KEY TAX INSIGHTS

TAX NEWSLETTER

# *Aroeste v. United States* – Sets Precedent Relating to the Tiebreaker Clause in United States-Mexico Tax Treaty

In Aroeste v. United States, the U.S. District Court of the Southern District of California held Mr. Aroeste is not liable for the penalties for alleged violation of the Report of Foreign Bank and Financial Accounts (**FBAR**) because he was a US Nonresident as determined by Article 4 of the United States-Mexico Tax Income Treaty (**the Treaty**) and therefore, was not required to file FBAR.

## Background

Mr. Alberto Aroeste, a Mexican citizen and lawful U.S. permanent resident (**US Status**), had US Status since 1984, and his wife was a naturalized U.S. citizen. The couple primarily resided in Mexico and maintained a Florida vacation residence.[1] For tax years 2012 and 2013 (**the Relevant Period**), Mr. Aroeste filed his US Tax returns with a status of "married filing jointly" but he did not file FBARs to disclose five financial accounts with an aggregate balance exceeding $10,000 (**the Financial Accounts**) he held in Mexico. In 2016, Mr. Aroeste amended his tax returns to file as a U.S. nonresident with a status of "married filing separately". He relied on the tie-breaker provisions of the Treaty, including Form 8833, Treaty-Based Return Position Disclosure for the claim.

In 2020, the U.S. Treasury assessed Mr. Aroeste for $100,000 in penalties for not filing FBARs for the Relevant Period. Under the Bank Secrecy Act, the Financial Crimes Enforcement Network (**FinCEN**), requires US Persons[2] to file an FBAR each year if the aggregate value of all foreign accounts exceeds $10,000 during the year. In response, Mr. Aroeste filed a lawsuit against the government, contending that he was not liable for the FBAR penalties because he was not a US Person under Article 4 of the Treaty.

# *Aroeste v. United States* – Sets Precedent Relating to the Tiebreaker Clause in United States-Mexico Tax Treaty

## Legal Review

The central question before the Court was whether Article 44 of the Treaty[3] should govern whether a taxpayer has an FBAR reporting requirement. Article 4 provides rules to determine residency, when an individual is a resident of both countries. The first rule states that an individual is deemed a resident in the country of his permanent home, and where they have a home in both countries, the individual shall be deemed to be a resident of the country with which his personal and economic relations are closer, which is known as the center of vital interest test. The Government argued that Mr. Aroeste had waived his rights under the Treaty to be treated as a resident of Mexico because he did not: (i) notify the IRS timely by filing Form 8833 with his original, and (ii) tax return file Form 8854, Initial and Annual Expatriation Statement. The Court disagreed with this argument and ruled that Mr. Aroeste's failure to file the relevant forms did not undermine his right to claim his treaty position.

Further, in interpreting Article 4(b) and the "*center of vital interest test*", the Court held that Mr. Aroeste was a resident of Mexico whose center of vital interest was Mexico. He lived with his wife in Mexico and spent most of his time there, and key aspects of his life such as voting and health services were conducted in Mexico. As such, he was not required to file the FBAR for the Relevant Period.

## Potential Impact of Aroeste v. United States

This case has set a precedent for the treatment of the tiebreaker rules in the US tax treaties with foreign nations. Given that the US has more than 60 tax treaties, and many of which contain tiebreaker rules like the ones provided in Article 4 of the Treaty, this precedent has potential expansive effects.

[1] https://casetext.com/case/aroeste-v-united-states-2
[2] https://www.fincen.gov/who-united-states-person
[3] https://www.irs.gov/pub/irs-trty/mexico.pdf

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