with limited liability and no authority to contract on partnership's behalf.

# Final Regulations on Commercial Activities: QPI Exception

- Taxpayer comment letters observed that the new minority ownership requirement is a material change from longstanding pre-existing guidance and deviates from market practice.
- On February 20, 2026, a senior IRS official indicated that Treasury is carefully considering these comments (noting the regulation is now final).

# Practical Considerations for Sovereign Wealth Funds and their Investment Partners

# Practical Considerations: Effective Control

- Existing investments:
  - Review ownership percentages and governance rights
  - Consider quantum of 892 benefits versus benefits of control rights
  - Create contingency plan
- New Investments:
  - Consider ownership thresholds and governance rights
  - Consider potential for, and quantum of, 892 benefits
- Aggregation issue: consider rights held by related sovereigns

# Practical Considerations: Debt Investments

- Reconsider practice of relying on small number of loans to avoid commercial activity.
- Consider whether existing debt investments could give rise to commercial activity (e.g., drawdown facilities).
- Increase scrutiny of the size of rescue capital/loans to entities in which the investor owns a small equity stake
- Consider the effects of participation on creditors' committees and in loan workouts.
- Reconsider commercial activity protections in LPAs, JVAs, and side letters – certain lending is often carved out.
- Consider different structuring for credit strategies.

# Practical Considerations: Final Regulations

- Reevaluate existing investments that rely on qualified partner exception. In particular, consider:
  - Ownership percentage
  - Governance and decision-making rights (including any negative covenants/veto rights)
  - Analysis must take into account aggregation with other related sovereigns
- Consider commercial activity protections in governance documents



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