Taxes and FBARs for Joint Bank Accounts

By Robert W. Wood


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Joint bank accounts between spouses filing joint tax returns raise few tax issues. But tax and reporting issues abound with foreign accounts maintained by non-spouses. In this article, Wood suggests how to address this tricky topic in practice.

Joint bank accounts are most classically opened by married couples. If they file joint tax returns, as 95 percent of married couples do, the question of who pays tax on the interest may not be an issue. But joint bank accounts can crop up in many other situations as well, such as with parent and child accounts, sibling accounts, and vacation home sharing accounts between unrelated persons.

These joint accounts allow equal access to funds but often have unclear ownership. People from all walks of life use them in many ways, including as will substitutes and as de facto powers of attorney. They can be arranged so that the money is beneficially owned 100 percent by one holder, equally by all holders, or in some other ratio.

At tax time, one approach to determine beneficial ownership is to ask the bank, which will doubtless send a Form 1099. If a Social Security number is on the account, a Form 1099 for 100 percent of the interest may answer the question. However, some taxpayers try to split the interest, reporting 100 percent and showing a deduction for the interest paid to the co-holder of the account.

Much of the current worry in this area concerns foreign accounts. For those, there will be no Form 1099 to alert holders about the income and its reporting. Taxpayers must consider beneficial ownership of the corpus and the interest, and must also consider foreign bank account reports. The potential penalties are enormous.

FBARs

Before turning to the income tax issues, consider FBARs. It may seem that the FBAR rules are irrelevant to this discussion. After all, every joint bank account over the aggregate $10,000 threshold carries an FBAR filing requirement. But there is still the question of the appropriate filing category.

If you have a mere signature interest, you file under one category on the FBAR. If you are an owner, you file under another. So which are you? One might assume that any joint account imports beneficial ownership. The safe assumption is probably that it does.

But as we will see, for income tax purposes at least, joint accounts are inherently unclear regarding ownership. One can presume equal access to the funds, but that is not the same as beneficial ownership. Thus, before one can fully answer the FBAR question, one should consider ownership for tax purposes.

Deference to Local Law

Federal income tax liability is generally allocated based on the shares to which each co-owner is entitled under local law.[1] The issues are intensely factual and may turn on the control over, and benefits derived from, the account. But ownership under local law and beneficial ownership under federal income tax rules are not always the same.

The IRS may seek to impose income tax liability on the beneficial owner of an account regardless of that person's rights to the account assets under the prevailing local law. This can trigger unexpected legal presumptions. For example, in Rev. Rul. 76-97,[2] the IRS ruled that a resident alien must include in income one-half of the interest from a savings

[1]*See Lipsitz v. Commissioner*, 220 F.2d 871, 873 (4th Cir. 1955).
[2]1976-1 C.B. 15.

account held jointly with a nonresident alien. In the ruling, state law provided that joint tenants share profits equally.

Ownership is determined under the law of the jurisdiction in which the income was earned.[3] Thus, federal income tax liability is *presumptively* allocated under the law of the prevailing foreign jurisdiction.

Judicial Exceptions

The IRS and the courts often look beyond local law to impose income tax on the party with beneficial ownership of the income-producing asset.[4] The courts may expressly reject local law ownership in favor of beneficial ownership.[5] The beneficial ownership analysis is applied to domestic as well as foreign bank accounts.[6]

For example, if someone "holds legal title to property as an agent, then for tax purposes the principal and not the [agent] is the owner."[7] Income should be taxed to the principal, even though the name of the agent may appear as a joint signatory.

The agent's name often appears on the account solely for the convenience of the principal. A nominal owner is not the owner for federal income tax purposes.[8] In *Bollinger*, the Supreme Court enunciated a three-part safe harbor to determine agency:

> a. a written agency agreement must be entered into with the agent contemporaneously with the acquisition of the asset;
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> b. the agent must function exclusively as an agent regarding the asset at all times; and
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> c. the agent must be held out as merely an agent in all dealings with third parties regarding the asset.[9]

Notably, the Tax Court has said that the *Bollinger* factors are nonexclusive.[10] The Tax Court has held that an *oral* agency agreement can suffice,[11] although it is preferable to commit these understandings to writing. Assuming a true agency, agents should not face taxes on income over which they have no control or beneficial right.

Beneficial Owners Taxed

The Tax Court has defined beneficial ownership as the "freedom to dispose of the accounts' funds at will."[12] Courts may weigh factors including: (1) which party enjoys the economic benefit of the property; (2) which party has possession and control; and (3) the intent of the parties.[13]

For example, in *CHEM Inc.*,[14] the taxpayer opened four bank accounts in the names of his four children. He deposited money into the accounts but later withdrew it to facilitate his business ventures. He continued to claim that his children owned the four accounts, so he did not report any of the income they generated.

The IRS proposed a deficiency, but the taxpayer argued that the accounts were solely for the benefit of his children. He claimed the withdrawals were mere loans and would be repaid. Nonetheless, the Tax Court determined that the father was the beneficial owner. That made him liable for the income tax deficiency. The court reasoned that[15]:

> Our finding here is based on the identity of the true owner of the income-producing property. In such an inquiry, we look not to mere legal title, but to beneficial ownership. It is command over the property or the enjoyment of its economic benefits that marks the real owner. When transactions are between family members, special scrutiny of the arrangement is necessary, lest what is in reality but one economic unit be multiplied into two or more.
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> While we do not doubt the sincerity of [the taxpayer's] long-term intentions, we nevertheless have found that [the taxpayer] owned the accounts in question during the years in issue. The circumstance that [the taxpayer] may have viewed the funds as the eventual property of his children does not change the nature of the

[3]*See id.*; *see also Santiago v. Commissioner*, 61 T.C. 53, 58 (1974) (applying Spanish law to determine ownership of income earned in Spain).

[4]*See Chu v. Commissioner*, T.C. Memo. 1996-549 (taxpayer subject to income tax as beneficial owner of bank account, despite lack of local law ownership).

[5]*See Chu*, T.C. Memo. 1996-549 ("It is the ability to command the property, or enjoy its economic benefits, that marks a true owner."); *Salty Brine I Ltd. v. United States*, 761 F.3d 484, 492 (5th Cir. 2014) ("Even assuming their validity under State law, contractual arrangements designed to circumvent this rule, by attempting to deflect income away from the one who earns it, will not be recognized for Federal income tax purposes. Determining who earns the income depends upon which person or entity in fact controls the earning of the income, not who ultimately receives the income.") (citing *Benningfield v. Commissioner*, 81 T.C. 408, 418-419 (1983)).

[6]*See, e.g., Big Hong Ng*, T.C. Memo. 1997-248.

[7]*Montgomery v. Commissioner*, T.C. Memo. 1989-295 (citing *Commissioner v. Bollinger*, 485 U.S. 340 (1988)).

[8]*See Bollinger*, 485 U.S. at 349 ("it is uncontested that the law attributes tax consequences of property held by a genuine agent to the principal").

[9]*Id.* at 349.

[10]*See Advance Homes Inc. v. Commissioner*, T.C. Memo. 1990-302.

[11]*Id.* ("We conclude that *Bollinger* does not require the existence of a written agency agreement.").

[12]*Chu*, T.C. Memo. 1996-549.

[13]*See id.; see also CHEM Inc. v. Commissioner*, T.C. Memo. 1993-520 (imposing income tax on the beneficial owner of accounts).

[14]*See CHEM Inc.*, T.C. Memo. 1993-520.

[15]*Id.* (internal citations omitted).

dominion and control he exercised over those funds during the years in issue. [The taxpayer's] access to, and use of, the money in the children's bank accounts to facilitate his own business ventures establish him as the constructive owner of those funds. As such, we hold that he is subject to tax on any income earned on the children's accounts.

Community Property Income

There are special statutory rules for married couples who earn ''community income,'' whether under the laws of a state or a foreign country, when one or both spouses are nonresident aliens.[16] Section 879(a) provides that:

a. earned income is allocated to the spouse who rendered the personal services;

b. trade or business income and a partner's distributive share of partnership income is allocated to the person participating in the business;

c. community income derived from the separate property of one spouse is allocated to that spouse only; and

d. all other community income is treated as provided under the local community property laws.[17]

Examples

Example 1: Tom is a U.S. taxpayer with a foreign joint bank account with his brother Bill, who is foreign. Tom deposited all of the account assets and intended them as gifts to Bill. Bill controls them and withdraws funds for his own benefit. Tom does not exercise control over the funds, nor does he withdraw or benefit from the account.

Q1: Can federal income tax be imposed on Tom in connection with the interest earned in this foreign account?

A1: Yes. As a joint owner, Tom may be taxed according to his ownership interest under local law.[18] Fortunately, however, the IRS and the courts may look beyond local law to impose income tax on the party with beneficial ownership of the income-producing asset.[19] Tom may be able to avoid income tax liability if the IRS and the courts are satisfied that he lacks beneficial ownership of the funds.

The IRS and the courts may consider: (1) which party enjoys the economic benefit of the property; (2) which party has possession and control; and (3) the intent of the parties.[20] Tom deposited the funds to benefit his brother Bill and never operated the account or withdrew money. Tom may fall within the *Bollinger* safe harbor.[21]

An agreement that Bill had complete authority over the account could help Tom meet the *Bollinger* requirements. If Tom ever withdraws funds, perhaps he can prove he withdrew and used them as Bill's agent and under Bill's instructions.

Example 2: Same as Example 1, except that Tom and Bill have agreed to share control over the foreign account and benefit equally. Under the law of the prevailing foreign jurisdiction, Tom owns all of the account assets.

Q2: Can federal income tax be imposed on Tom in connection with the interest earned in this foreign account?

A2: Yes. Because Tom owns *all* of the account assets under local law, he is presumptively liable for *all* income. However, federal income tax liability may be adjusted to conform to Tom's beneficial ownership of the funds. The IRS and the courts generally determine beneficial ownership by evaluating intent, control over the account, and benefits derived from the funds.

Tom and Bill agreed to equally share control and benefits from the account. If the terms of this agreement are followed, Bill arguably has beneficial ownership of one-half of the account assets and one-half of the tax liability.[22] That means Tom may be liable for only one-half of the federal income tax on the foreign account. The IRS might seek to

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[16]Section 879(a). Under specific circumstances, it is possible for a United States citizen or resident spouse and a nonresident alien spouse to elect joint filing with the IRS. *See* section 6013(g). This marital election effectively subjects *both* spouses to federal income tax liability on worldwide income. *See id.* If the election is made, section 879(a) is not applicable. *See* section 879(b).

[17]Section 879(a)(1)-(a)(4).

[18]*See Crawford v. United States*, 4 Cl. Ct. 699, 702 (1984); *see also* 2014 IRS Publication 17 (Feb 6, 2015), at 57 (''If two or more persons hold property (such as a savings account or bond) as joint tenants, tenants by the entirety, or tenants in common, each person's share of any interest from the property is determined by local law.'').

(Footnote continued in next column.)

[19]*See Chu*, T.C. Memo. 1996-549 (''The true owner of income-producing property, such as the [bank account], is the one with beneficial ownership, rather than mere legal title.'').

[20]*See generally CHEM Inc.*, T.C. Memo. 1993-520; *see also Big Hong Ng*, T.C. Memo. 1997-248.

[21]*See Bollinger*, 485 U.S. at 349-350; *see also Advance Homes Inc. v. Commissioner*, T.C. Memo. 1990-302.

[22]*See Lipsitz*, 220 F.2d at 873-874 (rejecting claim that local law should dictate taxable ownership and allocating income tax liability based on ''clear agreement'' and conduct of parties).

impose income tax on Tom based on actual conduct, rather than on the brothers' initial intent to equally share the funds.[23]

> **Example 3:** Tom is a U.S. citizen and his wife Wilma is a nonresident alien. Wilma has no obligation to file U.S. tax returns, and Tom files his U.S. tax returns separately. They live in a foreign country with community property laws and hold a joint bank account in that country. Tom and Wilma agreed to share control over the account and benefit equally.
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> **Q3:** Can federal income tax be imposed on Tom in connection with the interest earned in this foreign account?
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> **A3:** Yes. Although Wilma is not a U.S. taxpayer, Tom is still required to report his worldwide income.[24] There is a statutory rule for married couples who earn community income, whether under the laws of a state or foreign country, when one or both spouses are nonresident aliens.[25]

Section 879 may apply to Tom because Tom is married to a nonresident alien in a community property jurisdiction where the foreign joint account is located. Tom's federal income tax liability may depend on many factors, including whether the account assets are considered separate or community property under the community property laws of the foreign jurisdiction.

> **Example 4:** Same as Example 3, except that Tom and Wilma have divorced. They have decided to continue the foreign account as joint holders.
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> **Q4:** Can federal income tax be imposed on Tom in connection with the interest earned in this foreign account?
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> **A4:** Yes. Tom and Wilma divorced but retained the joint account. Because section 879(a) does not appear to apply to unmarried individuals, local law ownership and beneficial ownership should control. Thus, Tom's federal income tax liability would presumptively be allocated in proportion to his ownership of the account assets under the local law of the prevailing foreign jurisdiction.[26]

However, Tom and Wilma agreed to share control over and benefits from the account. Wilma is arguably the beneficial owner of one-half of the account assets and resulting tax liability, regardless of her or Tom's local law ownership. Assuming that Wilma is the beneficial owner of one-half of the account, Tom might be taxed on only one-half.

Tom could support his position with bank statements, agreements with Wilma, declarations, income tax filings, gift tax returns, FBAR forms (if any), and any other documents demonstrating shared control and benefits.

> **Example 5:** Tom is a U.S. taxpayer and is the sole signatory on a foreign bank account. Tom's parents, who are not U.S. taxpayers, deposited all of the funds for the support of Tom's daughter Daisy. Tom withdraws and uses the funds only according to his parents' instructions.
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> **Q5:** Can federal income tax be imposed on Tom in connection with the interest earned in this foreign account?
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> **A5:** Yes. Tom's federal income tax liability may presumptively be allocated in proportion to his local law ownership.[27] Because Tom is the only account holder, the IRS may seek to tax Tom on all income. However, Tom may be able to avoid income tax liability under the beneficial ownership analysis.

Tom may meet the *Bollinger* safe harbor. The funds were deposited by Tom's parents, Tom never operated the account without explicit instructions, and it was understood that the funds were solely for Daisy's benefit. These facts may even suggest that Tom's parents, rather than Tom, remain the beneficial owners.[28]

Assuming that Tom lacks all indicia of beneficial ownership, he arguably should not be taxed on the foreign account even if Tom's parents are not subject to U.S. tax. It would help if there were proof of an agreement that Tom lacked any authority over his parents' deposits and complied with their instructions. Written agreements, declarations, estate planning documents, and purchase receipts may help, as may income tax returns and FBARs filed by Tom's parents.

> **Example 6:** Same as Example 5, except that Tom did not use the funds to benefit his daughter Daisy. Instead, Tom invested the account assets in a business venture. Although this was against his parents' wishes, Tom plans on repaying the money.

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[23]*See CHEM Inc.*, T.C. Memo. 1993-520 (in determining owner of account for federal income tax purposes, taxpayer's conduct dispositive).

[24]*See Francisco v. Commissioner*, 119 T.C. 317, 319 (2002).

[25]*See* section 879(a).

[26]*See Crawford*, 4 Cl. Ct. at 702.

[27]*See id.*

[28]*See Hughes v. Commissioner*, T.C. Memo. 1994-139 (rejecting claim that taxpayer's brother owned account for income tax purposes when taxpayer exercised sole dominion and control).

Q6: Can federal income tax be imposed on Tom in connection with the interest earned in this foreign account?

A6: Yes. Tom appears to have local law ownership of the foreign account. Therefore, it is possible that Tom will be liable for all income generated by the account assets.[29] It will be difficult for Tom to avoid this income tax liability through the beneficial ownership analysis.

The *Bollinger* agency safe harbor requires that the agent function *exclusively* as an agent regarding the asset at *all* times.[30] Here, Tom has used account assets for his own benefit, something not authorized by his parents. The fact that Tom acted outside the scope of his parents' explicit instructions weakens the likelihood of meeting the agency safe harbor.

Moreover, beneficial ownership often turns on control over and benefits derived from an asset.[31] Tom withdrew funds and used them. At least one court has concluded that the intent to repay withdrawn funds is of little or no consequence in determining beneficial ownership.[32]

Tom may have acted outside the scope of his agency by disregarding his parents' instructions. He withdrew account funds at his own discretion and used them for his business venture. This freedom over the funds may suggest beneficial ownership and thus tax liability.[33]

Example 7: Same as Example 5, except that Tom's parents both died last year. Before passing, they expressed their hope that Tom continue to use the account for his daughter Daisy's benefit. Although not legally obligated, Tom withdraws the funds solely for the benefit of Daisy.

Q7: Can federal income tax be imposed on Tom in connection with the interest earned in this foreign account?

A7: Yes. Because Tom's parents did not legally bequeath the funds to Daisy, Tom is probably the owner of the funds under prevailing local law. His local law ownership may result in federal income tax liability on all income earned in the account.[34] Turning to beneficial ownership and agency, it is possible Tom was acting under the *Bollinger* safe harbor as a nontaxable agent while his parents were living.

However, an agency relationship generally terminates on the death of the principal, in this case Tom's parents.[35] Therefore, for federal income tax purposes, Tom's agency role may have terminated upon his parents' death. Some courts have concluded that dominion and control over funds implicitly includes the power to select a beneficiary and that this power is dispositive in determining beneficial ownership.[36]

Therefore, it is possible that the IRS and the courts could view Tom's unilateral authority over the account as indicative of beneficial ownership. Tom's agency relationship probably terminated upon his parents' death. His beneficial ownership is arguably demonstrated by his unilateral authority, discretionary withdrawals, and choice of beneficiary. It may be difficult for Tom to overcome the presumptive income tax liability on all income earned in the account.

Example 8: Tom is a U.S. taxpayer and is the sole signatory on a foreign account. Tom controls the account, and he alone benefits. Recently, however, Tom's brother Bill, who is not a U.S. taxpayer, deposited money into Tom's foreign account. Bill made it clear that Tom must return the deposited funds or use them only at Bill's request and under Bill's instructions. Tom agreed and later transferred the funds out of his foreign account to a third party at Bill's request.

Q8: Can federal income tax be imposed on Tom in connection with the interest earned on the funds that Bill deposited?

A8: Yes. Because Tom was the only account holder, it seems likely that he will be liable for all income generated by the account assets, including the money Bill deposited.[37] However, Tom arguably should not be taxed on the temporary funds deposited by his brother because he may have lacked beneficial ownership of those funds.

Tom and Bill agreed that Bill would retain complete authority and control over the funds, despite

[29]*See Crawford*, 4 Cl. Ct. at 702.
[30]*Bollinger*, 485 U.S. at 349-50.
[31]*See CHEM Inc.*, T.C. Memo. 1993-520.
[32]*See id.*
[33]*See Chu*, T.C. Memo. 1996-549 (defining beneficial ownership as the "freedom to dispose of the accounts' funds at will").
[34]*See Crawford*, 4 Cl. Ct. at 702.
[35]*See Estate of Cummins v. Commissioner*, T.C. Memo. 1993-518; *Malone & Hyde Inc. v. Commissioner*, T.C. Memo. 1992-661.
[36]*See Bailey v. Commissioner*, 52 T.C. 115, 118-119 (1969) (taxpayer who controlled funds was deemed beneficial owner despite use of funds for benefit of another); *see also CHEM Inc.*, T.C. Memo. 1993-520.
[37]*See Crawford*, 4 Cl. Ct. at 702.

Tom's apparent local law ownership. This agreement appears to have been followed. Tom did not benefit from the funds and transferred the money at the time and in the manner that Bill requested.

Based on these facts, Tom may meet the *Bollinger* safe harbor for the funds Bill deposited. On these transitory deposits, Tom had no beneficial right and no control. Nevertheless, the funds were comingled and solely in his name, so it may be difficult for him to prevail.

Tom might assemble relevant documentation, including a written agreement with Bill, declarations, and bank statements. It would be helpful if Bill continued to pay income tax on the deposited funds and filed FBARs reflecting his financial interest.

Conclusion

Joint and other combined ownership of bank accounts is confusing, with both local law and beneficial ownership in play. With foreign accounts, multiple legal regimes may be relevant. Such accounts are often established by people who know each other well, are related, or have a high degree of mutual trust.

It is only natural that there may be uncertainty regarding who really owns what. When significant penalties and even criminal liability may be at stake, these issues can take on enormous significance. Be mindful of your facts and be wary of inconsistent positions. And because proving something after the fact can be difficult, consider keeping good and timely documentation.