Bankruptcy Taxation/Business Reorganization/Young & New Members

Tax-Sharing Agreements in Bankruptcy that Have Been the Subject of Recent Appeals Court Decisions

Richard J. Corbi
U.S. Bankruptcy Court (E.D.N.Y.); Brooklyn

Todd C. Meyers
Kilpatrick Townsend & Stockton LLP; Atlanta

Whitman L. Holt
Klee, Tuchin, Bogdanoff & Stern LLP; Los Angeles

Jeffrey E. Schmitt
Federal Deposit Insurance Corporation; Washington, D.C.

COMMITTEE EDUCATIONAL SESSION

2015

AMERICAN BANKRUPTCY INSTITUTE

DISCOVER

interactive code&rules
law.abi.org

Start Your Research Here

Your Interactive Tool Wherever You Go!

With ABI's Code & Rules:

- **Search for a specific provision of the Bankruptcy Code and related Rules**
- **Access links to relevant case law by section (provided by site partner, LexisNexis®)**
- **Retrieve a Code section or case summary – even on your mobile device**
- **Personalize it with bookmarks and notes**
- **Receive it FREE as an ABI member**

Current, Personalized, Portable
law.abi.org

66 Canal Center Plaza • Suite 600 • Alexandria, VA 22314-1583 • phone: 703.739.0800 • abi.org

Join our networks to expand yours:

Tax Sharing Agreements in Bankruptcy

Jeffrey E. Schmitt, Counsel
Federal Deposit Insurance Corporation

April 18, 2015

DISCLAIMER: The views expressed in this presentation are the views of the author and presenter; the views are not endorsed in any manner, and do not represent the views of and should not be attributable to, the United States or the Federal Deposit Insurance Corporation.

Regulatory Context

- Bank holding companies are regulated by the Federal Reserve.
  - Banks regulated by either OCC, FDIC or Fed.
- Regulation based on access to Fed borrowing, deposit insurance and to ensure the safety and soundness of the financial system.
- Common theme of protecting the bank.

2

Regulatory Context

- Banks and holding companies represent their financial condition, capital ratios, income and certain risk factors to regulators through required "call reports." 12 U.S.C. § 1817(a)(3).
  - Assets of banks and their holding companies are represented separately.
  - Show the impact of management decisions and economic conditions on a bank's performance and balance-sheet composition.

3

Regulatory Context

- The ability to obtain a refund by carrying NOLs back to prior years, or to reduce future tax liability to the IRS, is recorded by entity as a "deferred tax asset."
  - Deferred tax assets are recorded as "other assets" on bank's and holding company's call reports.
- These "other assets" are included in the capital calculations for banks and bank holding companies.
  - Regulators rely on capital levels to determine the financial health of banks and holding companies.

4

Affiliate Transactions

- All transactions between banks and bank holding companies are regulated under 23A and 23B of the Federal Reserve Act, codified at 12 U.S.C. § 371c.
  - 23A prohibits extensions of credit from a bank to its holding company unless it is over-collateralized.
- The term "extension of credit" includes a transaction a result of which a holding company becomes "obligated to pay money (or its equivalent)" to its subsidiary bank. 12 C.F.R § 223.3(o).
  - Any amounts owed by holding company to subsidiary bank would have to be recorded on holding company's financial statements.

5

Tax Law Context

- Holding company acts as common parent and "sole agent" for bank subsidiary and other members of the consolidated group. Treas. Reg. § 1.1502.77(a).
  - For administrative convenience, IRS deals with holding company as agent for all members of the consolidated group, including bank subsidiaries.
- Internal Revenue Code and Treasury Regulations are silent as to ownership of tax refunds among group members.

6

Tax Law Context

Treasury Reg. § 301.6402-7(g)(2)(iii)

- If Bank and Holding company both have NOLS, then the taxable income for the carryback year is treated as offset first by the losses attributable to the Bank to the extent such losses are available.

Treas. Reg. § 1.1502-77(a)(2)(v)

- Common parent, as "sole agent," files claims for refund for the group.
- Federal refund paid to common parent discharges IRS liability to group.

Treas. Reg. §§ 301.6402-7(g) and (j)

- IRS may elect to pay refund to FDIC as fiduciary for failed bank.
- Payment to FDIC does not determine ownership issue.

7

1998 Interagency Policy Statement

- Issues arose in S&L Crisis related to improper treatment by holding companies of tax benefits attributable to subsidiary banks.
- Led to 1998 Interagency Policy Statement
  - Permits bank holding companies and subsidiary banks to file consolidated tax returns.
  - Encourages entities to enter into tax sharing agreements to establish process for filing consolidated tax returns and to ensure that bank assets are not improperly transferred to holding company.
  - States that a holding company receives a tax refund as agent for bank and prohibits tax sharing agreements that characterize refunds created by banks as property of the holding company.

8

2014 Addendum to Policy Statement

- Addendum to Policy Statement was issued by the Fed, OCC and FDIC on June 10, 2014.
  - Supplements and clarifies 1998 Policy Statement in response to court decisions adverse to FDIC as Receiver.
  - Requires institutions to amend tax allocation agreements to explicitly state BHC receives a refund as agent and in trust.
  - Required compliance by October 31, 2014.

9

Appellate Decisions–Compare and Contrast

- Courts in this crisis have generally interpreted agreements under applicable state law.
- What makes a tax sharing agreement ambiguous?
  - Scope of review – ownership of tax refunds or language interpreted to be debtor-creditor?
  - The 11th Circuit (two decisions) and the 6th Circuit held that tax sharing agreements that do not address *ownership* of tax refunds are ambiguous. Applied Delaware, Georgia and Ohio law.
  - The 9th Circuit and the 3th Circuit (unpublished decisions) held that tax sharing agreements containing words that they interpreted as indicative of a *debtor-creditor* relationship are unambiguous. Applied California law in both cases.

10

Appellate Decisions–Compare and Contrast

- What can a court consider to determine ambiguity?
  - The 11th and 6th Circuits have considered the regulatory context in which the agreement was executed to determine ambiguity.
    - Interagency Policy Statement and 23A and 23B of the Federal Reserve Act are part of the background in which agreement was executed.
  - The 9th and 3rd Circuits have not considered the regulatory context in which the agreement was entered to determine ambiguity.
    - These courts have held that only the four corners of tax sharing agreement matters.

11

Appellate Decisions–Compare and Contrast

- Why is ambiguity important?
  - If the agreement is ambiguous, courts will consider regulatory background and extrinsic evidence which generally favors FDIC.
  - If the agreement is unambiguous, some courts have interpreted the inclusion of words such as “pay” and “reimburse” and the lack of an express trust in the agreement as indicative of a debtor-creditor relationship.
    - The 9th Circuit therefore determined that it did not need to grapple with whether a resulting trust arises by law because establishing a resulting trust requires extrinsic evidence.

12

Appellate Decisions–Compare and Contrast

- What trust law is applicable and is an escrow or segregation required?
  - The 11th and 6th Circuits do not require tax sharing agreements to demonstrate an express trust, including an escrow and segregation.
    - These courts recognize the concept of a resulting trust where the holding company was not the intended owner of tax refunds, but rather was intended to operate as a conduit.
  - The 9th and 3rd Circuits have interpreted agreements that do not demonstrate an express trust or contain escrow/segregation language as indicative of a debtor-creditor relationship.
    - The 3rd Circuit viewed resulting trusts as inapplicable because it interpreted the doctrine to require inequitable conduct or unjust enrichment.

13

35228 Federal Register / Vol. 79, No. 118 / Thursday, June 19, 2014 / Notices

the system fault no longer exists, the TPMS telltale will no longer flash, and the ''Service TPM System'' message will no longer display.

In addition to the TPMS telltale alerting the operator of a significant loss of tire pressure, or a TPMS malfunction as required, the EVIC messages and owner's manual provide more than the minimum level of information required aiding the operator's association of the illuminated telltale with an appropriate response.

Chrysler also made reference to a previous petition for inconsequential noncompliance that addressed labeling issues that NHTSA granted.

Chrysler has additionally informed NHTSA that it has corrected the noncompliance so that all future production vehicles will comply with FMVSS No. 101.

In summation, Chrysler believes that the described noncompliance of the subject vehicles is inconsequential to motor vehicle safety, and that its petition, to exempt Chrysler from providing recall notification of noncompliance as required by 49 U.S.C. 30118 and remedying the recall noncompliance as required by 49 U.S.C. 30120 should be granted.

NHTSA notes that the statutory provisions (49 U.S.C. 30118(d) and 30120(h)) that permit manufacturers to file petitions for a determination of inconsequentiality allow NHTSA to exempt manufacturers only from the duties found in sections 30118 and 30120, respectively, to notify owners, purchasers, and dealers of a defect or noncompliance and to remedy the defect or noncompliance. Therefore, any decision on this petition only applies to the subject vehicles that Chrysler no longer controlled at the time it determined that the noncompliance existed. However, any decision on this petition does not relieve vehicle distributors and dealers of the prohibitions on the sale, offer for sale, or introduction or delivery for introduction into interstate commerce of the noncompliant vehicles under their control after Chrysler notified them that the subject noncompliance existed.

Authority: (49 U.S.C. 30118, 30120: delegations of authority at 49 CFR 1.95 and 501.8)

Jeffrey M. Giuseppe,

Acting Director, Office of Vehicle Safety Compliance.

[FR Doc. 2014–14285 Filed 6–18–14; 8:45 am]

BILLING CODE 4910–59–P

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

[Docket ID OCC–2013–0020; Docket No. OP–1474]

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

RIN 7100–AD 87

FEDERAL DEPOSIT INSURANCE CORPORATION

Addendum to the Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure

AGENCY: Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, Department of the Treasury (Agencies).

ACTION: Final Addendum to Interagency Policy Statement.

SUMMARY: The Agencies are issuing jointly an Addendum (Addendum) to the ''Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure'' to ensure that insured depository institutions (IDIs) in a consolidated group maintain an appropriate relationship regarding the payment of taxes and treatment of tax refunds. The Addendum instructs IDIs and their holding companies to review and revise their tax allocation agreements to ensure that the agreements expressly acknowledge that the holding company receives a tax refund from a taxing authority as agent for the IDI and are consistent with certain of the requirements of sections 23A and 23B of the Federal Reserve Act. The Addendum includes a sample paragraph that IDIs could include in their tax allocation agreements to facilitate the Agencies' instructions.

DATES: The Agencies expect institutions and holding companies to implement fully the Addendum to the Interagency Policy Statement as soon as reasonably possible, which the Agencies expect would not be later than October 31, 2014.

FOR FURTHER INFORMATION CONTACT:

Office of the Comptroller of the Currency: Steven Key, Assistant Director for Bank Activities and Structure, Bank Activities and Structure Division, Chief Counsel's Office, 202–649–5594 or *steven.key@occ.treas.gov;* Gary Jeffers, Counsel, Bank Activities and Structure Division, Chief Counsel's Office, 202–649–6208 or *gary.jeffers@occ.treas.gov,* Office of the Comptroller of the Currency, 400 7th Street SW., Washington, DC 20219.

Board of Governors of the Federal Reserve System: Laurie Schaffer, Associate General Counsel, (202) 452–2272, Benjamin McDonough, Senior Counsel, (202) 452–2036, Pamela Nardolilli, Senior Counsel, (202) 452–3289, or Will Giles, Counsel, (202) 452–3351, Legal Division; or Matthew Kincaid, Sr. Accounting Policy Analyst, (202) 452–2028, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551. Users of Telecommunication Device for Deaf (TDD) only, call (202) 263–4869.

Federal Deposit Insurance Corporation: Robert Storch, Chief Accountant, 202–898–8906 or *rstorch@fdic.gov;* Mark G. Flanigan, Counsel, Legal Division, 202–898–7426 or *mflanigan@fdic.gov;* Jeffrey E. Schmitt, Counsel, Legal Division, 703–562–2429 or *jschmitt@fdic.gov.*

SUPPLEMENTARY INFORMATION:

I. Background

In 1998, the Agencies and the Office of Thrift Supervision issued the ''Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure'' (Interagency Policy Statement) to provide guidance to insured depository institutions (IDIs) and their holding companies and other affiliates (Consolidated Groups) regarding the payment of taxes on a consolidated basis.[1] One of the principal goals of the Interagency Policy Statement is to protect IDIs' ownership rights in tax refunds, while permitting the Consolidated Group to file consolidated tax returns. The Interagency Policy Statement states that: (1) Tax settlements between an IDI and its holding company should be conducted in a manner that is no less favorable to the IDI than if it were a separate taxpayer; and (2) a holding company receives a tax refund from a taxing authority as agent for the IDI.

Since adoption of the Interagency Policy Statement, there have been many disputes between holding companies in bankruptcy and failed IDIs regarding the ownership of tax refunds generated by the IDIs. In these disputes, some courts have found that tax refunds generated by an IDI were the property of its holding company based on certain language contained in their tax allocation agreement that the courts interpreted as creating a debtor-creditor relationship. Accordingly, the Agencies are issuing an Addendum to the Interagency Policy Statement (Addendum) to ensure that IDIs in a

[1] 63 FR 64757 (November 23, 1998).

Consolidated Group maintain an appropriate relationship regarding the payment of taxes and treatment of tax refunds.

II. Description of Addendum

The Addendum is intended to clarify and supplement the Interagency Policy Statement to ensure that tax allocation agreements expressly acknowledge an agency relationship between a holding company and its subsidiary IDI to protect the IDI's ownership rights in tax refunds. The Addendum also clarifies how certain of the requirements of sections 23A and 23B of the Federal Reserve Act (FRA) apply to tax allocation agreements between IDIs and their affiliates.

The Addendum states that, to further the goals of the Interagency Policy Statement, IDIs and their holding companies should review and revise their tax allocation agreements to ensure their tax allocation agreements explicitly acknowledge that an agency relationship exists between the holding company and its subsidiary IDIs with respect to tax refunds and do not contain other language to suggest a contrary intent. The Addendum includes a sample paragraph for IDIs and their holding companies to use in their tax allocation agreements, which the Agencies generally would deem to adequately acknowledge that an agency relationship exists for purposes of the Interagency Policy Statement, the Addendum, and sections 23A and 23B of the FRA.

The Addendum also clarifies that all tax allocation agreements are subject to the requirements of section 23B of the FRA, and tax allocation agreements that do not clearly acknowledge that an agency relationship exists may be subject to additional requirements under section 23A of the FRA. Moreover, the Addendum clarifies that section 23B of the FRA requires a holding company to promptly transmit tax refunds received from a taxing authority to its subsidiary IDI. The sample paragraph in the Addendum incorporates this expectation.

III. Summary of Comments

The Agencies issued the Addendum in proposed form with a request for comment (Proposed Addendum) on December 19, 2013.[2] The comment period closed on January 21, 2014. The Agencies received two comment letters on the Proposed Addendum—one from an individual who viewed the Proposed Addendum favorably and did not suggest any modifications, and another from a financial institution trade association, which also did not suggest any modifications to the Proposed Addendum. However, this trade association requested that the Agencies provide institutions until the end of calendar year 2014 to amend their tax allocation agreements, as necessary, to ensure consistency with the Proposed Addendum. This commenter also suggested that this time period is appropriate because the Proposed Addendum will require reviews of existing tax allocation agreements and may require institutions and holding companies to receive board of directors' approvals to amend both their agreements and internal tax processes. The Agencies understand that institutions and holding companies require time to revise their tax allocation agreements, that some institutions and holding companies may wish to consult with tax counsel, and that more complex banking organizations with multiple subsidiaries and affiliates may require additional time to obtain all required approvals of the members of the Consolidated Group. Accordingly, the Agencies encourage institutions and holding companies to begin promptly the efforts to review and revise their tax allocation agreements. In this regard, the Agencies expect institutions and holding companies to implement fully the Addendum to the Interagency Policy Statement as soon as reasonably possible, which the Agencies expect would not be later than October 31, 2014.

The Agencies also received some informal inquiries regarding the applicability of the Addendum to holding companies that have elected S corporation status for federal income tax purposes.[3] The Addendum and Interagency Policy Statement concern tax allocation agreements between an IDI, its parent company, and its affiliates. Accordingly, the Addendum and Interagency Policy Statement does not apply to an IDI, its holding company, or other affiliates if the holding company is not subject to corporate income taxes at the federal or state level.

IV. Administrative Law Matters

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR part 1320, Appendix A.1), the Agencies reviewed the Addendum guidance for any collection of information. The Agencies may not conduct or sponsor, and an organization is not required to respond to, an information collection unless the information collection displays a currently valid Office of Management and Budget control number. There is no collection of information contained in the Addendum.

V. Text of the Addendum

The text of the Addendum follows:

Addendum to Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure

In 1998, the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC) (collectively, the Agencies), and the Office of Thrift Supervision (OTS) issued the ''Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure'' (the ''Interagency Policy Statement'').[4] Under the Interagency Policy Statement, members of a consolidated group, comprised of one or more insured depository institutions (IDIs) and their holding company and affiliates (the Consolidated Group), may prepare and file their federal and state income tax returns as a group so long as the act of filing as a group does not prejudice the interests of any one of the IDIs. That is, the Interagency Policy Statement affirms that intercorporate tax settlements between an IDI and its parent company should be conducted in a manner that is no less favorable to the IDI than if it were a separate taxpayer and that any practice that is not consistent with the policy statement may be viewed as an unsafe and unsound practice prompting either informal or formal corrective action.

The Interagency Policy Statement also addresses the nature of the relationship between an IDI and its parent company. It states in relevant part that:

- ''[A] parent company that receives a tax refund from a taxing authority obtains these funds as agent for the consolidated group on behalf of the group members,'' and
- A Consolidated Group's tax allocation agreement should not ''characterize refunds attributable to a subsidiary depository institution that the parent receives from a taxing authority as the property of the parent.''

Since the issuance of the Interagency Policy Statement, courts have reached

[2] 78 FR 76889 (December 19, 2013).

[3] S corporations are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes.

[4] 63 FR 64757 (Nov. 23, 1998). Responsibilities of the OTS were transferred to the Board, FDIC, and OCC pursuant to Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

varying conclusions regarding whether tax allocation agreements create a debtor-creditor relationship between a holding company and its IDI.[5] Some courts have found that the tax refunds in question were the property of the holding company in bankruptcy (rather than property of the subsidiary IDI) and held by the holding company as the IDI's debtor.[6] The Agencies are issuing this addendum to the Interagency Policy Statement (Addendum) to explain that Consolidated Groups should review their tax allocation agreements to ensure the agreements achieve the objectives of the Interagency Policy Statement. This Addendum also clarifies how certain of the requirements of sections 23A and 23B of the Federal Reserve Act (FRA) apply to tax allocation agreements between IDIs and their affiliates.

In reviewing their tax allocation agreements, Consolidated Groups should ensure the agreements: (1) Clearly acknowledge that an agency relationship exists between the holding company and its subsidiary IDIs with respect to tax refunds, and (2) do not contain other language to suggest a contrary intent.[7] In addition, all Consolidated Groups should amend their tax allocation agreements to include the following paragraph or substantially similar language:

> The [holding company] is an agent for the [IDI and its subsidiaries] (the ''Institution'') with respect to all matters related to consolidated tax returns and refund claims, and nothing in this agreement shall be construed to alter or modify this agency relationship. If the [holding company] receives a tax refund from a taxing authority, these funds are obtained as agent for the Institution. Any tax refund attributable to income earned, taxes paid, and losses incurred by the Institution is the property of and owned by the Institution, and shall be held in trust by the [holding company] for the benefit of the Institution. The [holding company] shall forward promptly the amounts held in trust to the Institution. Nothing in this agreement is intended to be or should be construed to provide the [holding company] with an ownership interest in a tax refund that is attributable to income earned, taxes paid, and losses incurred by the Institution. The [holding company] hereby agrees that this tax sharing agreement does not give it an ownership interest in a tax refund generated by the tax attributes of the Institution.

Going forward, the Agencies generally will deem tax allocation agreements that contain this or similar language to acknowledge that an agency relationship exists for purposes of the Interagency Policy Statement, this Addendum, and sections 23A and 23B of the FRA.

All tax allocation agreements are subject to the requirements of section 23B of the FRA, and tax allocation agreements that do not clearly acknowledge that an agency relationship exists may be subject to additional requirements under section 23A of the FRA.[8] In general, section 23B requires affiliate transactions to be made on terms and under circumstances that are substantially the same, or at least as favorable to the IDI, as comparable transactions involving nonaffiliated companies or, in the absence of comparable transactions, on terms and circumstances that would in good faith be offered to non-affiliated companies.[9] Tax allocation agreements should require the holding company to forward promptly any payment due the IDI under the tax allocation agreement and specify the timing of such payment. Agreements that allow a holding company to hold and not promptly transmit tax refunds received from the taxing authority and owed to an IDI are inconsistent with the requirements of section 23B and subject to supervisory action. However, an Agency's determination of whether such provision, or the tax allocation agreement in total, is consistent with section 23B will be based on the facts and circumstances of the particular tax allocation agreement and any associated refund.

Dated: May 15, 2014.

Thomas J. Curry,

Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, June 12, 2014.

Robert deV. Frierson,

Secretary of the Board.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Dated at Washington, DC, this 23rd day of May 2014.

Robert E. Feldman,

Executive Secretary.

[FR Doc. 2014–14325 Filed 6–18–14; 8:45 am]

BILLING CODE 4810–33–P; 6210–01–P; 6714–01–P

[5] Case law on this issue is mixed. *Compare Zucker* v. *FDIC, as Receiver for BankUnited,* 727 F.3d 1100, 1108–09 (11th Cir. Aug. 15, 2013) (''The relationship between the Holding Company and the Bank is not a debtor-creditor relationship. When the Holding Company received the tax refunds it held the funds intact—as if in escrow—for the benefit of the Bank and thus the remaining members of the Consolidated Group.'') with *F.D.I.C.* v. *Siegel (In re IndyMac Bancorp, Inc.),* ____ F. App'x ____, 2014 WL 1568759, *2 (9th Cir. Apr. 21, 2014) (*per curiam*) (''The TSA does not create a trust relationship. The absence of language creating a trust relationship is explicitly an indication of a debtor-creditor relationship in California'').

[6] *See e.g., F.D.I.C.* v. *Siegel (In re IndyMac Bancorp, Inc.),* ____ F. App'x ____, 2014 WL 1568759 (9th Cir. Apr. 21, 2014) (*per curiam*).

[7] This Addendum clarifies and supplements but does not replace the Interagency Policy Statement.

[8] Section 23A requires, among other things, that loans and extensions of credit from a bank to its affiliates be properly collateralized. 12 U.S.C. 371c(c).

[9] 12 U.S.C. 371c–1(a). Transactions subject to section 23B include the payment of money by a bank to an affiliate under contract, lease, or otherwise and transactions in which the affiliate acts as agent of the bank. *Id.* at § 371c–1(a)(2) & (a)(4).

The two tax refund cases in which the bankruptcy estate prevailed on appeal

IndyMac

2012 WL 1037481, 2012 Bankr. LEXIS 1462 (Bankr. C.D. Cal. Mar. 29, 2012), *report and recommendation approved and adopted by* 2012 WL 1951474, 2012 U.S. Dist. LEXIS 88666 (C.D. Cal. May 30, 2012), *aff'd*, 554 F. App'x 668 (9th Cir. 2014), *reh'g & reh'g en banc denied* (9th Cir. June 27, 2014)

Downey

499 B.R. 439 (Bankr. D. Del. 2013), *aff'd*, --- F. App'x ---, 2015 WL 307013, 2015 U.S. App. LEXIS 1100 (3d Cir. Jan. 26, 2015)

IndyMac

Facts

- Parent and bank were parties to a pre-bankruptcy tax sharing agreement ("TSA").
- TSA provided that parent would reimburse the bank in "an amount equal to the amount" that the bank could have received on a stand-alone basis within 15 business days after a refund was received.
- TSA had no escrow or segregation requirement and no trust terms.
- TSA provided that parent was the bank's "agent and attorney-in-fact" for purposes of various tax-related matters.
- TSA stated the parties' intent to "abide by all rules promulgated by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation."
- TSA's overarching "general intent" was for the bank "to determine its tax liability and to make and receive payments as if it were filing income tax returns separate from and excluding Parent."
- Disputed, post-bankruptcy tax refunds exceeded $55 million.

IndyMac (con't)

Trustee's Position

- TSA unambiguously describes a debtor-creditor relationship in which the bank has only an unsecured right to payment.
- Extrinsic evidence is irrelevant, but course of dealing supports the trustee.

FDIC's Position

- TSA's reference to "agency" relationship, its "general intent," and the reference to regulatory "rules" support trust or agency relationship.
- Extrinsic evidence (including declaration of former tax director) supports its interpretation.

IndyMac (con't)

Bankruptcy court's ruling

- Lengthy report and recommendation to the district court (because of *Stern*).
- Three factors demonstrate unambiguous debtor-creditor relationship under California law: (1) the TSA creates fungible "payment" obligations unrelated to any tax refunds; (2) the TSA lacks provisions requiring the parent to segregate or escrow any tax refunds and has no restrictions on the parent's use of the funds while in the parent's possession; (3) the TSA vests parent with complete and unrestrained decision-making regarding tax matters.
- Rejects contrary FDIC arguments, including (1) refunds did not exist on the petition date, (2) TSA does not opt-out of the Ninth Circuit's *Bob Richards* rule, (3) TSA was deemed rejected under Bankruptcy Code section 365(d), (4) TSA is not assumable under Bankruptcy Code section 365(c)(2), (5) 12 U.S.C. § 371c negates the TSA, (6) the 1998 interagency policy statement negates the TSA, (7) 12 U.S.C. § 1823(e) negates the TSA, and (8) various state law arguments ("resulting trust," "unjust enrichment," etc.).

IndyMac (con't)

District court's ruling

- Accepts bankruptcy court's report and recommendation and grants summary judgment in favor of the trustee.
- Agrees that the TSA is unambiguous and that the bankruptcy court properly excluded extrinsic evidence.
- Agrees that "[a]ccording to both bankruptcy law and California contract law, the TSA creates a debtor/creditor relationship" based on the three factors applied by the bankruptcy court.
- Rejects the FDIC's *Bob Richards* default rule argument.
- Rejects the FDIC's banking law and other defenses.

IndyMac (con't)

Ninth Circuit Court of Appeals' ruling

- Affirms in an unpublished, non-precedential memorandum.
- Concludes that the TSA places parties outside of the *Bob Richards* rule and presents a straightforward case of state law contract interpretation.
- Concludes that "[t]he TSA does not establish a principal-agent relationship under California law, because the Bank does not exercise control over Bancorp's activities under the TSA."
- Concludes that the TSA does not create a trust relationship.
- Briefly rejects the FDIC's argument "that recognizing a debtor-creditor relationship here would violate federal banking laws."
- Distinguishes *NetBank* based on lack of reference to the 1998 interagency policy statement in the operative TSA (does not discuss *BankUnited*).
- FDIC petitions for rehearing and rehearing *en banc*. This petition is denied, and the FDIC does not seek further review by the Supreme Court.

Downey

Facts

- Parent and bank were parties to a pre-bankruptcy TSA.
- TSA provided that parent would pay the bank its share of any tax refund within 7 business days after the parent receives the refund.
- TSA had no escrow or segregation requirement and no trust terms.
- TSA provided that parent had "the right, in its sole discretion" to take actions regarding the preparation, filing, and manner in which the consolidated group's tax returns are prosecuted.
- Historically, prior tax refund checks, even though made payable to the parent, were deposited directly into one of the bank's bank accounts.
- Disputed, post-bankruptcy tax refunds exceeded $370 million.

Downey (con't)

Trustee's Position

- TSA unambiguously describes a debtor-creditor relationship in which the bank has only an unsecured right to payment.
- Extrinsic evidence is irrelevant.
- FDIC violated the automatic stay.

FDIC's Position

- TSA must be construed against backdrop banking rules and context.
- Extrinsic evidence (including declaration of former general counsel, course of performance with prior checks, and accounting records) supports its interpretation.

Downey (con't)

Bankruptcy court's ruling

- Concludes TSA is plain, unambiguous, and creates a debtor-creditor relationship under California state law based on the three *IndyMac* factors.
- Finds the Eleventh Circuit's opinions in *BankUnited* and *NetBank* to be distinguishable.
- Rejects relevance and import of FDIC's extrinsic evidence.
- Concludes there is no basis for imposition of an express, constructive, or resulting trust in this context.
- Finds allegations of automatic stay violations to be moot.
- Decision was certified and accepted for a direct appeal to the Third Circuit under 28 U.S.C. § 158(d)(2).

Downey (con't)

Third Circuit Court of Appeals' ruling

- Affirms in an unpublished, non-precedential opinion (which was issued soon after the court cancelled oral argument).
- Concludes that bankruptcy court correctly excluded extrinsic evidence under California law.
- Finds *Bob Richards* rule inapplicable and agrees with bankruptcy court (and *IndyMac*) that TSA's unambiguous terms do not support a principal-agent or trust relationship under CA law.
- Specifically rejects resulting trust concept on the grounds that there would be no unjust enrichment in enforcing the TSA.
- Cites and relies on *IndyMac* and two other California law tax refund cases, but makes no mention of *BankUnited*, *NetBank*, or *AmFin*.
- FDIC seems likely to petition for rehearing and rehearing *en banc*. Unclear if FDIC might thereafter seek Supreme Court review – but seems unlikely.

Other California Law Cases

Imperial

- District court granted summary judgment for bankruptcy estate in a published opinion that relied heavily on the *IndyMac* analysis. *See Imperial Capital Bancorp, Inc. v. FDIC (In re Imperial Capital Bancorp, Inc.)*, 492 B.R. 25 (S.D. Cal. 2013).
- FDIC appealed to Ninth Circuit, but parties settled and appeal was dismissed.

Vineyard

- Bankruptcy court denied summary judgment, held a trial, and ultimately ruled in favor of the bankruptcy estate, relying on the *IndyMac* analysis while distinguishing *NetBank* and *BankUnited*. *See Sharp v. FDIC (In re Vineyard Nat'l Bancorp)*, 508 B.R. 437 (Bankr. C.D. Cal. 2014); 2013 WL 1867987, 2013 Bankr. LEXIS 1823 (Bankr. C.D. Cal. May 3, 2013).
- After stalled settlement talks, the bankruptcy court recently entered a partial final judgment under Federal Rule of Civil Procedure 54(b), which will allow a FDIC appeal to proceed to the district court.

Other California Law Cases (con't)

Temecula Valley

- Case is pending as Adversary Proceeding No. 14-ap-1250 (Bankr. C.D. Cal.). *See generally In re Temecula Valley Bancorp, Inc.*, 523 B.R. 210 (C.D. Cal. 2014) (denying FDIC motion to withdraw the reference).

Alliance Bancshares

- Case is pending as Adversary Proceeding No. 13-ap-2152 (Bankr. C.D. Cal.).

First Regional

- Case is pending as Adversary Proceeding No. 14-ap-1221 (Bankr. C.D. Cal.).
- Bankruptcy court dismissed the initial complaint for failure to plead the existence of an express or implied tax sharing agreement. *See Liquidating Trust v. FDIC (In re First Regional Bancorp)*, Adv. Proc. No. 2:14-ap-01221-ER, ECF No. 43 (Bankr. C.D. Cal. Oct. 2, 2014).
- FDIC motion to dismiss further amended complaint was pending in Feb. 2015.

Some questions

Is California law different?

1. Is there a ***substantive*** difference between California law and the laws of other states (including Delaware, Georgia, and Ohio, which laws applied in *BankUnited*, *NetBank*, and *AmFin*, respectively)?
2. Is the case law applying California law to determine whether a debtor-creditor relationship exists just more developed? *E.g.*, *Foothill Capital Corp. v. Clare's Food Mkt., Inc. (In re Coupon Clearing Serv., Inc.)*, 113 F.3d 1091 (9th Cir. 1997); *United States v. Lawson*, 925 F.2d 1207 (9th Cir. 1991); *Altura P'ship v. Breninc, Inc. (In re B.I. Fin. Servs. Grp., Inc.)*, 854 F.2d 351 (9th Cir. 1988); *Weststeyn Dairy 2 v. Eades Commodities Co*., 280 F. Supp. 2d 1044 (E.D. Cal. 2003); *Lonely Maiden Prods., LLC v. GoldenTree Asset Mgmt., LP*, 135 Cal. Rptr. 3d 69 (Ct. App. 2011); *Petherbridge v. Prudential Sav. & Loan Ass'n*, 145 Cal. Rptr. 87 (Ct. App. 1978).
3. Is some other factor at work that is leading to bankruptcy estate victories in tax refund ownership disputes governed by California state law?

Some questions

Published / Unpublished Divide

1. The FDIC has prevailed in three circuit court cases, each of which yielded a published, precedential opinion.
2. By contrast, the bankruptcy estate circuit victories have both been in unpublished, non-precedential opinions.
3. What do you think explains this striking divide? (Note that it seems especially odd in *Downey* where the Third Circuit initially found the issue important enough to accept a direct appeal under Judicial Code section 158(d)(2).)

Some questions

Chapter 7 vs. Chapter 11

1. *IndyMac* and *Downey* were both chapter 7 cases in which a third-party trustee represented the estate of a liquidated debtor.

2. By contrast, *BankUnited*, *NetBank*, and *AmFin* were all chapter 11 cases in which the FDIC's opponent was the debtor in possession or a chapter 11 plan trustee.

3. Do you think this influenced the different outcomes?

4. Should it? *See generally Superintendent of Ins. v. Ochs (In re First Cent. Fin. Corp.)*, 377 F.3d 209, 217-18 (2d Cir. 2004) (rejecting argument that bankruptcy estate is unjustly enriched if a ***chapter 7 trustee*** retains tax refunds generated by subsidiary income/losses).

KILPATRICK TOWNSEND

BankUnited

- **Bankruptcy Court Opinion**
  - *BankUnited Fin. Corp. v. Fed. Deposit Ins. Corp. (In re BankUnited Fin. Corp.)*, 462 B.R. 885 (Bankr. S.D. Fla. 2011)
  - Granted summary judgment in favor of Plan Administrator on the basis that approximately $48 million in tax refunds were property of HoldCo's bankruptcy estate, meaning FDIC had only an unsecured, prepetition claim therefor.
  - Rejected application of federal common law rule stemming from Ninth Circuit's *Bob Richards* opinion that parent of a consolidated group receives a tax refund as trustee of a specific trust in the absence of an implied or express agreement to the contrary

1

KILPATRICK TOWNSEND

BankUnited

- **Bankruptcy Court Opinion (cont.)**
  - Further held, recognizing that tax allocation arrangements were permissible under Delaware law, that the agreement did not create a trust or agency relationship but one of debtor and creditor.
    - Although agreement contemplated that HoldCo would deliver tax refund to bank at some stage, nothing suggests this was a requirement or that HoldCo held such funds in trust capacity.
  - No basis existed for a finding of implied trust either.
  - FDIC appealed and parties requested certification directly to Eleventh Circuit.

KILPATRICK TOWNSEND

BankUnited

- **Eleventh Circuit Opinion**
  - *Zucker v. Fed. Deposit Ins. Corp. (In re BankUnited Fin. Corp.)*, 727 F.3d 1100 (11th Cir. 2013)
  - Held that Bankruptcy court erred. Key determination for purposes of this ruling was that the TSA did not create a debtor-creditor relationship between bank and HoldCo.
  - Primary basis for Eleventh Circuit decision:
    - Key provisions of TSA were ambiguous.
    - Therefore, under Delaware law, necessary to determine parties' intent.
    - "Common-sense" reading of the TSA and context to determine intent, rather than close analysis (minimal citations to authority).

KILPATRICK TOWNSEND

BankUnited

- **Eleventh Circuit Opinion (cont.)**
  - Ambiguity in TSA related to payment and reimbursement process among tax group, governed by section 4 of TSA.
  - "[S]ection 4 does not state when the Holding Company must forward the tax refunds to the Bank, and second, it does not explain whether the Holding Company 'owns' the refunds before forwarding them to the Bank."
  - TSA also included unusual provision requiring that "[a]ny income tax refunds received by [the Bank] shall be allocated among, and paid to the members of the Group…."

KILPATRICK TOWNSEND

BankUnited

- **Eleventh Circuit Opinion (cont.)**
  - Key language:
    - "When the Holding Company received the tax refunds, it held the funds intact — as if in escrow — for the benefit of the Bank and thus the remaining members of the Consolidated Group. The parties intended that the Holding Company would promptly forward the refunds to the Bank so that the Bank could, in turn, forward them on to the Group's members. In the Bank's hands, the tax refunds occupied the same status as they did in the Holding Company's hands — they were tax refunds for distribution in accordance with the TSA."

KILPATRICK TOWNSEND

NetBank

- **Bankruptcy Court Opinion**
  - *Zucker v. Fed. Deposit Ins. Corp. (In re NetBank, Inc.)*, 459 B.R. 801 (2010)
  - Granted summary judgment in favor of Liquidating Supervisor on the basis that approximately $6 million tax refund was property of HoldCo's bankruptcy estate, meaning FDIC had only an unsecured, prepetition claim therefor.
  - Held that the Internal Revenue Code did not address relative rights to tax refunds and tax sharing agreement controlled.
  - Rejected application of federal common law rule stemming from Ninth Circuit's *Bob Richards* opinion that parent of a consolidated group receives a tax refund as trustee of a specific trust in the absence of an implied or express agreement to the contrary, since parties had in fact entered into an agreement (the TSA).

KILPATRICK TOWNSEND

NetBank

- **Bankruptcy Court Opinion (cont.)**
  - Further held, applying Georgia law, that TSA did not create a trust or agency relationship but instead one of debtor and creditor, since TSA did not restrict the HoldCo's use of tax refunds received and the HoldCo was not subject to the direction or control of the bank or any group member.
    - Placed particular significance on these facts and the fact that HoldCo was not required to escrow refund.
  - Also held that the economic reality of the TSA was to create a debtor-creditor relationship.
  - Dismissed the significance of the Interagency Policy Statement on Income Tax Allocation (the "Interagency Statement") on the tax refund dispute between bank and HoldCo.
  - FDIC appealed to district court.

KILPATRICK TOWNSEND

NetBank

- **District Court Order**
  - *Fed. Deposit Ins. Corp. v. Zucker (In re NetBank, Inc.)*, Adv. Pro. No. 3:08-ap-00346-JAF, 2012 WL 2383297 (M.D. Fla. June 25, 2012)
  - One page long.
  - Noted that the issue presented "has been the subject of much litigation across the country" and held that FDIC failed to show "that the bankruptcy court's comprehensive opinion, which is in accord with the strong majority view, is factually or legally erroneous."

KILPATRICK TOWNSEND

NetBank

- **Eleventh Circuit Opinion**
  - *Zucker v. Fed. Deposit Ins. Corp. (In re NetBank, Inc.)*, 729 F.3d 1344 (11th Cir. 2013).
  - Decided after similar appeal in *BankUnited* case. Reached same result.
  - Consistent with the opinion from that case, determination of whether tax refund was property of parent or subsidiary was a matter of contract interpretation.
  - Concluded, as in *BankUnited*, that parties intended to create agency (rather than debtor-creditor) relationship with regard to tax refunds and that refund was not property of HoldCo's bankruptcy estate.

KILPATRICK TOWNSEND

NetBank

- **Eleventh Circuit Opinion (cont.)**
  - Noted as key provisions of TSA the following:
    - § 4(d)-(e) – Requiring HoldCo to pay refunds to bank within 30 days of receipt.
    - § 9 – Granting authority to HoldCo to claim refunds for group and, according to Eleventh Circuit, providing that HoldCo acts as "agent" for its subsidiaries.
    - § 10(a) – Stating that intent is to allocate tax liability in accordance with Interagency Statement and, according to Eleventh Circuit, evincing an intent to comply with the Interagency Statement.

KILPATRICK TOWNSEND

NetBank

- **Eleventh Circuit Opinion (cont.)**
  - Primary basis for Eleventh Circuit decision:
    - Key provisions of TSA were ambiguous as to whether creating an agency or debtor-creditor relationship.
    - Therefore, under Georgia law, necessary to determine parties' intent in context, including Interagency Statement, with which parties expressed intent to comply.
    - Interagency Statement states that HoldCo receives refunds from taxing authority as agent for group and, as a result, TSA should not purport to characterize refunds attributable to subsidiary bank as property of HoldCo.
    - Furthermore, section 10(a) of TSA requires no less favorable treatment to group than if returns filed separately. Debtor-creditor relationship would violate this.
    - Accordingly, and resolving ambiguity in TSA by reference to Interagency Statement, the parties intended to create agency relationship.
    - Conceded certain "contraindications within the four corners of" TSA – namely, those identified by the bankruptcy court – but stated that these are merely what create ambiguity in TSA.
    - Also noted that "absence of provisions for interest and collateral might be more significant, in light of the fact that under 12 U.S.C. § 371c, banks are restricted in their ability to engage in certain transactions with affiliates — including issuing a loan or extension of credit without ensuring sufficient collateral protections."

KILPATRICK TOWNSEND

AmFin

- **District Court Opinion**
  - *Fed. Deposit Ins. Corp. v. AmFin Fin. Corp.*, 490 B.R. 548 (N.D. Ohio 2013)
  - Matter heard by district court in first instance because reference withdrawn upon FDIC motion.
  - Granted debtor's motion for judgment on the pleadings, holding that $195 million tax refund was property of the debtor's estate.
  - Found "no merit in the FDIC's contentions that the tax sharing agreements do not fully address the rights and obligations of the entities" and therefore held Ninth Circuit's *Bob Richards* rule inapplicable.

KILPATRICK TOWNSEND

AmFin

- **District Court Opinion (cont.)**
  - Reproduced specific provisions of tax sharing agreements in their entirety to demonstrate "unambiguous" creation of a debtor-creditor relationship between HoldCo and affiliates.
  - Because unambiguous, rejected FDIC argument that determination of agency (or lack thereof) could be made by review of the TSAs alone.
  - Further noted use in agreements of terms such as "reimbursement" and "promptly settle," which also undermined FDIC arguments.
  - Finally, held that TSAs not required to be set aside based upon 12 U.S.C. § 371c (which restricts loans and extensions of credit between related entities) or 12 U.S.C. § 1823(e) (invalidating any agreement that "tends to diminish or defeat" the interest of the FDIC in any asset acquired by it")

13

KILPATRICK TOWNSEND

AmFin

- **Sixth Circuit Opinion**
  - *Fed. Deposit Ins. Corp. v. AmFin Fin. Corp.*, 757 F.3d 530 (6th Cir. 2014)
  - Reversed district court and remanded with instructions to consider extrinsic evidence concerning parties' intent in light of Ohio agency and trust law.
  - Focused opinion narrowly on particular TSA, which it distinguished from TSAs in other cases such as *IndyMac*, *Imperial Capital Bancorp*, and *First Cent. Fin. Corp.* on the basis that those TSAs included language directly addressing distribution of refunds.
  - Cited Eleventh Circuit's *BankUnited* decision approvingly regarding inability to infer from TSA creation of debtor-creditor relationship.

14

KILPATRICK TOWNSEND

AmFin

- **Sixth Circuit Opinion (cont.)**
  - Rejected application of *Bob Richards* rule because state law determines extent of debtor's estate and there was no need to resort to federal common law.
  - As a result, held that district court required to look to evidence of parties' intent, as developed in discovery.
  - Further rejected debtor's objections under Ohio law to use of extrinsic evidence and remanded for consideration of parties' intent under Ohio agency and trust law.

KILPATRICK TOWNSEND

Are FDIC Claims "Senior Indebtedness" under Trust Preferred Indentures?

- FDIC has argued that, even if tax refund is property of bankruptcy estate, FDIC's unsecured claim against debtor has priority over claims of holders of trust preferred securities (TRuPS) because it is a claim for "money borrowed" that constitutes "Senior Indebtedness" under the relevant indenture.
- Background: Vast majority of debt in bank holding company cases is owed to holders of TRuPS. TRuPS are hybrid securities with characteristics of subordinated debt and preferred stock. Attractive to bank holding companies because they constituted Tier 1 capital for regulatory purposes.
- Potential Impact: If FDIC prevailed on this issue, its unsecured claim against HoldCo for payment of refund would have priority over significant percentage of all unsecured claims (those of TRuPS holders) and FDIC would receive lion's share of the refund regardless of having lost the ownership issue.
- No court has yet accepted FDIC argument.

16

KILPATRICK TOWNSEND

Are FDIC Claims "Senior Indebtedness" under Trust Preferred Indentures?

- Relevant provisions of indenture
  - "Senior Indebtedness means, with respect to the [Debtor], (i) the principal, premium, if any, and interest in respect of (A) indebtedness of the [Debtor] for money borrowed…."
  - "The payment by the [Debtor] of the principal of, and premium, if any, and interest on all Debentures shall, to the extent and in the manner hereinafter set forth, be subordinated and junior in right of payment to the prior payment in full of all Senior Indebtedness of the Company…."
  - "Any moneys collected by the Trustee … shall be applied in the following order … First: To the payment of costs and expenses incurred by, and reasonable fees of, the Trustee…. Second: To the payment of all Senior Indebtedness of the [Debtor] if and to the extent required by [the article of the indenture concerning subordination]…."

17

KILPATRICK TOWNSEND

Are FDIC Claims "Senior Indebtedness" under Trust Preferred Indentures?

- Case Law
  - *In re Imperial Capital Bancorp, Inc.*, Case No. 09-19431, slip op. at 12 (Bankr. S.D. Cal. May 23, 2012), [ECF No. 894]
    - "The types of debts embodied in the FDIC-R's tax refund claim [pursuant to a tax sharing agreement] do not qualify as 'money borrowed' applying the ordinary meaning of these words. Simply put: none of the debts arise from the act of the Debtor's borrowing of money from Imperial Capital Bank with the promise to repay, nor do they arise from the Bank's act of advancing money to the Debtor upon the Debtor's promise to repay."
  - *Siegel v. FDIC (In re IndyMac Bancorp, Inc.)*, Adv. Pro. No. 2:09-ap-01698-BB, 2012 WL 1037481 (Bankr. C.D. Cal. Mar. 29, 2012), *adopted by In re IndyMac Bancorp, Inc.*, No. 12-02967-RGK, 2012 WL 1951474 (C.D. Cal. May 30, 2012), *aff'd* 554 F. App'x 668 (9th Cir. 2014).
    - "The [tax sharing agreement] is not structured as a 'loan' or an 'extension of credit.' There is no borrowing event. There is no money or other property of the Bank ever borrowed by Bancorp. Instead of a claim for money borrowed, the [tax sharing agreement] creates a general contractual obligation that may be triggered by external events."

18