Recent court case discusses FBAR requirement for dual residents with treaty foreign residency

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On November 20, 2023, the US District Court for the Southern District of California ruled that an individual who was a lawful permanent resident of the United States should be treated as a non-resident of the United States for purposes of filing a Report of Foreign Bank and Financial Accounts (FBAR) once that individual began to be treated as a resident of Mexico under the residency tiebreaker provisions of the US-Mexico Income Tax Treaty. *Aroeste v. United States*, 22-cv-00682-AJB-KSC (S.D. Cal. Nov. 20, 2023).

A US person with a financial interest in, or signature authority over, one or more foreign financial accounts during a calendar year is required to file an FBAR if the aggregate value of the foreign financial account or accounts exceeds $10,000 at any time during the calendar year. For FBAR purposes, a US person includes a US resident, which is further defined to include an individual who is a "resident alien" under 26 U.S.C. § 7701(b). A non-US citizen is treated as a "resident alien" if he or she is a "lawful permanent resident of the United States at any time" during an applicable calendar year. However, under 26 U.S.C. § 7701(b)(6), "lawful permanent resident" status ceases to exist if an individual (1) commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country, (2) does not waive the benefits of such treaty applicable to residents of the foreign country, and (3) notifies the government of the commencement of such treatment. It is important to keep in mind that Treas. Reg. § 301.7701(b)-7 provides that a dual-resident taxpayer (i.e., an individual who is considered a US resident pursuant to the internal laws of the United States and also a resident of a treaty country pursuant to the internal laws of any treaty partner) who file as a non-US resident pursuant to the tiebreaker provision of a US income tax treaty is generally treated as a non-US resident only for purposes of the computation of the individual's US income tax liability. Said more simply, such an individual is treated as a US income tax resident with respect to all other Code sections. Therefore, such

individuals generally are required to complete all information reporting as if they were US income tax residents notwithstanding their treaty tiebreaker position to be treated as a non-US resident.

Mr. Aroeste, a Mexican citizen, became a US lawful permanent resident in 1984. He owned a condominium in Florida that he used for vacation purposes only. He always filed his Mexican tax returns as a resident of Mexico. During 2012 and 2013, Mr. Aroeste had a financial interest in or held signature authority over five accounts in Mexico with an aggregate balance in excess of $10,000 and did not file FBARs for disclosing these accounts. Mr. Aroeste also failed to timely notify the government that he had claimed tax residency in Mexico under the tiebreaker provision of the US-Mexico Income Tax Treaty by including Form 8833, *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)*, with a US income tax return. Mr. Aroeste was selected for IRS audit and the IRS eventually assessed $100,000 in FBAR penalties against him for 2012 and 2013. Mr. Aroeste paid a modest amount towards the assessed FBAR penalties and then proceeded to sue the government to recoup the penalty paid and discharge the balance of the FBAR penalties, contending that he was not liable for the FBAR penalties.

The District Court found that, in 2012 and 2013, Mr. Aroeste was a resident of Mexico under the tiebreaker provisions of the US-Mexico Income Tax Treaty and concluded that his status as a US lawful permanent resident had ceased, making him not obligated to file FBARs. The court also ruled that Mr. Aroeste's failure to make the tiebreaker claim on a timely filed Form 8833 did not preclude him from being treated as a resident of Mexico but did subject him to a financial penalty of $1,000 for each delinquent Form 8833.

It is expected that the government will appeal the court's decision in *Aroeste* to the Ninth Circuit, and therefore it is unclear whether the court's reasoning will be upheld and broadly applicable. For the time being, taxpayers filing as non-US residents under an applicable tie-breaker provision of a US income tax treaty (with Mexico or any other jurisdiction) should continue filing FBARs or any other required international information returns (such as Forms 3520, 5471, 8865, etc.). As noted, the section 7701(b) regulations state that a dual-resident taxpayer generally is treated as a US resident for purposes of the Internal Revenue Code other than the computation of the individual's US income tax liability, and therefore other US tax rules may continue to apply.

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Washington National Tax

Susan Segar
Managing Director
Deloitte Tax LLP
+1 703 885 6328

Jonathan Cutler
Senior Manager
Deloitte Tax LLP
+1 704 887 1576

Americas

John Rieger
Partner
Global GIR Leader
Deloitte Tax LLP
+1 212 436 6934

David Charlton
Principal
US GIR Leader
Deloitte Tax LLP
+1 617 437 2118

Denise Hintzke
Managing Director
Global GIR Market Leader
Deloitte Tax LLP
+1 212 436 4792

Duncan Brenan
Managing Director
GIR
Deloitte Tax LLP
+1 571 766 7552

Ephraim Davidowitz
Managing Director
GIR
Deloitte Tax LLP
+1 973 602 4664

Rona Hummel
Managing Director
GIR
Deloitte Tax LLP
+1 212 653 7859

Paddy Killimangalam
Managing Director
GIR
Deloitte Tax India Private Ltd
+1 678 299 0119

Kayla Laidlaw
FATCA/CRS Director
Caribbean and Bermuda
Deloitte Ltd
+1 284 394 2814

Peter Larsen
Principal
GIR
Deloitte Tax LLP
+1 415 783 4575

Anthony Martirano
Managing Director
GIR
Deloitte Tax LLP
+1 973 602 6986

Jeanne Murphy
Managing Director
GIR
Deloitte Tax LLP
+1 212 436 5910

Luke Nagle
FATCA/CRS Partner
Canada
Deloitte LLP
+1 416 354 1495

Sara Offen
Principal
GIR
Deloitte Tax LLP
+1 404 220 1072

Tim Rappoccio
Managing Director
GIR
Deloitte Tax LLP
+1 203 423 4452

Robert Schlock
Managing Director
GIR
Deloitte Tax LLP
+1 212 436 3541

Susan Schultz
Managing Director
Operations Leader
GIR Global Delivery Center
Deloitte Tax LLP
+1 612 397 4604

Kristen Starling
Managing Director
GIR
Deloitte Tax LLP
+1 212 436 4281

Sagun Vijayananda
Partner
GIR
Deloitte Tax LLP
+1 212 436 7329

Asia-Pacific

Troy Andrews
FATCA/CRS Partner
New Zealand
Deloitte
+64 93030729

Candy Chan
FATCA/CRS Partner
China / Hong Kong
Deloitte Advisory (HK) Ltd
+852 2852 5886

Gilbert Chiang
Partner
Taiwan
Deloitte & Touche
+886 2 27259988;ext=3619

Edmond Lam
FATCA/CRS Director
China / Hong Kong
Deloitte Advisory (HK) Ltd
+852 2238 7564

Kosaku Maeda
Partner
Japan
Deloitte Tohmatsu Tax Co.
+818034104701

Alison Noble
FATCA/CRS Partner
Australia
Deloitte Services Pty Ltd
+61 3 9671 6716

Terence Tan
FATCA/CRS Partner
Australia
Deloitte Tax Services Pty Ltd
+61 3 9671 5782

Michael Velten
FATCA/CRS Partner
Singapore
Deloitte & Touche LLP
+65 6531 5039

Europe, Middle East & Africa

Brandi Caruso
Tax Transparency Partner
Switzerland/Liechtenstein
Deloitte AG
+41 58 279 6397

Eric Centi
FATCA/CRS Partner
Luxembourg
Deloitte Tax & Consulting
+352 45145 2162

Pedro De La Iglesia
Counsel
Spain
Deloitte Ases.Tribut. SLU
+34 914381773

Owen Gibbs
UK FATCA/CRS/DAC Partner
United Kingdom
Deloitte LLP
+44 20 7007 4819

Petrit Ismajli
Partner
Switzerland
Deloitte AG
+41 58 279 6213

Keren Binyamin
Senior Manager
Israel
Deloitte Israel & Co.
+972 3 6085302

Jason McGarvey
Global GIR Technology Leader
United Kingdom
Deloitte LLP
+44 20 7303 0412

Karim Ousta
FATCA/CRS Leader
United Arab Emirates
Deloitte LLP
+971 4 5064700

Luis Pinto
Associate Partner
Portugal
Deloitte Tax
+351 210422500