INTERNAL REVENUE
BULLETIN

IRS

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2025–46
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These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Notice 2025-63, page 709.

This explains that proposed regulations will be issued to provide a rule for determining the source of certain borrow fees paid with respect to securities lending transactions and sale-repurchase transactions. These fees would be sourced based on the residence of the recipient.

REG-109742-25, page 712.

These proposed regulations would modify the determination of whether a qualified investment entity (QIE) is domestically controlled by removing a rule in previously promulgated final regulations that looks to the shareholders of certain domestic corporations in determining whether foreign persons hold directly or indirectly stock in a QIE.

Finding Lists begin on page ii.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part III

Source of Certain Borrow Fees

Notice 2025-63

SECTION 1. PURPOSE

Neither the Internal Revenue Code (the "Code") nor Treasury regulations directly specify how to determine the source of payments referred to as borrow fees or negative rebate (collectively, "borrow fees") with respect to securities lending transactions or sale-repurchase transactions. As a result, the appropriate source rule for those payments is uncertain. *See, e.g.*, TD 9579, 77 FR 9846, 9846 (Feb. 21, 2012) ("The Treasury Department and the IRS are considering whether separate guidance is needed on the source of income attributable to certain payments . . . that arise in securities lending transactions or repurchase transactions"). This notice announces that the Treasury Department ("Treasury") and the Internal Revenue Service ("IRS") intend to issue proposed regulations (the "forthcoming proposed regulations") providing that certain borrow fees (as circumscribed in section 3) are sourced based on the residence of the recipient.

SECTION 2. BACKGROUND

.01 *Sourcing Items of Income*

The general rules for determining whether items of income are from sources within or without the United States are found in sections 861 through 865 of the Code. The Code provides specific sourcing rules for, among other items, interest, dividends, compensation for personal services, rents and royalties, and income from sales of personal property. Section 863(a) grants authority to the Secretary to prescribe regulations allocating or apportioning items of gross income not otherwise specified in sections 861(a) and 862(a) to sources within or without the United States.

.02 *Securities Lending and Sale-Repurchase Transactions*[1]

(1) *Transactional Documentation*

Securities lending transactions and sale-repurchase transactions are typically entered into under a standardized form of agreement[2] that includes industry-standard legal and commercial terms and definitions, and attached annexes or schedules, which provide other standardized terms applicable to specific types of transactions and may include procedures for making elections permitted by the standardized agreement (together, a "master agreement"). A related short-form confirmation memorializes the specific business terms of a particular securities lending transaction or sale-repurchase transaction.

(2) *Securities Lending Transactions*

In a securities lending transaction, one party (the "securities lender") lends securities (the "loaned securities") to another party (the "securities borrower"), subject to an obligation by the securities borrower to return equivalent securities to the securities lender, and the securities borrower typically transfers collateral in the form of cash, securities, or other financial instruments to the securities lender as security for the securities borrower's obligation under the agreement.

Under the standard master agreement used in the U.S. financial markets, the fee arrangement in a securities lending transaction depends on the type of collateral posted. When the securities borrower posts non-cash collateral with the securities lender, the securities borrower pays the securities lender an explicit fee, often referred to as a borrow fee.

By contrast, when cash collateral is posted, the master agreement provides for the securities lender to pay the securities borrower an amount frequently described as a fee or "rebate" with respect to the cash collateral, which is computed daily based on the amount of cash held by the securities lender as collateral at a rate agreed to by the parties. The securities lender retains the excess of the return it generates on the cash collateral over the amount paid to the securities borrower. This differential retained by the securities lender provides it with the economic equivalent of a borrow fee. In most such cases, no explicit fee is paid by the securities borrower to the securities lender.

However, in certain circumstances where the securities borrower has posted cash collateral, the securities borrower may pay an explicit fee (sometimes referred to as a "negative rebate") to the securities lender. This may happen, for example, when the prevailing interest rates are low or the demand for the loaned securities is high. More specifically, if the borrow fee, on a standalone basis, exceeds the return the securities lender could earn on the cash collateral, the securities borrower would pay the securities lender a negative rebate equal to the excess of the borrow fee over the return on the cash collateral.

The terms of master agreements used in international financial markets or with respect to non-U.S. securities differ in some respects. Some master agreements require the securities borrower to pay an explicit fee to the securities lender without regard to the type of collateral posted by the borrower. In such cases, the securities borrower is always required to pay a borrow fee, although the payment may be set off against the return on the cash collateral.

(3) *Sale-Repurchase Transactions*

In a sale-repurchase transaction (sometimes referred to as a "repo"), one party (the "cash lender") purchases securities from another (the "cash borrower") sub-

[1] The description of securities lending transactions and sale-repurchase transactions in this Section 2.02 is intended as a description of market practice and does not represent a conclusion by Treasury or the IRS as to the tax characterization of the transactions.

[2] For examples of standardized master agreements for securities lending transactions, *see, e.g.,* Securities Industry and Financial Markets Association (SIFMA), Master Securities Loan Agreement (2017) (referring to a borrow fee as a "Loan Fee"); International Securities Lending Association, Global Master Securities Lending Agreement (2010). For examples of standardized agreements for sale-repurchase agreements, *see, e.g.,* SIFMA, Master Repurchase Agreement (1996); SIFMA and International Capital Market Association, Global Master Repurchase Agreement (2011); The Bond Market Association and International Securities Market Association, Global Master Repurchase Agreement (2000).

ject to an agreement for the cash borrower to repurchase equivalent securities in the future at a prearranged price. A sale-repurchase transaction may function economically as a secured loan of money, a securities lending transaction, or both.

If the transaction is initiated because the initiating party wants to borrow money or earn a rate of return on excess funds, then the transaction economically resembles a loan of money. The securities sold function as collateral for the loan, with the amount of that collateral determined based on the loan "principal." Where a sale-repurchase transaction is intended primarily as a secured loan of money, the parties will often agree to a general collateral sale-repurchase agreement. Under a general collateral sale-repurchase agreement, the parties agree in advance on the types of securities and related haircuts that the cash lender is willing to accept, which generally includes U.S. Treasuries, and the cash borrower can choose which of those securities to provide. The cash borrower will pay a "general collateral" rate of return on the loan "principal."

A sale-repurchase agreement may also function as a securities lending transaction. If the cash lender requires the cash borrower to sell and repurchase a specific security, then the sale-repurchase agreement is described as a "special sale-repurchase agreement." Generally, the effective interest rate on a special sale-repurchase agreement is less than the interest rate on a general collateral sale-repurchase agreement (of equal tenure). The difference between those rates economically functions as a borrow fee to the cash borrower. The greater the demand for a security, the greater the implicit borrow fee. In a manner similar to a securities lending transaction, a special sale-repurchase agreement may result in the cash lender paying a negative rebate when the interest rate for a general collateral sale-repurchase agreement is low or the demand for the specific security is high.

SECTION 3. PROPOSED REGULATIONS TO BE ISSUED

Pursuant to the Secretary's rulemaking authority under section 863(a), the forthcoming proposed regulations would provide that the source of borrow fees (as defined in this section) paid with respect to a securities lending transaction or a sale-repurchase transaction (also as defined in this section) is determined based on the residence of the recipient, subject to the following definitions and rules applicable solely for this purpose.

A securities lending transaction and a sale-repurchase transaction have the meanings provided under §§1.861-2(a)(7) (transactions with respect to debt securities) and 1.861-3(a)(6) (transactions with respect to equity securities).

A borrow fee (including negative rebate) is a fee that is (1) paid pursuant to a securities lending transaction or sale-repurchase transaction that is (i) documented on an industry-standard master agreement and confirmation (or electronic equivalent thereof) with standard market terms and (ii) entered into in the ordinary course of the taxpayer's and counterparty's trades or businesses or pursuant to their normal investment activities or objectives, and (2) paid in substance to compensate the lender of the securities (including a cash borrower in a sale-repurchase transaction) for making its securities available to the borrower of the securities (including a cash lender in a sale-repurchase transaction).

The residence of the recipient is determined in the same manner as under section 988(a)(3)(B).

SECTION 4. APPLICABILITY DATE AND RELIANCE

The forthcoming proposed regulations would provide that the regulations will apply prospectively to taxable years ending after the forthcoming proposed regulations are published in the Federal Register. The forthcoming proposed regulations would also provide that taxpayers may choose to apply the regulations, once finalized, before the applicability date. In addition, taxpayers may rely on the rules described in section 3 of this notice with respect to securities lending transactions and sale-repurchase transactions entered into before the forthcoming proposed regulations are published in the Federal Register.

This notice does not address the source of any other payments with respect to securities lending transactions, sale-repurchase transactions, or substantially similar transactions, including a payment described as a borrow fee that is not within the scope of this notice, such as an amount paid with respect to a one-off or structured transaction or a transaction that does not have standard market business terms. The label given to a payment does not govern the determination of source; whether a fee labeled as a borrow fee is treated as such for Federal income tax purposes is determined based on the substance of the fee.

SECTION 5. DRAFTING AND CONTACT INFORMATION

The principal author of this notice is D. Peter Merkel of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice, contact D. Peter Merkel on (202) 317-6938 (not a toll-free number).

Cross-References in Notice 2025-63

Internal Revenue Code (IRC) Section 861, Income from sources within the United States: Section 861 provides rules for determining when certain items of gross income are from sources within the United States.

IRC Section 862, Income from sources without the United States: Section 862 provides rules for determining when certain items of gross income are from sources without the United States.

IRC section 863, Special Rules Determining Source: Section 863(a) provides that the Secretary shall prescribe regulations related to the source of items of gross income, expenses, losses, and deduction for which sections 861(a) and 862(a) do not provide specific sourcing rules.

IRC section 864, Definitions and Special Rules. Section 864 provides definitions for terms such as "trade or business within the United States" and "effectively connected income." Section 864 also provides rules for the treatment of related person factoring income, allocating certain interest, and allocating certain research and experimental expenditures.

IRC section 865, Source Rules for Personal Property Sales: Section 865 provides source rules relating to the sale of personal property, including inventory, intangible property, and sales through an office or fixed place of business.

IRC section 988, Treatment of Certain Foreign Currency Transactions: Section 988(a)(3)(B) provides rules for determining the residence of a taxpayer for purposes of determining the source of foreign currency gain or loss attributable to a section 988 transaction. Section 988 gain or loss is sourced based on the residence of the taxpayer.

Treas. Reg. § 1.861-2(a)(7), Interest: Treas. Reg. §1.861-2(a)(7) provides a rule for determining the source of substitute interest payments made pursuant to a securities lending transaction or a sale-repurchase transaction.

Treas. Reg. § 1.861-3(a)(6), Dividends and income inclusions under sections 951, 951A, and 1293 and associated section 78 dividends: Treas. Reg. §1.861-3(a)(6) provides a rule for determining the source of substitute dividend payments made pursuant to a securities lending transaction or a sale-repurchase transaction.

TD 9579, 77 FR 9846 (Feb. 21, 2012), Source of Income from Qualified Fails Charges: This Treasury Decision provides a final regulation relating to the source of income from a qualified fails charge. A qualified fails charge is sourced based on the residence of a taxpayer who receives the income.

Part IV

Notice of Proposed Rulemaking

Domestically Controlled Qualified Investment Entities

REG-109742-25

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would modify existing regulations on the determination of whether a qualified investment entity is domestically controlled by removing a rule that looks to the shareholders of certain domestic corporations in determining whether foreign persons hold directly or indirectly stock in a qualified investment entity. The proposed regulations would primarily affect foreign persons that own stock in a qualified investment entity that would be a United States real property interest if the qualified investment entity were not domestically controlled.

DATES: Written or electronic comments and requests for a public hearing must be received by December 22, 2025.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG-109742-25) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the "Comments and Requests for a Public Hearing" section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted to the IRS's public docket. Send paper submissions to: CC:PA:01:PR (REG-109742-25), Room 5503, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Andrew F. Gordon (or any other staff member in the Office of the Associate Chief Counsel (International)) at (202) 317-3800 (not a toll-free number); concerning submissions of comments, requests for a public hearing, and access to a public hearing, Publications and Regulations Section at (202) 317-6901 (not toll-free numbers) or by e-mail to *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Background

Section 897(a)(1) of the Internal Revenue Code (Code) provides that gain or loss of a nonresident alien individual or foreign corporation from the disposition of a United States real property interest (USRPI) is taken into account under section 871(b)(1) or section 882(a)(1), as applicable, as if the nonresident alien individual or foreign corporation were engaged in a trade or business within the United States during the taxable year and such gain or loss were effectively connected with that trade or business.

Subject to certain exceptions, section 897(c)(1)(A) defines a USRPI as an interest in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the Virgin Islands, and any interest (other than solely as a creditor) in any domestic corporation unless the taxpayer establishes that such corporation was at no time a United States real property holding corporation (USRPHC) during the period set forth in section 897(c)(1)(A)(ii) (generally, the five-year period ending on the date of the disposition of the interest). Under section 897(c)(2), a USRPHC is generally any corporation if the fair market value of its USRPIs equals or exceeds 50 percent of the total fair market value of its USRPIs, its interests in real property located outside the United States, plus any other of its assets that are used or held for use in a trade or business.

Section 897(h)(1) provides that any distribution by a qualified investment entity (QIE) to a nonresident alien individual, a foreign corporation, or other QIE, to the extent attributable to gain from sales or exchanges by the QIE of USRPIs, is treated as gain recognized by such nonresident alien individual, foreign corporation, or other QIE from the sale or exchange of a USRPI, subject to certain exceptions. Section 897(h)(4)(A) defines a QIE as any (i) real estate investment trust (REIT), and (ii) any regulated investment company (RIC) which is a USRPHC or which would be a USRPHC if the exceptions in section 897(c)(3) and (h)(2) did not apply to interests in any REIT or RIC.

Section 897(h)(2) provides that a USRPI does not include an interest in a domestically controlled QIE (DC-QIE exception). Accordingly, gain or loss on the disposition of stock in a domestically controlled QIE is not subject to section 897(a). Section 897(h)(4)(B) provides that a QIE is domestically controlled if less than 50 percent of the value of its stock is held directly or indirectly by foreign persons at all times during the testing period prescribed in section 897(h)(4)(D) (generally, the five-year period ending on the date of the disposition).

On December 29, 2022, the Treasury Department and the IRS published proposed regulations (REG-100442-22) in the **Federal Register** (87 FR 80097) that set forth rules for determining whether stock of a QIE is considered "held directly or indirectly" by foreign persons for purposes of defining a domestically controlled QIE under section 897(h)(4)(B) (2022 proposed regulations). The 2022 proposed regulations defined stock in a QIE that is held "indirectly" by taking into account stock of the QIE held through certain entities under a limited "look-through" approach. Under that approach, only a "non-look-through person" is treated as holding directly or indirectly stock of a QIE, and stock of a QIE held by or through one or more intervening "look-through persons" is treated as held proportionately by the look-through person's

ultimate owners that are non-look-through persons.

The 2022 proposed regulations generally treated a "domestic C corporation," defined as any domestic corporation other than a RIC, REIT, or an S corporation, as a non-look-through person. However, the 2022 proposed regulations treated certain "non-publicly traded domestic C corporations" as look-through persons if foreign persons hold a 25 percent or greater interest (by value) in the stock of the corporation (domestic corporation look-through rule).

On April 24, 2024, the Treasury Department and the IRS published TD 9992 in the **Federal Register** (89 FR 31618) (2024 final regulations), which finalized the 2022 proposed regulations. The 2024 final regulations retained the general approach and structure of the 2022 proposed regulations with certain revisions. In particular, under the 2024 final regulations the domestic corporation look-through rule applies if foreign persons hold a more than 50 percent interest (by value) in the stock of the corporation. *See* § 1.897-1(c)(3)(iii)(B) and (c)(3)(v)(B). The 2024 final regulations also include a transition rule that exempts existing QIEs from the application of the domestic corporation look-through rule for a 10-year period, provided that there is not a significant change in the USRPIs held by the QIE or in the QIE's ownership. *See* § 1.897-1(c)(3)(vi).

Explanation of Provisions

I. *Removal of Domestic Corporation Look-Through Rule*

Following the publication of the 2024 final regulations, the Treasury Department and the IRS received feedback from taxpayers recommending the withdrawal of the domestic corporation look-through rule, focusing on the practical difficulty of tracing upstream ownership, often without access to reliable data, resulting in legal uncertainty, operational complexity, and potentially chilling effects on investment in U.S. real estate. The Treasury Department and the IRS share these concerns.

In addition, taxpayers argued that the domestic corporation look-through rule is inconsistent with the statute and conflicts with congressional intent. They noted that within the domestically controlled QIE provisions, section 897(h)(4)(B) does not contain explicit corporate look-through rules and that Congress enacted rules in 2015 providing for look-through treatment for certain corporate owners of QIEs, but only in the specific circumstances described in section 897(h)(4)(E). They argued that the presence of the look-through rules in section 897(h)(4)(E) (and in other areas under section 897) indicates that the absence of a similar rule in section 897(h)(4)(B) was intentional, and that interpreting section 897(h)(4)(B) to include corporate look-through rules would render the section 897(h)(4)(E) look-through rules surplus. The recommendations emphasized that the term "indirectly" can have meanings in the Code other than look-through treatment of domestic corporations. They further argued that the interests held by a domestic corporation are subject to U.S. corporate income tax and therefore the objective of section 897 is satisfied without looking through a domestic corporation.

In response to the feedback received, the Treasury Department and the IRS have further considered whether the interpretation of "indirectly" reflected in the domestic corporation look-through rule is consistent with the statutory text and purpose of the DC-QIE exception, which Congress intended to be available for QIEs that are controlled by United States persons. In light of this further consideration, the Treasury Department and the IRS are of the view that imposing look-through treatment under the domestic corporation look-through rule with respect to an entity that is subject to U.S. taxation based on a strict 50-percent foreign ownership threshold is not the construction that should be given to the text of section 897(h)(4)(B), as informed by the traditional tools of statutory construction, including evaluation of the provision's purpose.

Accordingly, the proposed regulations would remove the domestic corporation look-through rule and treat all domestic C corporations as non-look-through persons in determining whether a QIE is domestically controlled. The proposed regulations would also provide for various conforming revisions to § 1.897-1(c)(3) that are necessary because of the removal of the domestic corporation look-through rule.

II. *Applicability Date*

The proposed regulations, upon finalization, would apply to transactions occurring on or after October 20, 2025. However, taxpayers may choose to apply the final regulations, once published in the **Federal Register**, to transactions occurring on or after April 25, 2024 (and to transactions occurring before April 25, 2024, resulting from an entity classification election under § 301.7701-3 of this chapter that was effective on or before April 25, 2024, but was filed on or after April 25, 2024). Taxpayers may rely on the proposed regulations for transactions occurring before the date the proposed regulations are finalized.

Special Analyses

I. *Regulatory Planning and Review -- Economic Analysis*

The proposed regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (July 4, 2025) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations.

II. *Paperwork Reduction Act*

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) (PRA) generally requires that a Federal agency obtain the approval of the OMB before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the OMB.

The existing collection of information requirement in § 1.1445-2(c)(3) is a statement provided by a domestic corporation that certifies that an interest in such corporation is not a U.S. real property interest. Section 1.1445-2(c)(3) also provides that the same procedure may be used by a domestic corporation to certify that it is

a domestically controlled QIE (as determined under § 1.897-1(c)(3)), as long as the certification is voluntarily issued and otherwise complies with the requirements in § 1.897-2(h).

The proposed regulations do not modify any existing information collection requirements or create new or additional information collection requirements. For purposes of the PRA, the reporting burden associated with the collections of information in § 1.1445-2(c)(3) is reflected in the PRA submissions associated with the section 1445 regulations (OMB control number 1545-0902).

III. *Regulatory Flexibility Act*

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (5 U.S.C. chapter 6) (RFA) requires the agency to prepare and make available for public comment an initial regulatory flexibility analysis that will describe the impact of the proposed rule on small entities. *See* 5 U.S.C. 603(a). Section 605 of the RFA provides an exception to this requirement if the agency certifies that the proposed rulemaking will not have a significant economic impact on a substantial number of small entities. A small entity is defined as a small business, small nonprofit organization, or small governmental jurisdiction. *See* 5 U.S.C. 601(3) through (6).

The proposed regulations would remove the domestic corporation look-through rule and, therefore, a domestic C corporation would be treated as a non-look-through person in determining whether a QIE is domestically controlled. Data on the number of small entities potentially affected by the proposed regulations is not readily available. Even if a substantial number of small entities would be affected, the economic impact is not expected to be significant. The Treasury Department and the IRS are of the view that the proposed regulations will reduce the economic impact on small entities by reducing compliance burdens. Accordingly, a regulatory flexibility analysis is not required.

Notwithstanding this certification, the Treasury Department and the IRS welcome comments about the impacts of these regulations on small entities.

IV. *Section 7805(f)*

Pursuant to section 7805(f) of the Code, the proposed regulations (REG-109742-25) have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

V. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. The proposed regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

VI. *Executive Order 13132: Federalism*

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. The proposed regulations do not have federalism implications, do not impose substantial direct compliance costs on State and local governments, and do not preempt State law within the meaning of the Executive order.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any comments submitted will be made available at *http://www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of the proposed regulations is the Office of the Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.897-1 is amended by:

1. Revising paragraphs (a)(2) and (c)(3)(iii)(A);
2. Removing paragraph (c)(3)(iii)(B) and redesignating paragraph (c)(3)(iii)(C) as paragraph (c)(3)(iii)(B);
3. Revising the last sentence of newly redesignated paragraph (c)(3)(iii)(B);
4. Removing the language "see paragraph (c)(3)(vii)(A)" in the second sentence of paragraph (c)(3)(iv)(A) and adding "see paragraph (c)(3)(vi)(A)" in its place;
5. Revising paragraph (c)(3)(v)(B);
6. Removing the last sentence in paragraph (c)(3)(v)(C);
7. Revising paragraph (c)(3)(v)(D);

8. Removing paragraph (c)(3)(v)(E) and redesignating paragraph (c)(3)(v)(F) as paragraph (c)(3)(v)(E);
9. Removing paragraph (c)(3)(v)(G) and redesignating paragraphs (c)(3)(v)(H) through (J) as paragraphs (c)(3)(v)(F) through (H);
10. Revising the last sentence of newly redesignated paragraphs (c)(3)(v)(G) and (H);
11. Redesignating paragraphs (c)(3)(v)(K) through (O) as paragraphs (c)(3)(v)(I) through (M);
12. Removing paragraph (c)(3)(vi) and redesignating paragraph (c)(3)(vii) as paragraph (c)(3)(vi);
13. Revising the newly redesignated paragraph (c)(3)(vi); and
14. Removing the language "paragraph (c)(3)(ii) through (vii)" in paragraph (c)(4) and adding "paragraph (c)(3)(ii) through (vi)" in its place.

The revisions read as follows:

§1.897-1 Taxation of foreign investment in United States real property interests, definition of terms.

(a) * * *

(2) *Applicability date*. Except as otherwise provided in this paragraph (a)(2), the regulations set forth in this section and §§ 1.897-2 through 1.897-4 apply to transactions occurring after June 18, 1980. Paragraphs (c)(3) and (4) of this section apply to transactions occurring on or after October 20, 2025. For transactions occurring before October 20, 2025, see paragraphs (c)(3) and (4) of this section contained in 26 CFR part 1, as revised April 1, 2025. With respect to transactions occurring before October 20, 2025, taxpayers may apply paragraphs (c)(3) and (4) of this section for transactions occurring on or after April 25, 2024, and transactions occurring before April 25, 2024, resulting from an entity classification election under § 301.7701-3 of this chapter that was effective on or before April 25, 2024, but was filed on or after April 25, 2024. Paragraphs (k) and (l) of this section apply to transactions occurring on or after April 25, 2024, and transactions occurring before April 25, 2024, resulting from an entity classification election under § 301.7701-3 of this chapter that was effective on or before April 25, 2024, but was filed on or after April 25, 2024. For transactions occurring before April 25, 2024, see paragraphs (c)(2)(i) and (l) of this section and § 1.897-9T(c) contained in 26 CFR part 1, as revised April 1, 2024.

* * * * *

(c) * * *

(3) * * *

(iii) * * *

(A) *Certain holders of U.S. publicly traded QIE stock*. Notwithstanding any other provision of this paragraph (c)(3), a person holding less than five percent of U.S. publicly traded stock of a QIE at all times during the testing period, determined without regard to paragraph (c)(3)(ii)(A) of this section, is treated as a United States person that is a non-look-through person with respect to that stock, unless the QIE has actual knowledge that such person is not a United States person or has actual knowledge that such person is a look-through person that is a foreign-controlled entity. For an example illustrating the application of this paragraph (c)(3)(iii)(A), see paragraph (c)(3)(vi)(B) of this section (*Example 2*).

(B) * * * For an example illustrating the application of this paragraph (c)(3)(iii)(B), see paragraph (c)(3)(vi)(B) of this section (*Example 2*).

* * * * *

(v) * * *

(B) A *foreign-controlled entity* is any entity in which foreign persons hold directly or indirectly more than 50 percent of the fair market value of the entity's outstanding interests. For purposes of determining whether an entity is a foreign-controlled entity, the rules of paragraphs (c)(3)(ii)(A) through (C), (c)(3)(iii)(A) and (B), and (c)(3)(iv) of this section apply (treating the entity as if it were a QIE for this purpose).

* * * * *

(D) A *non-look-through person* is an individual, a domestic C corporation, a nontaxable holder, a foreign corporation (including a foreign government pursuant to section 892(a)(3)), a publicly traded partnership (domestic or foreign), a public RIC, an estate (domestic or foreign), an international organization (as defined in section 7701(a)(18)), a qualified foreign pension fund (including any part of a qualified foreign pension fund), or a qualified controlled entity. For special rules that treat certain holders of QIE stock as non-look-through persons, *see* paragraphs (c)(3)(iii)(A) and (B) of this section.

* * * * *

(G) * * * A RIC is not a public RIC, however, if the QIE whose status as domestically controlled is being determined under this paragraph (c)(3) has actual knowledge that the RIC is a foreign-controlled entity.

(H) * * * A domestic partnership is not a publicly traded partnership, however, if the QIE whose status as domestically controlled is being determined under this paragraph (c)(3) has actual knowledge that the domestic partnership is a foreign-controlled entity.

* * * * *

(vi) Examples. The rules of this paragraph (c)(3) are illustrated by the following examples. It is assumed that each entity has a single class of stock or other ownership interests, that the ownership described existed throughout the relevant testing period and that, unless otherwise stated, a QIE is not a public QIE as defined under paragraph (c)(3)(v)(F) of this section.

(A) *Example 1*: *QIE stock held by domestic C corporation--(1) Facts*. USR is a REIT, 51 percent of the stock of which is held by X, a domestic C corporation as defined in paragraph (c)(3)(v)(A) of this section, and 49 percent of the stock of which is held by nonresident alien individuals, which are foreign persons as defined in paragraph (k) of this section.

(*2*) *Analysis*. Under paragraph (c)(3)(v)(K) of this section, USR is a QIE. Because X is a domestic C corporation it is a non-look-through person as defined under paragraph (c)(3)(v)(D) of this section. Thus, under paragraph (c)(3)(ii)(A) of this section X is considered as holding directly or indirectly stock of USR for purposes of determining whether USR is a domestically controlled QIE. Under paragraph (c)(3)(ii)(C) of this section, the USR stock held directly or indirectly by X is not considered held directly or indirectly by any other person, including the shareholders of X. Because X is not a foreign person as defined in paragraph (k) of this section and holds directly or indirectly 51 percent of the single class of outstanding stock of USR, foreign persons hold directly or indirectly less than 50 percent of the fair market value of the stock of USR, and USR therefore is a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(*3*) *Alternative facts*: *QIE stock held by domestic partnership*. The facts are the same as in paragraph (c)(3)(vi)(A)(*1*) of this section (*Example 1*), except that, instead of being a domestic C corporation, X is a domestic partnership that is not a publicly traded partnership as defined in paragraph (c)(3)(v)(H) of this section. In addition, FC1, a foreign corporation, holds a 50 percent interest in X, and the remaining interests in X are held by U.S. citizens. X is not a

non-look-through person as defined in paragraph (c)(3)(v)(D) of this section and, therefore, is a look-through person as defined in paragraph (c)(3)(v)(C) of this section. Accordingly, under paragraph (c)(3)(ii)(A) of this section, X is not considered as holding directly or indirectly stock of USR for purposes of determining whether USR is a domestically controlled QIE. Under paragraph (c)(3)(ii)(B) of this section, the stock of USR that, but for paragraph (c)(3)(ii)(A) of this section, is considered held by X, a look-through person, is instead considered held proportionately by X's partners that are non-look-through persons. Accordingly, because FC1 and the U.S. citizen partners in X are non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, 25.5 percent of the stock of USR is considered as held directly or indirectly by FC1 (50% x 51%), a foreign person as defined in paragraph (k) of this section, and 25.5 percent (in the aggregate) of the stock of USR is considered as held directly or indirectly by the U.S. citizen partners in X (50% x 51%), who are not foreign persons as defined in paragraph (k) of this section. Foreign persons therefore hold directly or indirectly 74.5 percent of the stock of USR (49 percent of the stock of USR held directly or indirectly by nonresident alien individuals, who are non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, plus the 25.5 percent held directly or indirectly by FC1), and USR is not a domestically controlled QIE under paragraph (c)(3)(i) of this section. The result described in this paragraph (c)(3)(vi)(A)(*3*) would be the same if, instead of being a domestic partnership, X were a foreign partnership.

(*4*) *Alternative facts*: *QIE stock held by a qualified foreign pension fund*. The facts are the same as in paragraph (c)(3)(vi)(A)(*3*) of this section, except that, instead of being a foreign corporation, FC1 is a qualified foreign pension fund. The analysis is the same as in paragraph (c)(3)(vi)(A)(*3*) of this section regarding the treatment of X as a look-through person as defined in paragraph (c)(3)(v)(C) of this section. In addition, FC1, a foreign person under paragraph (c)(3)(iv)(A) of this section, is a non-look-through person as defined in paragraph (c)(3)(v)(D) of this section. Because FC1 and the U.S. citizen partners in X are non-look-through persons, 25.5 percent of the stock of USR is considered as held directly or indirectly by FC1 (50% x 51%), and 25.5 percent (in the aggregate) of the stock of USR is considered as held directly or indirectly by the U.S. citizen partners in X (50% x 51%). Thus, for the same reasons described in paragraph (c)(3)(vi)(A)(*3*) of this section, foreign persons hold directly or indirectly 74.5 percent of the stock of USR, and USR is not a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(B) *Example 2*: *QIE stock held by public QIE that is a domestically controlled QIE*--(*1*) *Facts*. USR2 is a REIT, 51 percent of the stock of which is held by USR1, a REIT that is a public QIE as defined in paragraph (c)(3)(v)(F) of this section. The remaining 49 percent of the stock of USR2 is held by nonresident alien individuals, which are foreign persons as defined in paragraph (k) of this section. The stock of USR1 is U.S. publicly traded QIE stock as defined in paragraph (c)(3)(v)(M) of this section. FC1 and FC2, both foreign corporations, each hold 20 percent of the stock of USR1. The remaining 60 percent of the stock of USR1 is held by persons that each hold less than 5 percent of the stock of USR1 (USR1 less than five-percent public shareholders) and with respect to which USR1 has no actual knowledge that such person is not a United States person or is a look-through person that is a foreign-controlled entity (as determined under paragraph (c)(3)(v)(B) of this section by treating any entity as if it were a QIE for this purpose).

(*2*) *Analysis*. Under paragraph (c)(3)(v)(K) of this section, USR2 and USR1 are QIEs. Under paragraph (c)(3)(iii)(A) of this section, each of the USR1 less than five-percent public shareholders is treated as a United States person that is a non-look-through person. Consequently, under paragraph (c)(3)(i) of this section USR1 is a domestically controlled QIE because FC1 and FC2, each a foreign person as defined in paragraph (k) of this section that is a non-look-through person under paragraph (c)(3)(v)(D) of this section, together hold directly or indirectly only 40 percent of the stock of USR1 and, thus, foreign persons hold directly or indirectly less than 50 percent of the fair market value of the stock of USR1. In addition, the USR2 stock held by USR1 is treated as held directly or indirectly by a United States person that is a non-look-through person under paragraph (c)(3)(iii)(B) of this section. Because USR1 holds directly or indirectly 51 percent of the stock of USR2, foreign persons hold directly or indirectly less than 50 percent of the fair market value of the stock of USR2, and USR2 is a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(*3*) *Alternative facts: QIE stock held by public QIE that is not a domestically controlled QIE*. The facts are the same as in paragraph (c)(3)(vi)(B)(*1*) of this section (*Example 2*), except that 25 percent of the stock of USR1 is held by each of FC1 and FC2, with the remaining 50 percent of the stock of USR1 held by the USR1 less than five-percent public shareholders. Regardless of the treatment of the USR1 less than five-percent public shareholders, USR1 is not a domestically controlled QIE under paragraph (c)(3)(i) of this section because FC1 and FC2, each a foreign person as defined in paragraph (k) of this section that is a non-look-through person under paragraph (c)(3)(v)(D) of this section, together hold directly or indirectly 50 percent of the stock of USR1 and, thus, foreign persons do not hold directly or indirectly less than 50 percent of the fair market value of the stock of USR1. In addition, the USR2 stock held by USR1 is treated as held by a foreign person that is a non-look-through person under paragraph (c)(3)(iii)(B) of this section. Because USR1 holds directly or indirectly 51 percent of the stock of USR2, foreign persons do not hold directly or indirectly less than 50 percent of the fair market value of the stock of USR2, and USR2 is not a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(C) *Example 3*: *QIE stock held by non-public QIE*--(*1*) *Facts*. USR2 is a REIT, 49 percent of the stock of which is held by nonresident alien individuals, and 51 percent of the stock of which is held by USR1, a REIT. USR1 is not a public QIE as defined in paragraph (c)(3)(v)(F) of this section. U.S. citizens hold 50 percent of the stock of USR1. The remaining 50 percent of the stock of USR1 is held by PRS, a domestic partnership, 50 percent of the interests in which are held by DC, a domestic C corporation as defined in paragraph (c)(3)(v)(A) of this section, and 50 percent of the interests in which are held by nonresident alien individuals.

(*2*) *Analysis*. Under paragraph (c)(3)(v)(K) of this section, USR2 and USR1 are QIEs. USR1 is not treated as a non-look-through person under paragraph (c)(3)(iii)(B) of this section because USR1 is not a public QIE as defined in paragraph (c)(3)(v)(F) of this section. Each of USR1 and PRS is a look-through person as defined in paragraph (c)(3)(v)(C) of this section that is not treated as holding directly or indirectly stock in USR2 for purposes of determining whether USR2 is a domestically controlled QIE under paragraph (c)(3)(ii)(A) of this section. Because the U.S. citizens who hold USR1 stock are non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, those U.S. citizens are treated under paragraph (c)(3)(ii)(B) of this section as holding directly or indirectly 25.5 percent of the stock of USR2 through their USR1 stock interest (50% x 51%) in accordance with paragraph (c)(3)(ii)(A) of this section. Similarly, because DC and the nonresident alien partners in PRS are non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, each is treated under paragraph (c)(3)(ii)(B) of this section as holding directly or indirectly the stock of USR2 through its interest in PRS and PRS's interest in USR1. Thus, DC is treated as holding directly or indirectly 12.75 percent of the stock of USR2 (50% x 50% x 51%) and the nonresident alien individual partners, which are foreign persons as defined in paragraph (k) of this section, are treated as directly or indirectly holding a 12.75 percent aggregate interest in the stock of USR2 (50% x 50% x 51%). Foreign persons therefore hold directly or indirectly 61.75 percent of the stock of USR2 (the 49 percent stock in USR2 directly held by nonresident alien individuals, who are foreign persons and non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, plus the 12.75 percent in stock indirectly held by the nonresident alien individual partners in PRS), and USR2 is not a domestically controlled QIE under paragraph (c)(3)(i) of this section.

* * * * *

Jarod J. Koopman,
Acting Chief Tax Compliance Officer.

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Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2025–27 through 2025–52 is in Internal Revenue Bulletin 2025–52, dated December 22, 2025.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2025–27 through 2025–52 is in Internal Revenue Bulletin 2025–52, dated December 22, 2025.

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