Tax Insights
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Treasury proposes transition relief for Section 892 foreign government investment rules

May 29, 2026

In brief

What happened?

Treasury and the IRS on May 29 issued proposed regulations (2026 proposed regulations) revising the applicability dates of proposed rules under Section 892 governing income of foreign governments from US investments. The guidance would provide transition relief for foreign governments with existing debt holdings or entity interests and for certain holdings acquired during a transition period or under binding commitments entered into before the end of that period.

The guidance also withdraws the applicability-date provisions in Prop. Regs. 1.892-4(d) and 1.892-5(e) that were included in proposed regulations issued in December 2025 (2025 proposed regulations).

Why is it relevant?

The 2025 proposed regulations addressed two Section 892 issues: when an acquisition of debt may constitute commercial activity, and when a foreign government has 'effective control' of an entity. The 2026 proposed regulations do not revise those substantive rules; instead, they propose new applicability dates and transition relief that would preserve existing Section 892 treatment for certain legacy holdings and binding commitments if the 2025 proposed regulations are finalized.

Actions to consider

Taxpayers should assess debt holdings, entity interests, and binding commitments to determine which holdings may qualify for transition relief. Comments on the proposed regulations are due by July 31, 2026.

In detail

Background

Section 892 provides a targeted exemption from US federal income tax for certain investment income earned by a foreign government, which for this purpose includes its integral parts (such as ministries or governing authorities) and controlled entities that are wholly owned and meet specific conditions. Broadly, the exemption covers income from stocks, bonds, and other securities, certain financial instruments held in the execution of governmental financial or monetary policy, and interest on US bank deposits. The exemption does not apply to income derived from commercial activity, income received from or through a controlled commercial entity (CCE), or gain from disposing of an interest in a CCE. A CCE is an entity engaged in commercial activities anywhere in the world where the foreign government owns at least 50% by value or vote or otherwise has effective control. Conceptually, Section 892 is meant to distinguish sovereign investment and policy activity, which can qualify for the exemption, from situations where the foreign government operates or effectively controls a commercial business, which does not.

Treasury and the IRS, in December 2025, issued final regulations, which finalized proposed regulations that had been issued in 2011 and 2022, and additional proposed regulations under Section 892 on the US taxation of income earned by foreign governments and their controlled entities from investments in the United States. The 2025 proposed regulations intended to resolve open questions significant for modern sovereign investment structures—namely, which entities can qualify as ‘controlled entities’ of a foreign government, when acquiring or originating debt should be treated as commercial activity, and how to determine when a foreign government has ‘effective control’ of a commercial entity so that it becomes a controlled commercial entity.

For more discussion on Section 892 and the 2025 proposed regulations, refer to this PwC Tax Insight.

Observation: As originally published, the 2025 proposed regulations would have applied to tax years beginning on or after the publication date of final regulations. Although framed as prospective, that approach could have caused the final rules to affect pre-existing foreign government holdings, including debt instruments, entity interests, and related arrangements entered into before the rules were finalized — and potentially before the 2025 proposed regulations were issued. Commenters, including PwC, recommended a number of substantive changes to the proposed regulations, including transition relief to preserve existing Section 892 treatment for legacy holdings and for acquisitions made pursuant to

binding commitments entered into before the final rules become applicable. The PwC comment letter, for example, explained the concern as follows:

> Without a change in the effective date, [foreign governments] that currently conduct activity that is NOT commercial activity (under current law) will find that they are engaged in commercial activity immediately upon the finalization of the Proposed Debt Acquisition Regulation. The prospect of this possibility may cause SWFs [sovereign wealth funds] to change the way they invest today. It might even cause SWFs to dispose of debt in a way that could impact the broader capital markets. Therefore, it is critical that an announcement grandfathering current activity be made publicly as soon as possible. In the absence of certainty, sovereign investors and the public and private credit industries (including private equity funds, real estate and infrastructure funds, etc.) currently engaging in non-commercial activity may have to adjust their behavior as if the Proposed Debt Acquisition Regulation were finalized as is. Foreign investors investing in such instruments or funds will also need to consider now whether to invest capital in debt by assuming that the Proposed Debt Acquisition Regulation will be finalized as is. Thus, even if the Proposed Debt Acquisition Regulation is eventually significantly modified, its existence may have a significant chilling effect on the credit markets now.

Due to this concern, comments also recommended that IRS and Treasury officials publicly state that they would change the effective date well in advance of finalizing the 2025 proposed regulations. Officials publicly signaled their intent to do so in early 2026. The 2026 proposed regulations do this by withdrawing the effective date of the 2025 proposed regulations and replacing it with a new proposed effective date.

2026 proposed regulations

The 2026 proposed regulations would revise the proposed applicability dates for the rules addressing the taxation of income of foreign governments from US investments. The regulations also withdraw the prior proposed applicability-date provisions in Prop. Regs. 1.892-4(d) and 1.892-5(e) that were included in the 2025 proposed regulations.

New proposed applicability dates

The 2026 proposed regulations provide that existing Section 892 rules would continue to apply to foreign government holdings acquired before the relevant transition date. Existing rules also would continue to apply to holdings acquired on or after that date if the holdings are acquired pursuant to a binding commitment entered into before that date.

Observation: The 2026 proposed regulations address only applicability dates. Treasury and the IRS acknowledged that stakeholders raised substantive issues about the 2025 proposed regulations' debt acquisition and effective control rules and stated that they are evaluating how to reflect those comments,

considering established market practices and the general policy of supporting current and future sovereign wealth fund investment in the United States.

Applicability date for debt acquisition rules

Prop. Reg. 1.892-4(d)(2) provides that the debt acquisition rule in Prop. Reg. 1.892-4(c)(1) would apply to acquisitions of debt on or after the later of (1) the first day of the acquirer's first tax year beginning on or after the date final rules are published, or (2) 90 days after publication of the final rules. The 2026 proposed regulations provide that the debt acquisition rule would not apply to debt acquired pursuant to a binding commitment entered into before the later of those two dates.

For debt acquired before the later of those dates, or pursuant to a qualifying binding commitment, Regs. 1.892-4 and 1.892-4T, as in effect on April 1, 2026, would continue to determine whether the acquisition is commercial activity and whether income received from that debt in future periods is derived from commercial activity.

The preamble to the 2026 proposed regulations also states that it is the acquisition of debt, not the mere holding of debt, that is potentially treated as commercial activity for Section 892 purposes. Therefore, a debt acquirer is not engaged in commercial activity in later tax years solely because it continues to hold debt acquired in an earlier year. The guidance further states that debt acquired in a prior year and held in the current year does not cause other debt acquisitions in the current year to be treated as commercial activity.

Observation: The debt transition rule ties application of the final rules to acquisition timing rather than continued ownership. One open item is how broadly 'binding commitment' will be interpreted. Taxpayers may need documentation showing when commitments became legally binding and what debt was covered.

Applicability date for effective control rules

The 2026 proposed regulations provide a proposed effective control applicability rule with a transition period similar to the debt acquisition rule. The final effective control rules would apply on or after the later of (1) the first day of the foreign government's first tax year beginning on or after publication of final regulations, or (2) 90 days after publication of final regulations.

The 2026 proposed regulations also provide special rules for previously acquired interests. If a foreign government holds previously acquired interests in an entity, the final effective control rule would apply beginning on the date the foreign government first acquires 'new controlling interests' in that entity. For legacy interests, the existing effective control rules would continue to apply unless the foreign government later acquires sufficient new interests to trigger effective control under the final rules.

'New controlling interests' is defined as one or more interests in an entity, other than previously acquired interests, that in the aggregate result in effective control of the entity under Prop. Reg. 1.892-5(c)(2).

‘Previously acquired interests’ is defined as interests acquired before the later of the transition dates or acquired pursuant to a binding commitment entered into before the later of those dates.

Under the 2026 proposed regulations, the final effective control rules would not apply to existing interests unless the foreign government acquires, after the transition period and outside a qualifying binding commitment, new interests that by themselves would provide effective control under the final regulations. Unless and until that occurs, whether the entity is a CCE would be determined under existing rules, taking into account all interests, regardless of when acquired.

Observation: This transition rule is designed to protect legacy entity investments from being reclassified solely because the effective control standard changes. An important compliance question is when later-acquired rights or interests are sufficiently significant to constitute ‘new controlling interests.’ There also could be interpretive issues around amendments, side letters, governance rights, veto rights, consent rights, and expansions of existing rights that are not framed as acquisitions of new equity interests.

Partial withdrawal of 2025 proposed regulations

The 2026 proposed regulations withdraw the original applicability-date provisions and substitute newly proposed applicability-date provisions. They do not withdraw the 2025 proposed regulations relating to debt acquisition or effective control.

See also

- Cross-border Tax Talks: In Jeopardy: Sovereign wealth funds and section 892 (February 12, 2026)
- Tax Insight: Highlights of regulations taxing the income of foreign governments from investments in the United States (December 17, 2025)

Let’s talk

For a deeper discussion of how the proposed regulations affect your business, please contact:

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