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Wells Fargo Found Liable In Abusive Tax Shelter Scheme

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After its fake account scandal, the hits keep coming for Wells Fargo. Now, Wells Fargo has been found liable in [federal court](#) for a 20% IRS negligence penalty in connection with an abusive tax shelter. Wells had claimed \$350 million of foreign tax credits based on a tax shelter known as Structured Trust Advantaged Repackaged Securities or STARS. Last year, a [Minnesota jury verdict](#) nixed the tax credits Wells had claimed, concluding that the transaction lacked both economic substance and a non-tax business purpose. This trial was the second, this time determining if the smoke and mirrors

STARS transaction had economic substance.

Wells Fargo contended that STARS was a single, integrated transaction that resulted in low-cost funding. The jury didn't buy it, finding that in reality, STARS was really two economically distinct and independent transactions: a loan and a trust. Regarding the loan, the jury found that Wells Fargo entered into the loan solely for tax-related reasons. Regarding the trust, the jury found that it had no reasonable potential for pretax profit. Besides, the jury found that Wells Fargo entered into the trust structure *solely* for tax reasons.

Complexity is a feature of almost every shelter. How complex was STARS? In the transaction, Wells Fargo would voluntarily subject some of its income-producing assets to U.K. taxation by placing them in a trust with a U.K. trustee. It would then offset those U.K. taxes by claiming foreign-tax credits on its U.S. returns. In turn, Barclays would get significant U.K. tax benefits as a result of Wells Fargo's actions. Barclays would

compensate Wells Fargo for engaging in STARS by making a monthly payment. Wells Fargo claimed foreign-tax credits for the U.K. taxes that it paid in connection with STARS, but the IRS disallowed the credits on the ground that STARS was a sham and violated the economic substance requirements.

Barclays Bank PLC marketed the STARS transaction to American banks. The shelter was designed to exploit differences between the tax laws in the United States and in the United Kingdom. But STARS has not done well in litigation. Three other courts have rejected STARS tax shelters that Bank of New York, [BB&T Bank](#) and Santander Bank purchased. See [Santander Holdings USA, Inc. v. United States](#), 844 F.3d 15 (1st Cir. 2016), *pet. for cert. filed*, March 20, 2017 (No. 16-1130); [Bank of N.Y. Mellon Corp. v. Comm’r](#), 801 F.3d 104 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 1377 (2016); [Salem Fin., Inc. v. United States](#), 786 F.3d 932 (Fed. Cir. 2015), *cert. denied*, 136 S. Ct. 1366 (2016).

STARS started with foreign tax credits, something that is fundamental to U.S. tax law and seems downright fair. U.S. companies can claim foreign tax credits on their U.S. taxes. That way they are not taxed twice on the same profits. But like just about everything else in U.S. tax law, the law is complex and sometimes even Byzantine. The creative minds who cooked up STARS wanted to *manufacture* tax credits for Barclays, and for the U.S. corporate taxpayers that bought into the deal. The idea was to circulate the U.S. income through an entity taxed in the U.K., the IRS claimed.

But this really was not double-taxed in a way that qualifies for tax credits, said the IRS. Because of the differences between U.S. and U.K. rules, STARS enabled Barclays to reimburse a U.S. company for half the tax paid in the U.K. without reducing the amount of foreign tax credits that could be claimed by either party. For that and other reasons, the IRS said this was a shelter, pure and simple. In large part, the court agreed.

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