

benefit of private persons. Accordingly, the trust is considered a controlled entity of FC.

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

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

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

(b) The facts are the same as in *Example 4(a)*, except that MW is a controlled entity of foreign sovereign FC. The result is the same as in *Example 4(a)*. However, should MW engage in commercial activities (whether within or outside the United States), the income from the Treasury obligations earned by the pension fund will not be exempt from tax-

ation under section 892 since MW will be considered a controlled commercial entity within the meaning of § 1.892-5T(a).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(b) *Illustrations*. The principles of paragraph (a) of this section may be illustrated by the following examples.

Example 1. X, a foreign corporation not engaged in commercial activity anywhere in the world, is a controlled entity of a foreign sovereign within the meaning of §1.892-2T(a)(3). X is not a Central bank of issue as defined in §1.895-1(b). In 1987, X received the following items of income from investments in the United States: (i) Dividends from a portfolio of publicly traded stocks in U.S. corporations in which X owns less than 50 percent of the stock; (ii) dividends from BTB Corporation, an automobile manufacturer, in which X owns 50 percent of the stock; (iii) interest from bonds issued by noncontrolled entities and from interest-bearing bank deposits in noncontrolled entities; (iv) rents from a net lease on real property; (v) gains from silver futures contracts; (vi) gains from wheat futures contracts; (vii) gains from spot sales of nonfunctional foreign currency in X’s possession; (viii) gains from the disposition of a publicly traded partnership interest, and (ix) gains from the disposition of the stock of Z Corporation, a United States real property holding company as defined in section 897, of which X owns 12 percent of the stock. Only income derived from sources described in paragraph (a)(1) of this section is treated as income of a foreign government eligible for exemption from taxation. Accordingly, only income received by X from items (i), (iii), (v) provided that the silver futures contracts are held in the execution of governmental financial or monetary policy, and (ix) is exempt from taxation under section 892.

Example 2. The facts are the same as in *Example 1*, except that X is also a central bank of issue within the meaning of section 895. Since physical possession of nonfunctional foreign currency when held by a central bank of issue is considered a financial instrument, the item (vii) gains from spot sales of nonfunctional foreign currency are exempt from taxation under paragraph (a)(1) of this section, if physical possession of the currency was an essential part of X’s reserve policy in the execution of its governmental financial or monetary policy.

Example 3. State Concert Bureau, an integral part of a foreign sovereign within the meaning of §1.892-2T(a)(2), entered into an agreement with a U.S. corporation engaged in the business of promoting international cultural programs. Under the agreement the State Concert Bureau agreed to send a ballet troupe on tour for 5 weeks in the United States. The Bureau received approximately \$60,000 from the performances. Regardless of whether the performances themselves constitute commercial activities under §1.892-4T, the income received by the Bureau is not exempt from taxation under section 892 since the income is from sources other than described in paragraph (a)(1) of this section.

[T.D. 8211, 53 FR 24062, June 27, 1988]