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IRS Contends with Wells Fargo in Tax Deductions

The IRS is in a legal battle with Wells Fargo & Co over alleged illegal tax dodges. These alleged tax dodges involve transactions where a tax-free organization transfers to a taxable one (like Wells Fargo) tax benefits for a fee. The technical term for such transactions is 'Sale In Lease Out' (SILO) transactions. According to the IRS, Wells Fargo has claimed losses amounting to nine-digit figures through such transactions.

The Tax Division of the Justice Department has submitted 319 pages of documents in its filing earlier this week over the alleged abusive tax avoidance transactions practiced by the bank. These allegations by the IRS are not recent events. Instead, the IRS and Wells Fargo have been in dispute over various issues for years now. In the most recent case in September, the bank objected to the IRS' attempts at obtaining papers from independent auditors KPMG that detail Wells Fargo's exposure to questionable tax deductions between 2007 and 2008. The bank has declined to comment on this matter.

According to industry experts, SILO transactions usually have to do with depreciable assets like buses, trains or telecommunications equipment that are transferred to the purchaser-lessor in order for them to obtain tax deductions from an otherwise tax-free entity.

According to the IRS, from 1997 to 2006, Wells Fargo claimed losses of $613 million relating to SILO transactions and the bank intends to claim $169 million more for at least 129 SILO transactions in 2007 and 2008.

In another case, Wells Fargo lost a SILO case in January in the court of Federal Claims in Washington D.C. involving a refund of $115 million it was claiming from its 2002 SILO transactions. The bank is appealing the case. It maintains that it was the legal owner of the assets in the SILO transactions for tax purposes and therefore was entitled to deduct its depreciation cost in its books.

In addition, the IRS claims that Wells uses means other than SILO transactions to dodge taxes. Upon a close examination of the bank's tax claims in 2007 and 2008, it was discovered that Wells had suspiciously reincorporated a corporation in the Cayman Islands. The IRS found that a wholly-owned US subsidiary of the Cayman Islands corporation is used to claim 80% exclusion from dividends received in the US. If the claim is approved, this would essentially create a permanent income tax benefit in which Wells Fargo would claim about $340 million from this transaction for the tax years 2008 and 2009.

To get to the bottom of this, the IRS is seeking the release of tax accrual workpapers from KPMG and has issued a summons for them. The bank has submitted a motion to suppress the summons which is due to be heard in court January 10.