John Hancock Loses $560 Million Tax Lawsuit

by Joseph M. Donegan on August 23, 2013

The U.S. Tax Court recently ruled against the John Hancock Life Insurance Co. in a tax lawsuit involving hundreds of millions in deductions, Bloomberg News reports.

The court opposed John Hancock's argument that tax deductions on a series of leveraged lease transactions - including depreciation, rental and interest expense, and transaction costs - amounting to $560 million were valid. The issue involves the insurance company's use of lease-in-lease-out and sale-in-lease-out transactions - notably referred to as LILO and SILO. These transactions occur when companies purchase sizable assets, which are then leased to third parties for use. Most companies then adopted the practice of claiming deductions on the assets, Bloomberg notes.

Since 2008, however, the IRS has determined that these types of transactions are vehicles for improper tax avoidance. The agency claims that firms cannot legally claim deductions under federal law because they never actually owned the assets. After giving companies a chance to terminate LILOs and SILOs in exchange for 20 percent of the savings, the IRS has won a series of cases relating to these vehicles.

In John Hancock's tax case, the IRS argued that the transactions "lacked economic substance and the substance of the transactions is not consistent with their form." U.S. Judge Harry Haines agreed with the federal agency on the latter half of the argument, according to his court opinion.

"John Hancock did not acquire the benefits and burdens of ownership" wrote Judge Harry Haines.

However, he did not directly address the economic substance argument, which may give the company some room to appeal the decision. In an emailed statement, John Hancock alluded to the possibility of appealing the ruling.

"We continue to believe our position on the tax treatment of our lease investments was appropriate and factually distinguishable from other recent cases addressing the tax treatment of leverage lease investments," wrote Roy Anderson, a spokesman for Bloomberg.