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Whose Refund Is It? Ninth Circuit Holds Tax Refund Belongs to Bankruptcy Estate of Bank Holding Company, Not to Receivership Estate of Subsidiary Bank

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Summary: We previously reported on the Eleventh Circuit's decisions in *BankUnited* and *NetBank* in which the Eleventh Circuit held that tax refunds attributable to losses incurred by an insolvent bank but received by the bank's holding company belonged to the FDIC, as receiver for the bank, rather than to the holding company's bankruptcy estate. We noted in those reports that it remained to be seen whether these decisions would change the general direction of the law on this issue, or be viewed as limited to their facts. The Ninth Circuit's recent decision in the *IndyMac Bancorp* bankruptcy case, which holds that disputed tax refunds belong to the bankruptcy estate of holding company IndyMac Bancorp, rather than to the FDIC as the receiver for IndyMac Bank, suggests that courts may limit the Eleventh Circuit decisions to their facts.

In prior Client Alerts, we reported on two Eleventh Circuit decisions, *BankUnited* and *NetBank*, in which the Eleventh Circuit seemingly broke from prior precedent established by lower courts and held that tax refunds attributable to losses incurred by an insolvent bank, but received by the bank's holding company, belonged to the FDIC, as receiver for the bank, rather than to the bankruptcy estate of the holding company. In those prior Client Alerts, we queried whether in the future other courts would follow the Eleventh Circuit's approach in *BankUnited* and *NetBank* or limit these cases to their facts and continue to follow the earlier precedent. The recent Ninth Circuit decision arising from the IndyMac Bancorp ("IndyMac") bankruptcy case, which—like the decision of the Delaware bankruptcy court in *In re Downey Financial Corp.*, about which we also reported—reaches the opposite result from the Eleventh Circuit, suggests that courts may limit the Eleventh Circuit cases to their facts. *See In re IndyMac Bancorp, Inc.*, No. 12-02967, 2014 WL 1568759 (9th Cir. April 21, 2014).

Just as in the other cases on which we have reported, the Ninth Circuit decision in the *IndyMac* case arose from a dispute between the FDIC, as receiver for a subsidiary bank (in this case, IndyMac Bank F.S.B. (the "Bank")), and the bankruptcy estate of its holding company parent (in this case, IndyMac (the "Holding Company")). As in the other cases, the dispute concerned the ownership of tax refunds attributable to losses that had been incurred by the Bank but paid to and received by the Holding Company as the result of the Bank's and Holding Company's decision to file

a consolidated tax return. As in *BankUnited* and *NetBank*, both the bankruptcy court and the district court ruled that the tax refunds at issue (more than $55 million) belonged to the Holding Company and not to the Bank. And, as in those earlier cases, the bankruptcy and district courts held that, while the FDIC as receiver for the Bank had a claim against the Holding Company for those refunds, the claim was merely a general unsecured claim.

Unlike the Eleventh Circuit in *BankUnited* and *NetBank*, however, the Ninth Circuit in *IndyMac* affirmed the rulings of the lower courts. In doing so, it relied on the terms of the Tax Sharing Agreement (the "TSA") to which the Holding Company and the Bank were parties, noting that the lower courts' findings that the agreement was unambiguous had not been challenged by either party on appeal. In a prior case, the Ninth Circuit had held that in the absence of an explicit agreement between the parties to the contrary, tax refunds attributable to losses incurred by a subsidiary bank but paid to the parent holding company were the property of the bank. *See In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262, 264 (9th Cir. 1973). But, in the *IndyMac* case, the court held that the TSA was just such an "explicit agreement." In particular, it held that (i) the TSA provided for any refund to be paid to the Holding Company, and (ii) when the Holding Company received the tax refunds, it did not receive them as agent or trustee for the Bank. Applying California law, the Ninth Circuit concluded that the TSA did not establish a principal-agent relationship between the Holding Company and the Bank because the Bank did not exercise control over the Holding Company's activities, and did not create a trust relationship because there was no explicit language to that effect. Rather, under the TSA, the funds became the Holding Company's property, and the Bank simply became a general unsecured creditor of the Holding Company for the amount of the refund.

Significantly, the Ninth Circuit concluded that it did not need to address the Eleventh Circuit's decision in *NetBank* because NetBank "involved a tax sharing agreement that explicitly incorporated the Interagency Statement on Income Tax Allocation in Holding Company Structure (which the TSA in this case did not) . . . and involved the application of Georgia, not California, state law." *In re IndyMac Bancorp*, 2014 WL 1568759, *2. (As we have previously reported, the Interagency Statement on Income Tax Allocation provides that a parent company receives refunds from a taxing authority as agent for the members of the tax sharing group and counsels banks against entering into tax allocation agreements that would grant the parent company ownership of refunds attributable to losses of the bank.). The court never mentioned the Eleventh Circuit's *BankUnited* decision.

The Bottom Line

While the Ninth Circuit's decision in *IndyMac* will almost certainly not be the final word on this issue, it does suggest that the Eleventh Circuit's decisions in *BankUnited* and *NetBank* may not lead to a general shift in the direction of the law in this area. However, even if subsequent courts continue to limit those decisions to their facts, as the Ninth Circuit did in *IndyMac* (and as the Delaware Bankruptcy Court did in *Downey Financial*), the Eleventh Circuit decisions will continue to be important support for the principle that clear and explicit language regarding the ownership of any tax refunds in the tax sharing agreements between banks and their non-bank affiliates will likely be controlling.

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