

regulations. Section 1.892-2T defines a foreign government. In particular it describes the extent to which either an integral part of a foreign sovereign or an entity which is not an integral part of a foreign sovereign will be treated as a foreign government for purposes of section 892. Section 1.892-3T describes the types of income that generally qualify for exemption and certain limitations on the exemption. Section 1.892-4T provides rules concerning the characterization of activities as commercial activities. Section 1.892-5T defines a controlled commercial entity. Section 1.892-6T sets forth the extent to which income of international organizations from sources within the United States is excluded from gross income and is exempt from taxation. Section 1.892-7T sets forth the relationship of section 892 to other Internal Revenue Code sections.

(b) *Effective date.* The regulations set forth in §§ 1.892-1T through 1.892-7T apply to income received by a foreign government on or after July 1, 1986. No amount of income shall be required to be deducted and withheld, by reason of the amendment of section 892 by section 1247 of the Tax Reform Act of 1986 (Pub. L. 99-514, 100 Stat. 2085, 2583) from any payment made before October 22, 1986.

[T.D. 8211, 53 FR 24061, June 27, 1988; 53 FR 27595, July 21, 1988]

§ 1.892-2T Foreign government defined (temporary regulations).

(a) *Foreign government—(1) Definition.* The term “foreign government” means only the integral parts or controlled entities of a foreign sovereign.

(2) *Integral part.* An “integral part” of a foreign sovereign is any person, body of persons, organization, agency, bureau, fund, instrumentality, or other body, however designated, that constitutes a governing authority of a foreign country. The net earnings of the governing authority must be credited to its own account or to other accounts of the foreign sovereign, with no portion inuring to the benefit of any private person. An integral part does not include any individual who is a sovereign, official, or administrator acting in a private or personal capacity. Consideration of all the facts and cir-

cumstances will determine whether an individual is acting in a private or personal capacity.

(3) *Controlled entity.* The term “controlled entity” means an entity that is separate in form from a foreign sovereign or otherwise constitute a separate juridical entity if it satisfies the following requirements:

(i) It is wholly owned and controlled by a foreign sovereign directly or indirectly through one or more controlled entities;

(ii) It is organized under the laws of the foreign sovereign by which owned;

(iii) Its net earnings are credited to its own account or to other accounts of the foreign sovereign, with no portion of its income inuring to the benefit of any private person; and

(iv) Its assets vest in the foreign sovereign upon dissolution.

A controlled entity does not include partnerships or any other entity owned and controlled by more than one foreign sovereign. Thus, a foreign financial organization organized and wholly owned and controlled by several foreign sovereigns to foster economic, financial, and technical cooperation between various foreign nations is not a controlled entity for purposes of this section.

(b) *Inurement to the benefit of private persons.* For purposes of this section, income will be presumed not to inure to the benefit of private persons if such persons (within the meaning of section 7701(a)(1)) are the intended beneficiaries of a governmental program which is carried on by the foreign sovereign and the activities of which constitute governmental functions (within the meaning of § 1.892-4T(c)(4)). Income will be considered to inure to the benefit of private persons if such income benefits:

(1) Private persons through the use of a governmental entity as a conduit for personal investment; or

(2) Private persons who divert such income from its intended use by the exertion of influence or control through means explicitly or implicitly approved of by the foreign sovereign.

(c) *Pension trusts—(1) In general.* A controlled entity includes a separately organized pension trust if it meets the following requirements:

(i) The trust is established exclusively for the benefit of (A) employees or former employees of a foreign government or (B) employees or former employees of a foreign government and non-governmental employees or former employees that perform or performed governmental or social services;

(ii) The funds that comprise the trust are managed by trustees who are employees of, or persons appointed by, the foreign government;

(iii) The trust forming a part of the pension plan provides for retirement, disability, or death benefits in consideration for prior services rendered; and

(iv) Income of the trust satisfies the obligations of the foreign government to participants under the plan, rather than inuring to the benefit of a private person.

Income of a pension trust is subject to the rules of §1.892-5T(b)(3) regarding the application of the rules for controlled commercial entities to pension trusts. Income of a superannuation or similar pension fund of an integral part or controlled entity (which is not a separate pension trust as defined in this paragraph (c)(1)) is subject to the rules that generally apply to a foreign sovereign. Such a pension fund may also benefit non-governmental employees or former employees that perform or performed governmental or social services.

(2) *Illustrations.* The following examples illustrate the application of paragraph (c)(1).

Example 1. The Ministry of Welfare (MW), an integral part of foreign sovereign FC, instituted a retirement plan for FC's employees and former employees. Retirement benefits under the plan are based on a percentage of the final year's salary paid to an individual, times the number of years of government service. Pursuant to the plan, contributions are made by MW to a pension trust managed by persons appointed by MW to the extent actuarially necessary to fund accrued pension liabilities. The pension trust in turn invests such contributions partially in United States Treasury obligations. The income of the trust is credited to the trust's account and subsequently used to satisfy the pension plan's obligations to retired employees. Under these circumstances, the income of the trust is not deemed to inure to the benefit of private persons. Accordingly, the trust is considered a controlled entity of FC.

Example 2. The facts are the same as in *Example 1*, except that the retirement plan also benefits employees performing governmental or social services for the following non-government institutions: (i) A university in a local jurisdiction; (ii) a harbor commission; and (iii) a library system. The retirement benefits under the plan are based on the total amounts credited to an individual's account over the term of his or her employment. MW makes annual contributions to each covered employee's account equal to a percentage of annual compensation. In addition, the income derived from investment of the annual contributions is credited annually to individual accounts. The annual contributions do not exceed an amount that is determined to be actuarially necessary to provide the employee with reasonable retirement benefits. Notwithstanding that retirement benefits vary depending upon the investment experience of the trust, no portion of the income of the trust is deemed to inure to the benefit of private persons. Accordingly, the trust is considered a controlled entity of FC.

Example 3. The facts are the same as in *Example 1*, except that employees are allowed to make unlimited contributions to the trust, and such contributions are credited to the employee's account as well as interest accrued on such contributions. Retirement benefits will reflect the amounts credited to the individual accounts in addition to the usual annuity computation based on the final year's salary and years of service. A pension plan established under these rules is in part acting as an investment conduit. As a result, the income of the trust is deemed to inure to the benefit of private persons. Accordingly, the trust is not considered a controlled entity of FC.

Example 4. (a) The facts are the same as in *Example 2*, except that MW establishes a pension fund rather than a separate pension trust. A pension fund is merely assets of an integral part or controlled entity allocated to a separate account and held and invested for purposes of providing retirement benefits. Under these circumstances, the income of the pension fund is not deemed to inure to the benefit of private persons. Accordingly, income earned from the United States Treasury obligations by the pension fund is considered to be received by a foreign government and is exempt from taxation under section 892.

(b) The facts are the same as in *Example 4(a)*, except that MW is a controlled entity of foreign sovereign FC. The result is the same as in *Example 4(a)*. However, should MW engage in commercial activities (whether within or outside the United States), the income from the Treasury obligations earned by the

pension fund will not be exempt from taxation under section 892 since MW will be considered a controlled commercial entity within the meaning of § 1.892-5T(a).

(d) *Political subdivision and transnational entity.* The rules that apply to a foreign sovereign apply to political subdivisions of a foreign country and to transnational entities. A transnational entity is an organization created by more than one foreign sovereign that has broad powers over external and domestic affairs of all participating foreign countries stretching beyond economic subjects to those concerning legal relations and transcending state or political boundaries.

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§ 1.892-3T Income of foreign governments (temporary regulations).

(a) *Types of income exempt—(1) In general.* Subject to the exceptions contained in §§ 1.892-4T and 1.892-5T for income derived from the conduct of a commercial activity or received from or by a controlled commercial entity, the following types of income derived by a foreign government (as defined in § 1.892-2T) are not included in gross income and are exempt:

(i) Income from investments in the United States in stocks, bonds, or other securities;

(ii) Income from investments in the United States in financial instruments held in the execution of governmental financial or monetary policy; and

(iii) Interest on deposits in banks in the United States of moneys belonging to such foreign government.

Income derived from sources other than described in this paragraph (such as income earned from a U.S. real property interest described in section 897(c)(1)(A)(i)) is not exempt from taxation under section 892. Furthermore, any gain derived from the disposition of a U.S. real property interest defined in section 897(c)(1)(A)(i) shall in no event qualify for exemption under section 892.

(2) *Income from investments.* For purposes of paragraph (a) of this section, income from investments in stocks, bonds or other securities includes gain from their disposition and income earned from engaging in section 1058

securities lending transactions. Gain on the disposition of an interest in a partnership or a trust is not exempt from taxation under section 892.

(3) *Securities.* For purposes of paragraph (a) of this section, the term “other securities” includes any note or other evidence of indebtedness. Thus, an annuity contract, a mortgage, a banker’s acceptance or a loan are securities for purposes of this section.

However, the term “other securities” does not include partnership interests (with the exception of publicly traded partnerships within the meaning of section 7704) or trust interests. The term also does not include commodity forward or futures contracts and commodity options unless they constitute securities for purposes of section 864(b)(2)(A).

(4) *Financial instrument.* For purposes of paragraph (a) of this section, the term “financial instrument” includes any forward, futures, options contract, swap agreement or similar instrument in a functional or nonfunctional currency (see section 985(b) for the definition of functional currency) or in precious metals when held by a foreign government or central bank of issue (as defined in § 1.895-1(b)). Nonfunctional currency or gold shall be considered a “financial instrument” also when physically held by a central bank of issue.

(5) *Execution of financial or monetary policy—(i) Rule.* A financial instrument shall be deemed held in the execution of governmental financial or monetary policy if the primary purpose for holding the instrument is to implement or effectuate such policy.

(ii) *Illustration.* The following example illustrates the application of this paragraph (a)(5).

Example. In order to ensure sufficient currency reserves, the monetary authority of foreign country FC issues short-term government obligations. The amount received from the obligations is invested in U.S. financial instruments. Since the primary purpose for obtaining the U.S. financial instruments is to implement FC’s monetary policy, the income received from the financial instruments is exempt from taxation under section 892.