September 8, 2010

Crisis Commission Argues on IRS Assistance for Wachovia

The Financial Crisis Commission has put forth its argument that Wells Fargo & Co's purchase of Wachovia was with government assistance despite the widely held belief that it was not. The IRS had changed the tax code just after the Federal Deposit Insurance Corporation (FDIC) announced it would provide open-bank assistance to Wachovia. Although the change had allowed Wells Fargo to purchase Wachovia without FDIC help, it still constituted as government assistance. According to the Commission, this has resulted in a significant loss of revenue to the Treasury.

Under the original deal which was announced on September 25, 2008, the FDIC would have backstopped the sale of Wachovia to Citigroup Inc. But a few days after that, the IRS came up with its tax code change that allowed banks to carry forward losses from troubled financial institutions. Shortly after that, Wells Fargo initiated its bid to buy Wachovia without FDIC assistance and was successful.

Bill Thomas, the Vice Chairman of the Financial Crisis Commission and former chairman of the House Ways and Means Committee, reiterated that the government had lost a sizeable portion of income because the deal was not considered a government bailout. He also questioned the timing of the IRS act of changing the tax code. Changing the tax code clearly benefited a certain group of institutions, namely the Federal Deposit Insurance Corporation and the Federal Reserve Board, although both parties denied they enjoyed any benefits.

The IRS made the change to the tax code on September 30 without consulting Congress because of pressure from Treasury officials. Because of their unilateral action, the ultimate losers will be the American taxpayers in the long run because they will have less revenue. Another member of the Commission, Byron Georgiou, agreed with Thomas and explained that the tax change was a "different form of government assistance, perhaps a delayed form of government assistance".

The tax change was later reversed by Congress but how much Wells Fargo benefited from the change is hard to determine. Even members of the Commission are at variance in calculating the estimates. Wells themselves say that they have yet to recognize the carry forward for tax purposes.

On the other hand, Robert Steel, the former chief executive of Wachovia denied that the IRS deal was a government bailout because it benefited several parties not only Wells and Wachovia. Incidentally, Steel was a former top Treasury official before being appointed CEO at Wachovia.