UPDATES & OTHER TIDBITS

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TAXPAYER F.B.A.R. VICTORIES

The Bank Secrecy Act ("B.S.A.") requires U. S. persons with certain financial interests in foreign accounts to file an annual report known as an "F.B.A.R.," which is embodied in FinCEN Form 114 (Report of Foreign Bank and Financial Accounts). Two February decisions provided welcomed news to F.B.A.R. non-filers.

Penalties Assessed Per Report

In a 5-4 split decision, the U.S. Supreme Court held in *Bittner v. U.S.*[1] that non-willful F.B.A.R. violations apply on a per-report basis, not a per-account basis, significantly reducing potential penalties.

The petitioner was a dual citizen of Romania and the U.S. He returned to Romania in the 1990's where he launched a successful business career. Like many dual citizens, he was unaware that the U.S. required its citizens to report their overseas financial accounts even while living abroad. After returning to the U.S. in 2011, he learned of his reporting obligations and prepared the required F.B.A.R. forms. Upon review, the government asserted the reports neglected to address more than 25 of his accounts.

Section 5314 of the B.S.A. requires individuals to file reports related to foreign accounts. Section 5312 authorizes the Secretary of the Treasury to impose a penalty of up to $10,000 for violations of §5314. The government assessed a $2.72 million penalty for nonwillfully failing 272 time to report accounts over a five-year period (on average, 54.4 accounts x $10,000 each x 5 years = $2.72 million). The petitioner challenged the government's assessment arguing the penalty should apply per report, not per account.

Initially, the U.S. Federal District Court ruled for the petitioner,[2] but the Fifth Circuit Court of Appeals reversed[3] and upheld the government's assessment creating a split among the U.S. Federal Circuit Courts of Appeal.[4] The Supreme Court granted certiorari in order to resolve the conflict, and held in favor of the petitioner.

The Court observed that the nonwillful penalties under 31 U. S. C. § §5321 do not speak in terms of accounts. The government insisted that since Congress explicitly authorized per-account penalties for some willful violations, the Court should infer that Congress meant to do so for analogous nonwillful violations. The Court rejected

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1 143 S. Ct. 713 (2023).

2 469 F. Supp. 3d 709, 724–726 (ED Tex. 2020).

3 19 F. 4th 734, (5th Cir. 2021).

4 U.S. v. Boyd,. , 991 F. 3d 1077 (CA9 2021).

the argument and stated that if Congress intended to subject nonwillful violations to penalties on a per-account basis, it should have explicitly done so like it had with similar provisions. The Court further observed that previously issued guidance repeatedly seemed to inform the public that the failure to file a report represents a single violation exposing a nonwillful violator to one $10,000 penalty. In particular, the Court stated in n.5:

> Our point is not that the administrative guidance is controlling. Nor is it that the government's guidance documents have consistently endorsed Mr. Bittner's reading of the law. It is simply that, when the government (or any litigant) speaks out of both sides of its mouth, no one should be surprised if its latest utterance isn't the most convincing one. This is no new principle in the law any more than it is in life. In Skidmore, this Court noted that the persuasiveness of an agency's interpretation of the law may be undermined by its inconsistency "with earlier [agency] pronouncements." 323 U. S., at 140.

Accordingly, the Court concluded that the B.S.A. applies a per- penalty for nonwillful F.B.A.R. violations report, not a per-account penalty.

Tax Treaty Offers "Escape Hatch"

A recent decision in the U.S. District Court for the Southern District of California rejected a longstanding I.R.S. position that green card holders who are tax resident in the U.S. and a tax treaty partner jurisdiction are U.S. persons for F.B.A.R. purposes regardless of the treaty. In *Aroeste v. U.S.*,[5] the court held that dual residence tiebreaker rules within U.S. income tax treaties apply to F.B.A.R. filing requirements.

The plaintiff was a green card holder in the U.S., but his permanent home and tax residence was in Mexico. Consequently, the plaintiff asserted he was a resident of Mexico under the Mexico-U.S. Income Tax Treaty (the "Treaty") and was therefore not considered a U.S. person required to file an F.B.A.R. The I.R.S. argued that the plaintiff's status under the Treaty was irrelevant for F.B.A.R. purposes because tax treaties only address income and excise taxes.

The court ultimately held that tax residency under the Treaty is relevant and provided a five-step process under which tax treaties could offer an "escape hatch" for dual-resident taxpayers excluding them from F.B.A.R. filing requirements:

- Under 26 U.S.C. §7701(b)(6), anyone allowed to permanently reside within the U.S. by virtue of U.S. immigration laws is a "lawful permanent resident" for tax purposes unless an applicable tax treaty allows that person to be treated as a resident of a foreign country for tax purposes, only.
- Under 26 U.S.C. §7701(b)(1)(A)(i), any "lawful permanent resident" is a "resident alien."
- Under 31 C.F.R. §1010.350(b)(2), any "resident alien" is a "resident of the United States."

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[5] Case No. 22-cv-682-AJB-KSC (S.D. Cal. 2023), reported unofficially at 131 AFTR 2d 2023-623.

- Under 31 C.F.R. §1010.350(b), Any "resident of the United States" is a "United States person" required to file an F.B.A.R.
- Therefore, any person allowed to permanently reside in the U.S. by virtue of U.S. immigration laws must file an F.B.A.R. unless that person is entitled to be treated as a resident of a foreign country under a tax treaty.

Having recited the above, the Court held that the Treaty overrode the regulatory definition of the term "resident of the U.S."

> The question is whether the Treaty provides [Mr. Aroeste] an escape hatch. Because the United States and Mexico indisputably have a tax treaty, Mr. Aroeste would not be a lawful permanent resident within the meaning of 26 U.S.C. section 7701(b)(6) if he commenced to be treated as a resident of Mexico under the Treaty (with the additional caveats enumerated in the statute); which might in turn have ultimately excused him from the requirement to file FBARs as a "United States person." The Court therefore concludes a determination of Mr. Aroeste's tax residency under the Treaty is directly relevant to—indeed it is outcome determinative of—the issue of whether he was required to file the FBARs at issue in this lawsuit.

Green card holders in similar positions should take note. The decision is appealable to the 9th Circuit Court of Appeals and is sure to bring about further developments.

U.S. CONCEDES ON GIFT TAX ISSUE

In 2022, a U.S. resident, who received an $830,000 gift from his Polish mother after she won the Polish lottery, filed suit against the U.S. challenging foreign gift tax penalties for failure to report the monetary gifts on Form 3520.[6] He argued the penalties should be abated since he relied on advice from his accountant that he did not have to report the gifts, and therefore had reasonable cause for his failure to file. On March 7, 2023, the Department of Justice filed a "status report in lieu of answer" conceding the issues and noted the I.R.S. will refund the penalties.

U.S. individuals are required to report gifts from foreign persons that exceed $100,000 in a given year. Failure to do so results in a 5% penalty of the amount of the gift for each delinquent month, with a maximum penalty of 25%.[7] The penalty shall not apply if the individual shows that the failure to report is due to reasonable cause and not due to willful neglect.[8]

Courts have held that reasonable reliance on a tax professional can meet the reasonable cause requirement.[9] The I.R.S.'s concession in this case reaffirms this position and will hopefully facilitate additional relief to taxpayer's who have reasonable cause for failing to report foreign gifts.

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6 *Wrzesinski v. United States*; No. 2:22-cv-03568.

7 Code §6039F(c)(1)(B).

8 Code §6039F(c)(2).

9 *United States v. Boyle*, 469 U.S. 241 (1985); *Neonatology Associates PA v. Commr.*, 115 T.C. 43 (2000), aff'd 299 F.3d 221 (3d Cir. 2002).

BE-12 REPORT: DUE MAY 31 (MAIL OR FAX) OR JUNE 30 (EFILE)

The BE-12 Benchmark Survey of Foreign Direct Investment in the U.S., conducted every five years by the Department of Commerce's Bureau of Economic Analysis, is due on May 31 for those filing by mail or fax, or June 30 for those filing electronically.

Extensions can be easily obtained through the B.E.A. secure e-file system at www.bea.gov/efile.

Background

The Benchmark Survey of Foreign Direct Investment in the U.S. is part of routine efforts by the U.S. government to secure current economic data on the operations of U.S. affiliates of foreign enterprises. This includes, in particular, foreign investment in U.S. real estate for non-personal use.

Key Q&A's

1. *Who must file a BE-12 report?*

   The BE-12 report is required for each U.S. business enterprise (including real estate held for nonpersonal use) if a foreign person or entity owned or controlled, directly or indirectly, 10% or more of the voting interest in the business enterprise at the end of the business enterprise's fiscal year that ended in 2022.

2. *What is a business enterprise?*

   A business enterprise includes any commercial activity, including any ownership in real estate. However, an enterprise that holds residential real estate exclusively for personal use and not to make profits is excepted from reporting requirements. Personal-use property includes a primary residence in the U.S. that the owner leases while he or she is outside the U.S. but intends to reoccupy. All other situations where real estate is rented out, including all situations where the real estate is not a primary residence, do not qualify as personal use and are therefore subject to the filing requirement.

3. *Who is a foreign person?*

   Foreign person means any individual or entity that is resident outside the U.S. or subject to the jurisdiction of a country other than the U.S. An individual is a foreign resident if he or she resides, or expects to reside, outside of the U.S. for one year or more.

   However, there is an exception for individuals who reside outside their country of citizenship for one year or more if

   - the individual owns or is employed by a business enterprise;
   - the individual is a citizen of the country where the enterprise is located;

- the individual is residing in another country for the purpose of furthering the enterprise's business; and
- the individual intends to return to his or her country of citizenship within a reasonable period of time.

Such individuals will be considered residents of their country of citizenship.

4. *Are there exceptions to filing?*

A U.S. business enterprise described in (1) is not required to complete a survey if

- it is a private fund;
- it does not own, directly or indirectly, an operating company (a business enterprise that is not a private fund or holding company) in which its foreign parent owns at least 10%; and
- if the foreign parent owns the business enterprise indirectly through another U.S. business enterprise, there are no U.S. operating companies between the foreign parent and the business enterprise in question.

If the B.E.A. has contacted an enterprise about filing, but the enterprise is not required to complete the survey for any reason, it must complete a form informing the B.E.A. of the exemption. No action is required for enterprises that are not required to file and have not been contacted by the B.E.A.

Additionally, the 10% ownership threshold discussed in Q&A 1 is met only if the foreign owner holds at least 10% of the voting power in the U.S. business. Thus, for example, a limited partnership with a U.S. general partner and foreign limited partner will typically not be required to file a BE-12 report, because limited partners do not have a say in running the partnership and are generally considered to hold 0% of the voting interests.

5. *By when must the report be filed?*

As mentioned above, the 2022 BE-12 report is due on May 31, 2023, if filing by mail or fax, or June 30, 2023, if filing electronically.

6. *Are extensions available?*

Yes, provided that the extension is requested no later than May 31. The extension is approved automatically at www.bea.gov/efile.

7. *What is the information used for?*

Survey data may be used by the U.S. government only for statistical and analytical purposes.

8. *Is the information kept confidential?*

Yes. This report is authorized under the International Investment and Trade in Services Survey Act of 1977 (Pub. L. No. 94-472). Confidentiality is protected by law. The B.E.A. is prohibited from granting another agency access to the data for tax, investigative, or regulatory purposes.

9. *Is there a penalty for failure to file?*

   Technically yes, but it is rarely imposed.

10. *Can Ruchelman P.L.L.C. assist a reporting person in completing the forms?*

    Yes. Our team of Galia Antebi (antebi@ruchelaw.com) and Wooyoung Lee (lee@ruchelaw.com) can assist in identifying the required information and filling out required forms. Contact them by e-mail or by telephoning the firm at +1 212 755 3333.