



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

Global Information Reporting

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 (“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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