The Real Estate Roundtable

February 12, 2026

The Honorable Scott Bessent
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Re: Proposed Regulations Relating to the Taxation of the Income of Foreign Governments from Investments in the United States (REG-101952-24)

Dear Secretary Bessent:

The Real Estate Roundtable appreciates the opportunity to submit comments to the Treasury Department regarding the recently released proposed regulations concerning the tax exemption for certain U.S. investment income of foreign governments under section 892 of the Internal Revenue Code of 1986, as amended (the "Code").[1]

Foreign capital, including investment by sovereign wealth funds, foreign pension funds, and other governmental entities, is a critical source of financing for capital-intensive real estate projects in the United States. Since 2011, foreign governments have invested over $100 billion in U.S. commercial real estate alone.[2] Passive foreign government investors provide both equity and debt for new housing construction, infrastructure build-outs, retail and office improvements, new medical and life sciences buildings, data centers, and much more. Equity contributed by foreign governments supports investments that are operated, managed, and controlled by U.S. persons. This patient and long-duration foreign capital drives ambitious and transformative investments that create new housing supply, lower housing costs, and spur job growth and economic opportunity in American cities and suburbs. Sovereign investors are helping reposition outdated and obsolete properties in the post-COVID era. U.S. real estate projects financed, in part, with foreign investment generate new sources of local tax revenue for schools and first responders, and they create vibrant spaces for small businesses to thrive and communities to gather.

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1 Notice of Proposed Rulemaking, *Income of Foreign Governments and of International Organizations*, 90 Fed. Reg. 57,938 (Dec. 15, 2025). Unless otherwise indicated, all "section" references herein are to the Code or to the Treasury Department regulations promulgated thereunder.

2 CBRE, U.S. Cross-Border CRE Investment Volumes by Governments & Sovereign Wealth Funds (2026) (based on MSCI Real Assets data).

Section 892 is a cornerstone of our tax rules and principles that encourage and promote inbound investment in U.S. real estate and infrastructure. The provision has existed in the U.S. tax laws, in one form or another, since 1917.[3] While the predecessor of section 892 was enacted just four years after adoption of the federal income tax, the current version was codified in 1986, and Congress has not amended the provision for over 35 years. Over that time, proposed, temporary, and final Treasury regulations have provided helpful guidance to taxpayers. In certain other areas that have lacked specific rules, a body of conservative and well-grounded practices, understandings, and interpretations has emerged to assist foreign governments and U.S. sponsors undertaking long-term investments in the United States. These investments often are measured in decades, not years.

As the Treasury Department moves forward with its rulemaking under section 892, the Roundtable is appreciative of your express commitment to "preserve established market practices and continue to support current and future sovereign wealth fund investment in the United States."[4] The Administration has been steadfast in its support of policies that promote inbound investment as a means to spur domestic economic activity, improve U.S. economic resilience, and create well-paying jobs.[5] Your clarifying statement provided important assurances to investors.

Guidance is needed in the areas addressed by both the proposed and related final regulations.[6] It is clear that Treasury was thorough and thoughtful in drafting these rules, and we agree with Treasury's general approach of pairing commercial safe harbors (applicable in circumstances that do not implicate relevant policy concerns) with principle-based standards (applicable in circumstances beyond the scope of any safe harbor). In particular, the Roundtable commends Treasury on several aspects of the final regulations, including the finalization of the "qualified partnership interest" and "inadvertent commercial activity" exceptions, and the narrowing of the rule deeming a U.S. real property holding corporation to be engaged in commercial activity so that the rule only applies to U.S. corporations. The clarity provided by the final regulations will reduce regulatory burdens and encourage continued investment by sovereign investors in U.S. real estate projects.

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3 *War Revenue Act*, §30, ch. 63, 40 Stat. 300, 337 (1917) (establishing tax exemption for foreign governments). *See also* NYSBA, Report on the Tax Exemption for Foreign Sovereigns under Section 892 of the Internal Revenue Code (June 2008).

4 Treasury Secretary Scott Bessent [@SecScottBessent],"President Trump's policies are driving trillions of dollars in investment into the United States. @USTreasury's recent notice of proposed rulemaking under §892 was issued in response to sovereign investors' requests for greater clarity and certainty. Treasury has received feedback from stakeholders that will inform any final regulations on these technical U.S. tax rules. We will preserve established market practices and continue to support current and future sovereign wealth fund investment in the United States as we drive economic growth for the benefit of all Americans." x.com, Jan. 17, 2026, 9:41 PM.

5 *See, e.g.*, White House, *Fact Sheet: President Donald J. Trump Encourages Foreign Investment While Protecting National Security*, Feb. 21, 2025 ("The NSPM establishes that welcoming foreign investment is crucial for economic growth, job creation, and innovation. . . . The United States will continue to encourage passive investments from all persons.").

6 T.D. 10042 (Dec. 15, 2025).

However, one aspect of the proposed regulations—the rules determining when a minority equity holder has "effective control" of an entity and, in particular, the treatment of customary veto rights[7]—has caused significant uncertainty among both sovereign investors and U.S.-based sponsors[8] that raise capital from such investors, and we fear, based on discussions with a number of prominent sovereign wealth funds that have invested heavily in the United States, that unless these provisions are clarified in the final regulations, they would dramatically reduce foreign sovereign investment in U.S. real estate and infrastructure. We respectfully request that Treasury respond to stakeholder comments to the proposed regulations promptly to avoid the proposed regulations, even in proposed form, from discouraging foreign investment in the United States.

U.S. sponsors frequently rely on minority equity investments from sovereign investors in co-investment or joint venture structures, as well as private fund structures. In these structures, sovereign investors generally are passive investors that have neither the means nor desire to actively manage U.S. real estate investments, encompassing substantially all operational and managerial activities. However, given the significant capital commitments that sovereign investors make in these structures—often in the hundreds of millions or even billions of dollars for a single real estate investment or portfolio —they generally require meaningful investor protections to ensure the appropriate stewardship of their large capital investment. In particular, these investor protections, which often take the form of veto rights, help ensure that any contributed capital will be invested and managed in a manner that is consistent with the basis on which the sovereign investor committed its capital. The protections are, in the typical case, fundamental, customary, and insufficient to grant the sovereign investor "control" over the relevant investment vehicle.

Nevertheless, the Roundtable is concerned that the provisions of the proposed regulations that address such veto rights could be read to suggest that certain common governance structures utilized by U.S. sponsors to raise capital from sovereign investors might be treated as resulting in effective control. This would inappropriately jeopardize the eligibility of sovereign investors to claim the section 892 exemption and would have a significant chilling effect on sovereign investment in the U.S. real estate market. Accordingly, as described in greater detail in Part II of this letter, the Roundtable respectfully requests that Treasury clarify the treatment of certain veto rights, provide a "grandfathering" rule for existing governance structures, and provide additional guidance to withholding agents.

Finally, and separate from the issue of effective control, while a full discussion of the provisions of the proposed regulations that address when an investment in a debt instrument constitutes "commercial activity" is beyond the scope of this letter, we believe that the regulations reach (or imply) an inappropriate result in at least two important scenarios: first, in the case of a significant modification negotiated by a sovereign investor to protect its position in a distressed debt

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[7] As used in this letter, veto rights include consent rights or other similar rights that would require an investor's consent or approval for a particular action to be taken (or where a breach would result if such consent or approval were not obtained).

[8] This letter generally refers to sponsors based in the United States because those are most common in the case of U.S. real estate investments, but the same principles regarding control would apply to a sponsor based outside of the United States.

investment; and second, in the case of certain loans made by a sovereign investor in connection with an equity investment made by that sovereign investor. In both cases, the activities conducted by the sovereign investor are more properly viewed as investment activities rather than commercial activities, and customary market practice is to treat them as such for purposes of section 892. Accordingly, Part III of this letter recommends additional safe harbors relating to such transactions.

I. Background

A. Basic Rules and Congressional Intent

Section 892 encourages inbound investment in the United States by generally exempting from U.S. federal income tax certain types of income of foreign governments, including income received from U.S. investments in domestic securities (e.g., dividends paid by domestic corporations and gain from the sale of an interest in a domestic U.S. real property holding corporation).[9] The section 892 exemption does not apply to income received directly or indirectly from commercial activities, including income received from a controlled commercial entity or derived from the disposition of any interest in a controlled commercial entity.[10]

An entity is a controlled commercial entity if the entity is engaged or treated as engaged in commercial activities and is "controlled" by a foreign government.[11] An entity is controlled by a foreign government if the foreign government holds, directly or indirectly: (i) any interest in the entity that is 50% or more of the total interests in the entity by value or voting power; or (ii) any other interest in the entity that provides the foreign government with "effective control" of the entity.[12]

The definition of the term "controlled commercial entity," including its control requirement, was added to the Code in 1986.[13] The legislative history thereto described the reasons Congress chose to exclude from the section 892 exemption income received from an entity engaged in commercial activities and controlled by a foreign government:

> While an exemption for income from passive investment may be appropriate in some cases, payments to a controlling entity, in Congress's view, are in the nature of a return on a direct investment, not on a portfolio investment. These payments, in Congress's view, are not passive investment income. Congress did not believe that exemption is appropriate in this case . . . Thus, the Act ensures taxation of income derived directly or indirectly by foreign governments from commercial activities.[14]

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9 I.R.C. § 892(a)(1). *See also* Treas. Reg. § 1.892-3T(b), Ex. 1.

10 Treas. Reg. § 1.892-3T(a)(1) (flush language); I.R.C. § 892(a)(2)(A)(ii)-(iii).

11 I.R.C. § 892(a)(2)(B).

12 I.R.C. § 892(a)(2)(B)(i)-(ii). *See also* Treas. Reg. § 1.892-5(a)(1)(iii)(A)-(B).

13 Tax Reform Act of 1986, Pub. L. No. 99–514, title XII, sec. 1247(a), Oct. 22, 1986, 100 Stat. 2583.

14 Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, 1058-59 (May 4, 1987).

That is, in the context of income received by a foreign government from an entity engaged in commercial activities, the stated intent of the concept of control is to address Congress's concern that income received from a controlled entity could, in certain circumstances, substantively constitute something akin to direct investment or active business income rather than passive investment income from an investments in securities. In any event, given that the standard adopted by Congress to make this distinction was one of "control"—an interest that represents, actually or effectively, 50% or greater ownership—the standard could not have been intended to encompass customary rights intended to protect a minority investment.

B. Common Governance Structures

Sovereign investors are among the largest institutional investors in U.S. real estate and infrastructure. In most cases, however, sovereign investors act as a passive source of capital rather than an active manager of the projects they invest in. Thus, in a typical structure, a U.S. sponsor—such as a publicly traded REIT or general partner of a private equity or real estate fund—will form an investment vehicle (such as a co-investment or joint venture vehicle) to hold one or more U.S. real estate investments, which investment vehicle will be a domestic corporation, in many cases a real estate investment trust ("REIT"). The U.S. sponsor will then contribute its own capital, capital that it manages on behalf of its clients, and/or capital that it raises from other investors, including sovereign investors, in exchange for equity interests in the investment vehicle (or an entity that holds direct or indirect equity interests in the investment vehicle, which entities are typically structured as partnerships for tax purposes).[15] In each case relevant to this comment letter, the sovereign investor will own, directly and/or indirectly, less than 50% (by vote and value) of the equity interests in the investment vehicle. [16]

Since the investment vehicle will typically be engaged or treated as engaged in commercial activities, income received from the investment vehicle—dividends paid by the investment vehicle and gain on the sale of its stock—will be exempt from U.S. federal income tax under section 892 only if the sovereign investor does not have effective control of the investment vehicle. Accordingly, determining whether a sovereign investor has effective control of the investment vehicle is critical to evaluating the tax consequences of its investment (particularly in the case of REITs, which are required to annually pay dividends that, but for section 892, would be subject to U.S. withholding tax and whose foreign investors are often subject to taxation under FIRPTA on exit).

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[15] In a typical case, such a partnership's only assets, either directly or through other partnerships, would be interests in one or more investment vehicles treated as corporations for U.S. federal income tax purposes. In that event, the partnership would not be treated as engaged in "commercial activity" and thus would not be a controlled commercial entity even if the sovereign investor controlled the partnership. For this reason, as described below, the relevant question is whether the sovereign controls the corporate investment vehicle, not any particular upper-tier partnership.

[16] If the sovereign investor owned 50% or more of the interests by value or voting power, it would control the investment vehicle per se under section 892(a)(2)(B)(i). *See also* Treas. Reg. § 1.892-5(a)(1)(iii)(A).

In most cases, consistent with the sovereign investor's status as a passive provider of capital making an investment in securities, the activities of the investment vehicle (and in turn the underlying project), including nearly all operational and managerial activities, are generally managed by the U.S. sponsor or one or more of its affiliates, which serve as the property manager, leasing agent, developer, and/or portfolio manager for these investments, often making a significant amount of decisions on a regular basis. These activities are generally extensive and important and include, among others: (i) all dealings with the property's tenants (e.g., responding to tenant requests, collecting rent, enforcing lease obligations, overseeing/approving a tenant's improvements to their space, providing various services to the tenants); (ii) maintaining/repairing the property (e.g., common area maintenance, working with all contractors on routine and non-routine maintenance and repairs related to the building's electrical and mechanical systems, elevators, lobby, facade, roof, sidewalks); (iii) dealings with prospective tenants (i.e., marketing activities, working with third-party brokers identifying prospective tenants, negotiating/documenting all lease terms/agreements); (iv) dealings with vendors and other service providers (e.g., contracting with any third-party service providers, overseeing a property manager if a third party); (v) managing real estate taxes (including appeals); (vi) preparing the annual budget, tracking budget variances, preparing financial statements and tax returns, tracking performance of the investment and otherwise gathering and analyzing data to support strategic decisions; (vii) dealing with all legal matters and litigation related to the property and its tenants (e.g., slip-and-fall cases), and (viii) managing any development activity (e.g., obtaining zoning approvals, overseeing architects and contractors). These activities are critical to the long-term success of the project and the value that will be ultimately realized by the project's investors.[17]

Although generally not responsible for any of these activities, the sovereign investor (and often other minority investors) will typically require, as a condition to making a significant capital commitment, various customary minority protections that often take the form of veto rights over significant decisions that could materially impact the value of their minority investment. For example, the U.S. sponsor may agree not to make certain capital expenditures in excess of agreed thresholds, sell certain material assets, incur additional indebtedness outside of agreed parameters, make certain extraordinary leasing decisions outside of agreed parameters, make certain material tax elections or structural changes that would adversely impact the sovereign investor, or materially change the business plan or budget of the investment vehicle, in each case without the consent of the sovereign investor and any other minority investors that receive similar rights.[18]

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[17] In recognition of the importance of the U.S. sponsor's role in controlling these and other activities, sponsors will very often receive a right to share in a significant portion of the profits or appreciation in the entity.

[18] The exact corporate mechanism for how the sovereign investor receives these rights may differ from transaction to transaction depending on the precise corporate structure. For one common example, assume that (i) the corporate investment vehicle is a limited liability company taxed as a REIT (which, under Section 856(a)(1) is generally required to be managed by a board), (ii) the sole common shareholder of the REIT is a limited partnership, (iii) the U.S. sponsor is the general partner of the partnership, and (iv) the sovereign investor and other investors are limited partners in the partnership. The partnership's operating agreement, or a side letter between the U.S. sponsor and the sovereign investor, may specify that the partnership will appoint a majority of the REIT's board at the direction of the U.S. sponsor and one member at the sovereign investor's direction, with the REIT's operating agreement specifying that certain decisions require unanimous consent of the board (thus giving the REIT's board appointee a veto). Alternatively, the U.S. sponsor may appoint the entirety of the REIT's board, with the U.S. sponsor

Thus, veto rights granted to the sovereign investor in these circumstances are typically in the nature of investor protections that represent safeguards put in place for the benefit of a minority investor, preventing the U.S. sponsor from taking actions outside the ordinary course of business that would risk a material reduction in the value of the minority investment.[19]

Importantly, these veto rights are not affirmative rights but "negative" rights—in other words, they do not permit the sovereign investor to cause the investment vehicle to take any particular action but merely permit the sovereign investor to prevent (or make a claim for breach upon the occurrence of) certain specified actions outside of the day-to-day conduct of the investment vehicle's business. Rather, the U.S. sponsor itself generally retains the responsibility for any affirmative actions that are not subject to the sovereign's veto rights and, even for those actions that are subject to such veto rights, the U.S. sponsor is responsible for recommending those actions and implementing them if they are approved—for example, the U.S. sponsor would typically manage the process of buying or selling investments, including by overseeing the marketing of investments to be sold, negotiating sales contracts, overseeing due diligence, and ensuring closing conditions are satisfied. As a result, the U.S. sponsor itself, by definition, will effectively have the same veto rights as the sovereign, in addition to the affirmative rights associated with running the business on a daily basis and taking any extraordinary actions that are not specifically subject to veto or otherwise reserved for the other investors. Simply put, the U.S. sponsor has a role in, and often sole authority over, nearly all decisions, whereas the sovereign investor merely has a right to object to a limited subset of decisions. Moreover, because the rights relate to significant matters outside of the day-to-day conduct of the entity's business, they do not confer on the sovereign investor the ability to hold the U.S. sponsor hostage by preventing it from conducting the ordinary operations of the entity. Consequently, these rights do not provide the sovereign investor with the power to control the investment vehicle and, thus, should not be considered to transform passive investment income into something akin to direct investment or active business income.

C. Proposed Effective Control Rules

Under the proposed regulations, effective control is achieved by any interest in an entity that, directly or indirectly, either separately or in combination with other interests, results in control of the "operational, managerial, board-level, or investor-level decisions" of the entity, and the determination of effective control is made considering all of the facts and circumstances related to the interests in an entity, which may include voting rights in the entity, including the power to

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contractually agreeing in the partnership's operating agreement or side letter not to cause certain actions to occur without the sovereign investor's consent (where a breach would result if such consent or approval were not obtained). For purposes of the "effective control" analysis, the substance of the rights, not the form in which they are provided, should be the relevant question.

[19] We note further that, in contrast to an example in the proposed regulations' preamble, the sovereign investor will not typically have a unilateral right to remove the U.S. sponsor from its role of controlling the board or otherwise overseeing the operational and managerial activities of the entity. Removal would typically only be permitted for specified bad acts, such as fraud, willful misconduct, criminal actions, or material uncured breaches of the governing documents. Such a removal right is, like the veto rights described above, a reasonable and customary minority investor protection.

appoint directors or managers, and to veto decisions.[20] In addition, pursuant to a "special rule," a foreign government is per se deemed to have effective control if it is, or controls an entity that is, a managing partner or member of the entity (or any equivalent role under local law).[21]

Example 5 of the proposed effective-control regulations ("Effective Control Example 5") addresses the effect of veto rights on the effective control analysis.[22] In that example, the relevant investment vehicle is a corporation managed by a board of directors, and the foreign government is entitled to appoint one of three directors to that board. The corporation has a single class of equity, no equity holder holds an interest in the corporation that is 50% or more of the total interests in the corporation by value or voting power, and it is generally required that more than 50% of the equity holders of the corporation approve the election of its directors, the selection of its officers, and certain major corporate decisions.[23] However, the director appointed by the foreign government "*alone*" has rights to unilaterally veto dividend distributions, material capital expenditures, sales of new equity interests, and the operating budget.[24] Effective Control Example 5 concludes that these veto rights give the foreign government control over decisions as to "the operation of" the corporation and, thus, result in effective control.[25]

Example 4 of the proposed effective-control regulations ("Effective Control Example 4") contains a similar example, except the appointed director "alone" has the power to unilaterally appoint or dismiss the manager (instead of the veto rights described in Effective Control Example 5).[26] The preamble, in describing Effective Control Example 4, emphasizes that the foreign government's "*sole power*" to unilaterally appoint or dismiss the manager results in effective control. The preamble later requests comments "as to the circumstances, if any, in which the holder of a minority equity interest in an entity should not be treated as having effective control (or as having at least 50 percent of voting power) of the entity if managerial or board-level decisions of the entity are subject to veto or 'blocking' rights of the holder *and other holders* (for example, through consent rights, supermajority requirements, or otherwise)" (emphasis added).

Although Effective Control Example 5 indicates that a minority equity interest, together with certain veto rights, can result in effective control in certain circumstances, in view of the facts of Effective Control Example 5, as well as the facts of the similar example described in the preamble, we believe that Effective Control Example 5 is best understood as limited to situations in which no parties unrelated to a sovereign investor—such as a U.S. sponsor in the typical governance structure described above—have rights that are equal to or greater than the sovereign investor's rights. As described above, in more common governance structures typical of U.S. real estate investments, the

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20 Prop. Treas. Reg. § 1.892-5(c)(2)(i).

21 Prop. Treas. Reg. § 1.892-5(c)(2)(ii).

22 Prop. Treas. Reg. § 1.892-5(c)(2)(iii)(F).

23 Prop. Treas. Reg. § 1.892-5(c)(2)(iii)(A)(*3*)-(*5*).

24 Prop. Treas. Reg. § 1.892-5(c)(2)(iii)(F)(*1*).

25 Prop. Treas. Reg. § 1.892-5(c)(2)(iii)(F)(*2*).

26 *See* Prop. Treas. Reg. § 1.892-5(c)(2)(iii)(E).

veto rights granted to sovereign investors are either held by the U.S. sponsor itself (and, potentially, one or more other investors) or are in the nature of minority investor protections where a U.S. sponsor would unilaterally be making other decisions that are not subject to the investor veto right (and therefore the U.S. sponsor has more control than any minority investor), or both. However, because Effective Control Example 5's conclusion is not expressly so limited, it creates significant uncertainty regarding the treatment of most customary governance structures, such as those described above.

In a conceptually similar example, Example 8 of the proposed effective-control regulations ("Effective Control Example 8"), a foreign government is a creditor of a U.S. corporation and, under the credit agreement, the corporate borrower is subject to various restrictions on the type of investments it can make, asset dispositions, levels of future borrowing, and dividend distributions.[27] The credit agreement also provides the foreign government with veto rights over dividend and stock repurchases, additional borrowing, capital expenditures, the borrower's annual operating budget, and redemption of subordinated debt. The example concludes that the foreign government's rights as a creditor are sufficient to give it effective control over the borrower.[28]

As with Effective Control Example 5, the rights and restrictions in Effective Control Example 8 are very common for a commercial loan agreement, and, thus, the example similarly creates significant uncertainty as to whether many market-standard lending arrangements create effective control. In such an arrangement, any controlling equity holders, although restricted by the terms of the loan agreement, will necessarily have greater rights over the borrower's conduct than the lender does. For the same reasons discussed above in the context of Effective Control Example 5, these types of rights alone should not cause a sovereign investor to be deemed to have control, especially since a borrower always has the option to eliminate these rights by refinancing or otherwise repaying the loan. Instead, loan covenants should be deemed to give rise to effective control, if at all, only when the sovereign investor also has meaningful rights as an equity holder and the combination of the rights as lender and equity holder effectively permit the sovereign investor to manage the operations of the borrower.[29]

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[27] Prop. Treas. Reg. § 1.892-5(c)(2)(iii)(I)(1).

[28] Prop. Treas. Reg. § 1.892-5(c)(2)(iii)(I)(2).

[29] We note further that a rule that deems a sovereign investor to have control as a result of veto rights on matters outside of the day-to-day conduct of the business would be inconsistent with the framework adopted in the final regulations for the "qualified partnership interest" ("QPI") exception. Under those regulations, in order to qualify for the QPI exception, a sovereign investor, among other requirements, *both* (i) must not have effective control of the applicable partnership *and* (ii) must not have rights to participate in the management and conduct of the partnership's business. In other words, lack of control is a necessary but not sufficient condition for satisfying the QPI exception, meaning that the set of rights that give rise to effective control must necessarily be more extensive than the rights that cause a partnership interest not to be a QPI. Yet the QPI regulations also correctly specify that rights to participate in monitoring or protecting the partnership interest holder's capital investment in the partnership generally do not constitute rights to participate in the management and conduct of the partnership's business, to the extent such rights are not rights to participate in the day-to-day management or operation of the partnership's business. Customary veto rights that sovereign investors receive are exactly the type of non-operational, non-day-to-day rights that should qualify for the QPI exception, but it would be impossible for an investor with such rights to qualify if they were alone sufficient to result in effective control. Treasury should not

D. Proposed Regulations on Debt Investments

Although a detailed discussion of the definition of "commercial activity" is beyond the scope of this letter, the final regulations correctly provide that activities that are not commercial include, subject to certain exceptions, investments in loans, stocks, bonds, other securities, or financial instruments.[30] But as the proposed regulations recognize, there can be uncertainty as to whether an acquisition of debt qualifies as investment or should instead be considered a commercial activity (e.g., in the case of origination of loans by a financing business).

To that end, the proposed regulations set forth a non-exclusive list of factors, as well as two safe harbors, for determining whether an acquisition of debt is an investment. The list of factors is generally consistent with customary "loan origination guidelines" and, we believe, generally an appropriate framework. A few of the examples, however, apply those principles in a way that in one case reaches, and in another case implies, that commercial activity can result from what is more appropriately viewed as investment activity.

First, in Example 5 of the proposed acquisition-of-debt regulations ("Debt Example 5"), a foreign government acquires a debt instrument as an investment at a time when the debt instrument was not distressed and, three years later when the debt instrument unexpectedly became distressed, participates in the negotiation of a significant modification of the debt instrument.[31] The example concludes that, because of the foreign government's participation in the negotiations during the later debt workout, the significant modification is commercial activity.[32] We believe this is an inappropriate result given that a sovereign investor is, in this circumstance, merely protecting an existing investment and did not acquire the investment expecting to do so.

Second, in Example 2 of the proposed acquisition-of-debt regulations ("Debt Example 2"), a foreign government that owns 80% of the equity of a corporation (worth $100 million) makes a $50 million loan to that same corporation.[33] The example concludes that the loan does not give rise to commercial activity because the foreign government owned a substantial portion of the equity of the borrower and the amount of the loan was not "significant" relative to the size of the equity investment.[34] The example, however, leaves open the result in many common scenarios, such as where either (i) a sovereign investor's stake in the borrower's equity is much less than 80%, or (ii) the amount of the loan was larger relative to the value of the equity. The sovereign investor in many

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apply a standard under the effective control rules that would effectively render meaningless the lack-of-control requirement in the QPI exception.

30 Treas. Reg. § 1.892-4(c)(1)(i), (2). Investments (including loans) made by a banking, financing, or similar business constitute commercial activities, even if investments do not give rise to income effectively connected to the active conduct of a banking, financing, or similar business in the U.S. by reason of the application of Treasury Regulation section 1.864-4(c)(5). Treas. Reg. § 1.892-4(c)(1)(iii); Treas. Reg. § 1.892-4T(c)(1)(iii).

31 Prop. Treas. Reg. § 1.892-4(c)(ii)(D)(*6*)(*i*).

32 Prop. Treas. Reg. § 1.892-4(c)(ii)(D)(*6*)(*ii*).

33 Prop. Treas. Reg. § 1.892-4(c)(ii)(D)(*3*)(*i*).

34 Prop. Treas. Reg. § 1.892-4(c)(ii)(D)(*3*)(*ii*).

of these situations is still acting as an investor and is making the loan primarily as a means to protect or facilitate the equity investment, without engaging in the extensive loan negotiation and structuring activities that a participant in a true lending business would.

In addition, the preamble to the proposed regulations requests, but the proposed regulations do not address, the treatment of "delayed-draw" loans, whereby the entirety of the loan is not made at one time but rather is made over time as the borrower makes draw requests. In situations where a sovereign investor purchases, in the secondary market, a delayed-draw loan that is not yet fully funded and thereby becomes committed to fund future draws (subject to objective conditions outside of the sovereign investor's control), the sovereign investor likewise does not engage in the loan negotiating and structuring activities that are hallmarks of a lending businesses. Instead, it merely provides, and earns a return based on, the capital that it is legally committed to fund.

II. Recommendations Regarding Effective Control

A. Clarify Treatment of Veto Rights

In order to clarify the treatment of veto rights, including the uncertainty created by Effective Control Examples 5 and 8, and avoid the chilling effect that is likely to result if sovereign investors fear that customary governance structures will not qualify for the section 892 exemption, the Roundtable respectfully requests that the final regulations clarify that veto rights such as those present in such structures will not give rise to effective control.

In particular, Treasury—consistent with its stated philosophy of pairing safe harbors with principle-based standards—should provide a "minority investor protections" safe harbor under which certain veto rights and similar protections granted to a minority interest holder are treated as investor protections that do not result in effective control, as described in more detail below. This safe harbor would thus clarify that a minority interest holder does not have effective control of an entity by reason of one or more veto rights that are in the nature of minority investor protections.

Under the Roundtable's recommendation, the safe harbor would apply to one or more veto rights of a minority interest holder if **both** of the following requirements are satisfied:

(1) another interest holder unrelated to the sovereign investor either: (i) holds an equity interest in the entity that is more than 50% of the total interests in the entity by voting power (including by the power to appoint, or exercise the vote of, more than 50% of any governing board); (ii) is the sole managing partner or managing member of the entity (or equivalent role under local law); or (iii) is otherwise generally entitled to direct the day-to-day conduct of the entity (such an interest holder, a "Managing Interest Holder");[35] and

[35] For purposes of the safe harbor, references to the rights of any Managing Interest Holder or other investor should include rights of its representatives, agents and affiliates. For example, if an agent or affiliate of an investor is the managing member of, or appoints a majority of the board of, an entity, that investor should qualify as a Managing Interest Holder even though it is not itself the managing member. This could be the case, for example, where a private equity fund is the actual investor and the fund's general partner is the managing member or board-

(2) the veto rights granted to the sovereign investor either: (i) are not exclusive (i.e., one or more other investors unrelated to the sovereign investor, including the Managing Interest Holder, have, explicitly or effectively, substantially the same veto rights); or (ii) are with respect to specified actions outside of the day-to-day conduct of the entity.[36]

To illustrate the safe harbor, assume that a U.S. sponsor holds a minority economic interest in a corporation but a majority interest by voting power as a result of its ability to appoint a majority of the corporation's board. Further assume that a sovereign investor has a significant economic interest representing a minority by value and voting power,[37] and that all decisions are made by majority vote (and, therefore, controlled by the U.S. sponsor) other than certain "major decisions," which require unanimous consent, i.e., the consent of the U.S. sponsor, as well as the sovereign investor. In this circumstance, the sovereign investor's veto rights should qualify for the safe harbor and thus not be treated as creating effective control in view of the fact that (i) the U.S. sponsor controls the corporation's board and all matters that are not major decisions, thus making the U.S. sponsor a Managing Interest Holder, and (ii) the U.S. sponsor has the same rights to veto major decisions (i.e., the major decisions cannot occur without the U.S. sponsor's vote and thus are not exclusive to the

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controlling party, or where a public REIT is the actual investor and the REIT's wholly owned subsidiary is the managing member or board-controlling party. Similarly, if an investor's affiliate is designated as asset manager or property manager of an investment vehicle (or is responsible for overseeing a third-party asset manager or property manager) and, in that capacity, has generally been delegated authority over the day-to-day conduct of the investment vehicle's business, that investor should likewise qualify as a Managing Interest Holder.

[36] A veto right should be considered outside of the day-to-day conduct of the entity if, based on all the facts and circumstances, it does not interfere with the ability of the entity to conduct its ordinary business. Relevant factors for this purpose include, but are not limited to, (i) the nature of the entity's business, (ii) the expected frequency of the actions subject to veto, and (iii) the nature of materiality or other qualifiers or exceptions to the veto. Examples of rights outside the day-to-day conduct would generally include rights to approve sales of material assets, bankruptcy, liquidation, admission of a new investor, material deviation of an initial business plan, material amendments of investor agreements, terminating a property manager, entry into transactions with affiliates of the Managing Interest Holder (i.e., transactions that raise the possibility of conflicts of interest), waiving rights or taking certain other actions outside the ordinary course of business with respect to certain material leases, incurring financing outside of agreed parameters, in-kind or non-pro rata dividend distributions, and material capital expenditures. In particular, of the four rights specified in Effective Control Example 5, the operating budget is the most likely to impact day-to-day operations, but even that should be viewed as occurring outside the day-to-day if, as is typical, (i) the corporation is permitted, without investor approval, to deviate from its budget within commercially reasonable parameters, and (ii) there is a mechanism preventing the corporation from being "locked up" in the event of a deadlock on budget (e.g., the last approved budget remains in effect with an inflation adjustment).

In this regard, we would further recommend that Treasury modify the proposed regulations' general standard for determining effective control (i.e., that effective control results from control of any of the "operational, managerial, board-level, or investor-level decisions"). This standard is problematic in two respects: (1) it is very unclear in which of those categories any particular right falls into, and thus the standard would be extremely hard to interpret and administer, and (2) controlling only one of those categories (especially investor-level) should not outweigh a sovereign investor's lack of control over the others. Thus, we would recommend that the general standard for effective control focus on control of day-to-day decision-making, which would generally encompass operational and managerial matters.

[37] The remaining interests in the corporation could be owned by a single other investor or two or more other investors.

sovereign investor).[38] In this case, whatever rights one could say the sovereign investor has as a result of its veto power, the U.S. sponsor's rights are by definition meaningfully greater. Under these circumstances, the sovereign investor should not be viewed as effectively controlling the corporation.

If a veto right does not qualify for the safe harbor, then it would be evaluated, together with all other rights, under the facts-and-circumstances test. For purposes of that test, the final regulations should clarify that the following would be among the factors taken into account in determining whether veto rights are in the nature of minority investor protections that tend not to establish effective control:

(1) whether the entity has a Managing Interest Holder;

(2) whether (and how many) other interest holders unrelated to the sovereign investor (including any Managing Interest Holder) have substantially similar rights as the sovereign investor's veto rights;

(3) whether the veto can be overridden by a combination of other investors voting together, and, if so, the number of other investors that must agree to override the veto and any practical impediments to their doing so;

(4) whether the decisions could substantially impact the value of the sovereign investor's investment or substantially change the nature of the business of the entity; and

(5) the extent to which the veto rights relate to the day-to-day conduct of the entity.

As an example of an arrangement that would not give rise to effective control under the facts-and-circumstances test, consider a variation of Effective Control Example 5 where one or both of the other board members had veto rights over the same matters as the sovereign investor, and all other facts are the same as Effective Control Example 5. Although the lack of a Managing Interest Holder would cause the arrangement not to qualify for the safe harbor as articulated above, the sovereign investor nevertheless does not control the corporation under the facts and circumstances. In particular, (i) the sovereign investor's vote can be overridden on any matter that is not subject to veto merely by the two other board members agreeing to vote in concert,[39] (ii) the sovereign

[38] The safe harbor would also independently apply to any veto rights that were outside the day-to-day conduct of the corporation, even if, for example, the sovereign investor was the only investor with those veto rights. In that case, the fact that the veto rights could not impair the U.S. sponsor's conduct of the day-to-day operation of the corporation indicates that the sovereign investor should not be viewed as controlling merely because of those veto rights.

[39] This situation would be distinguishable from, for example, a case in which the corporation were publicly traded, the sovereign investor had a meaningful minority position (e.g., 30%), and the remaining ownership (e.g., 70%) was widely dispersed among small public shareholders who, as a practical matter, cannot act with one voice. In that event, although the sovereign may only have 30% direct voting power, it may very well effectively control the corporation given that many public shareholders do not even show up to vote, not to mention the virtual impossibility that they could coordinate their votes to act in concert in a manner that nullified the sovereign investor's voting power. But such concerns are not implicated in most privately held investments owned by a relatively small number of investors, such as typical joint ventures and funds.

investor cannot affirmatively cause any action without convincing at least one of such other board members to vote with it, and (iii) one or both of the other board members have the same veto rights as the sovereign investor, thus substantially neutering the impact of the sovereign investor's veto rights. In these circumstances, the sovereign investor's veto rights cannot be said to give it sufficient influence to constitute control, and if a version of Effective Control Example 5 is retained in the final regulations, we believe that Treasury should clarify that facts such as the foregoing would be distinguishable and lead to a different result.[40]

In conjunction with the clarifications described above, we would recommend removing from the final regulations Effective Control Example 8 on the basis that veto and similar rights contained in a loan agreement would be subject to the same framework set forth above. As noted above, in most cases, customary loan covenants should not give rise to effective control because they do not permit the lender to manage the day-to-day conduct (including operational or managerial matters) of the borrower and, even then, can be eliminated by the borrower's repayment of the loan.

Finally, Treasury should modify the "special rule" that treats a foreign government as having per se control of an entity if it (or an entity it controls) has a managing member or similar role with respect to the entity. Instead, Treasury should clarify that status as a managing member is one of the facts and circumstances that must be considered. Although a managing member will in many cases exercise actual control over an entity, this may not be true in all situations, and thus a per se rule could be a trap for the unwary. For example, assume that for non-tax regulatory reasons, a U.S. sponsor and an entity controlled by a sovereign investor are designated as co-managing members of an entity, but the documents provide that only the U.S. sponsor can actually exercise that authority (e.g., the U.S. sponsor can overrule the sovereign investor on most or all matters). In this case, in substance the sovereign investor has no control and the co-managing member designation is illusory, yet the per se rule would inappropriately deem the sovereign investor to have effective control.

B. Grandfathering of Existing Governance Structures

Regardless of what substantive rules are contained in the final regulations, we are concerned that applying the final regulations to existing governance arrangements will lead to inequitable results. In particular, if a sovereign investor has relied in good faith on market-standard advice, it should not be required to lose its exemption on an effectively retroactive basis as a result of Treasury's determination of where to draw the line on effective control. In addition, applying the final regulations to existing arrangements will create an undue administrative burden by requiring sovereign investors to determine the application of the final regulations to all existing governance structures in place at the time the regulations are finalized, which, for any given foreign government, may include dozens or hundreds of existing investments. Accordingly, the Roundtable respectfully requests that Treasury modify the effective date of the proposed regulations to permit

[40] Similarly, we believe the same result (i.e., that there is no effective control) should apply even if the other two board members do not have the same veto rights, as long as the sovereign investors' veto rights are outside of the day-to-day conduct of the corporation, thus generally not impacting operational or managerial matters. Again, in that case, the sovereign could still be overridden on all matters relating to day-to-day conduct by the other two board members and would not, through its veto rights, be able to impede such conduct.

sovereign investors to elect to "grandfather" investments with existing governance structures established prior to finalization, whether or not such investments have been fully funded at the time of finalization. To prevent abuse of such a grandfathering rule, we would support an exception where either (i) any existing governance structure is amended after finalization to materially increase the rights of the sovereign investor or (ii) the primary business of the entity is altered with a principal purpose of grandfathering separate investments that would otherwise be made through a new structure that is subject to the finalized regulations.

Although we recognize that such a grandfathering rule would not prevent the IRS from arguing that a sovereign investor has effective control based on the facts and circumstances as applied under existing law, we think that such a rule would nevertheless minimize market disruption by providing an opportunity for sovereign investors to determine that they are comfortable with existing arrangements based on longstanding market practice and previous legal advice.

C. Additional Guidance to Withholding Agents

As noted above, the determination of whether a sovereign investor effectively controls an entity is inherently factual and, thus, will by definition be less than perfectly certain in most cases. Although some degree of uncertainty is inevitable and must necessarily be borne by the sovereign investor itself, we fear that, if U.S. sponsors and other third-party withholding agents (such as a REIT that may be subject to withholding under section 1441, a partnership that may be subject to withholding under section 1446, or a purchaser of REIT stock that may be subject to withholding under section 1445) are required to independently analyze and reach a conclusion on this determination, it will significantly disrupt market transactions even if each of the recommendations made above are adopted in final regulations. Accordingly, the Roundtable respectfully requests that Treasury clarify that a withholding agent is permitted to rely on an IRS Form W-8EXP provided by a sovereign investor or, in the case of the disposition of an interest in a domestic U.S. real property holding corporation, a non-recognition certificate under Treasury Regulation section 1.1445-2(d)(2), without the need to independently determine whether the sovereign investor has effective control. Indeed, it may be impossible for the withholding agent to even have all of the information necessary to fully analyze the effective control question, given that it would be impacted by, among other things, interests and governance that the sovereign investor has with respect to other investors or other third parties unrelated to the withholding agent. And even if the withholding agent had all the information, in light of the inherently factual nature of the effective-control determination, requiring withholding agents to make independent determinations would be exceedingly burdensome and likely to lead to significant disputes between sovereign investors and counterparties, including U.S. sponsors. Additionally, permitting withholding agents to rely on IRS Form W-8EXPs should not raise policy concerns, as sovereign investors are generally represented by reputable counsel and thus are unlikely to deliver fraudulent forms, and the IRS would have no difficulty in locating the sovereign investor in the event it wished to challenge the sovereign investor's position.

III. Recommendations Regarding Debt Investments

A. *Significant Modifications of Distressed Debt*

Although we agree that it may be appropriate, in certain circumstances, to treat a significant modification of a debt instrument as commercial activity, many common modifications occur under circumstances consistent with investment activity, even when the sovereign investor participates in negotiating the modification. In particular, sovereign investors should be permitted to protect distressed investments through modifications as long as the sovereign investor did not acquire the investment with the expectation of modifying it. In such a case, the sovereign investor is acting consistently with its status as an investor and not akin to an operator of a loan origination business, nor should it be forced to stand by idly while a distressed investment deteriorates in a situation where a modification may protect that investment.

Accordingly, the Roundtable respectfully requests that the final regulations delete Debt Example 5 and instead include a safe harbor or example clarifying that a significant modification of a debt instrument will not give rise to commercial activity, even if the sovereign investor materially participates in negotiating or structuring the modification, as long as:

(1) at the time of the sovereign investor's original acquisition of the debt instrument, the debt was not in default, and the sovereign investor did not believe that the debt would go into default or otherwise would be significantly modified,

(2) at the time of the modification, the debt either was in default or there was a significant risk that the loan would go into default if the modification were not effected, and

(3) the sovereign investor believed (i) the modified debt instrument presented a substantially reduced risk of default, as compared with the pre-modified loan, (ii) the modification would meaningfully increase the sovereign investor's recovery on the debt instrument, or (iii) the modification was preferable to incurring the cost, expense, and burden of foreclosing on and managing any underlying collateral, or pursuing rights in a bankruptcy or other court proceeding.

These circumstances indicate that the sovereign investor acquired the debt instrument as an investment and activities the sovereign investor participated in as part of the modification were done in the context of protecting its investment.

B. *Debt Acquired in Connection with Equity Investment*

Although the proposed regulations are correct in concluding that the making of a loan in connection with an equity investment indicates that the activity is investment rather than commercial, the standards implied by Debt Example 2 suggest that many common loan structures could be inappropriately characterized as commercial activity. For example, if a corporation has 10 shareholders (including a sovereign investor), each of which owns only 10%, but they agree to capitalize the corporation in part with loans made pro rata by each of them, such a loan is made in connection with that equity investment and should not be viewed as commercial activity,

notwithstanding that the equity owned by the sovereign investor is significantly less than the 80% in Debt Example 2. Similarly, if a sovereign investor had a subsidiary corporation and chose to capitalize it with more than $50 million of shareholder debt when there is $100 million of equity (including shareholder debt in excess of $100 million), the loan likewise should not be viewed as commercial activity. Finally, in many joint ventures, if one equity holder fails to fund in response to a capital call from the joint venture, the joint venture's organizational documents contain a right by the funding members to loan the non-funding members the proceeds needed for them to fund their share of the capital call on such terms as are set forth in those organizational documents. In such a case, the loan is made in connection with, and to protect, an existing equity investment without a separate negotiation of material loan terms.

Accordingly, in order to clarify the treatment of the foregoing and many other common examples, the Roundtable respectfully requests that the final regulations include a safe harbor to the effect that a loan will be treated as investment activity rather than commercial activity if:

(1) the borrower of the loan is either (i) an entity in which the sovereign investor (or its affiliate) owns an equity interest, either directly or through one or more intermediate entities,[41] or (ii) another equity holder in such an entity where the loan is funding an equity contribution to the entity, and

(2) the entity making the loan would not make the loan but for the equity interest described in clause (1)(i) above.

C. Delayed-Draw Loans

It is very common for commercial mortgage loans and other corporate loans to have a delayed-draw feature, where the lender commits up front to make a certain amount of loans as and when drawn by the borrower, subject to the borrower's satisfaction of certain conditions. For example, many construction loans are structured in this way, where draws are made as construction costs need to be paid.

In the event that a sovereign investor purchases such a loan after it is committed but before all draws have been made, the sovereign investor's funding of post-purchase draws should not constitute commercial activity as long as the conditions for the draws are reasonably objective and outside of the sovereign investor's control (i.e., the sovereign investor does not have discretion to refuse to make any future loans based on subjective criteria). In such a case, the sovereign investor is not participating in negotiating or structuring the terms of the loans or even making an investment decision whether or not to fund; it is merely complying with its obligation to fund based on terms previously negotiated by a third party and is thus earning a return based on the provision of its capital, not on its efforts.

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[41] For example, this would cover a situation in which the sovereign investor owned an interest in an upper-tier partnership or corporation that, in turn, owned an interest in the borrower (including through other intermediate entities).

Accordingly, in order to clarify the treatment of many customary delayed-draw loans, the Roundtable respectfully requests that the final regulations include a safe harbor or example to the effect that a delayed-draw loan will be treated as investment activity rather than commercial activity if:

(1) at the time the sovereign investor acquired an interest in the loan and the corresponding commitment, the selling lender was subject to a binding commitment to make loans in respect of future draws, subject to the conditions described in clause (2); and

(2) the conditions for the draws are reasonably objective and outside of the sovereign investor's control (i.e., the sovereign investor does not have discretion to refuse to make any future loans based on subjective criteria).

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We very much appreciate the Administration's strong advocacy and support for policies that encourage greater foreign investment in the United States as means to spur domestic economic activity, improve U.S. economic resilience, and create well-paying jobs. Thank you in advance for your consideration of the issues addressed above and our comments. Please do not hesitate to have your staff contact me with questions or requests for additional information.

Sincerely,

Jeffrey D. DeBoer
President and Chief Executive Officer

CC:

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