

Proposed Treasury Regulations Clarify U.S. Taxation of Investments by Foreign Governments

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On November 2, 2011, Treasury released proposed revisions to the regulations under Section 892 of the Internal Revenue Code of 1986 (the “Code”). Section 892 provides an exemption from U.S. federal income tax on certain types of U.S.-source investment income derived by foreign government entities, including sovereign wealth funds.

The Section 892 exemption does not apply to (i) income that is derived from the conduct of a “commercial activity” or (ii) income that is received by, or from, a “controlled commercial entity,” including any income that would otherwise qualify for the Section 892 exemption. The proposed regulations provide favorable guidance on the types of activities that constitute “commercial activity” and the types of activities and investments that would cause a controlled entity of a foreign government to be treated as a “controlled commercial entity.”

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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