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Whose Refund Is It? The Sixth Circuit Weighs in, Finding Tax Sharing Agreement Between Bank and Holding Company Ambiguous on Ownership of Refunds

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Summary: In its recent *AmFin* decision, the Sixth Circuit joined a growing line of cases considering whether tax refunds paid to a bank holding company pursuant to a tax sharing agreement between the holding company and its subsidiary bank, but attributable to losses incurred by the bank, are the property of the holding company's bankruptcy estate or of the FDIC as receiver for the bank. The Sixth Circuit reversed a district court decision which had held that the tax refund belonged to the bankruptcy estate of the holding company. Finding that the tax sharing agreement was ambiguous, the Sixth Circuit remanded for the district court to consider extrinsic evidence of the parties' intent. In so holding, the Sixth Circuit appeared to take a different approach than that adopted by the Ninth Circuit in its recent decision in *IndyMac* and a line of lower court decisions, which had held in favor of the bankruptcy estate of the holding company parent. But this growing line of cases regarding the construction of tax sharing agreements in the bankruptcy/receivership context could come to an end if a recent regulatory change promulgated by the Federal Reserve and FDIC leads banks and their holding company parents to adopt tax sharing agreements that unambiguously provide that any tax refunds attributable to losses incurred by the banks are the banks' property.

In its recent *AmFin* decision, the Sixth Circuit joins the line of courts seeking to interpret tax sharing agreements deemed ambiguous in the bankruptcy context. But that growing line of cases could one day end if a recent regulatory change promulgated by the Federal Reserve and FDIC resolves those ambiguities in tax sharing agreements moving forward.

As we have discussed in prior Client Alerts, the Eleventh Circuit, the Ninth Circuit, and the Delaware bankruptcy court have all recently weighed in on the issue of whether tax refunds arising out of losses of an insolvent bank belong to the FDIC, as receiver for the bank, or to the bankruptcy estate of the bank's holding company parent to whom the IRS issued the refund. The Eleventh Circuit addressed this issue in *BankUnited* and *NetBank*, concluding in both cases that the refund belonged to the FDIC, as receiver for the bank. These decisions were an apparent departure from a long line of lower court decisions that had held in favor of holding companies' bankruptcy estates in such disputes. The Eleventh Circuit decisions were followed by the Delaware bankruptcy court's

decision in *Downey Financial Corp.* and the Ninth Circuit's decision in *IndyMac Bancorp*, both of which held that the tax refund at issue belonged to the holding company's bankruptcy estate. Those cases suggested that the Eleventh Circuit decisions in *BankUnited* and *NetBank* might be limited to their facts and would not be followed by other courts. In its decision in *FDIC v. AmFin Financial Corp.*, No. 13-3669, 2014 WL 3057097 (6th Cir. July 8, 2014), the Sixth Circuit has now weighed in on this issue, and the direction of the law on this issue is once again unclear.

AmFin Financial Corp. ("AFC") is the parent of a group of banks that included AmTrust Bank ("AmTrust"). AFC and its affiliates, including AmTrust, entered into a Tax Sharing Agreement ("TSA"). The TSA addressed the manner in which the affiliated companies would allocate the consolidated tax liability of the group and the manner in which certain tax attributes were to be treated among the group. With respect to tax refunds, the TSA provided only that, in the event a loss carryback refund application was filed, the parties to the TSA would redetermine their respective liabilities to account for the loss carryback and "promptly settle any amounts owing among them." *Id*. at *2.

In November 2009, AFC filed for bankruptcy, and the FDIC closed AmTrust and placed it into FDIC receivership. AFC later filed a consolidated tax return on behalf of the consolidated tax group which reported operating losses of $805 million, almost all of which were attributable to AmTrust's operations. That return resulted in a refund issued to AFC in the amount of $194 million. The FDIC maintained that $170 million of that refund belonged to AmTrust and filed a complaint in the United States District Court for the Northern District of Ohio seeking a declaratory judgment that the refund belonged to AmTrust. The district court granted judgment for AFC on the pleadings, concluding that the TSA unambiguously created only a debtor-creditor relationship between AFC and AmTrust with respect to the tax refunds and that the refund thus was the property of the AFC bankruptcy estate. The district court denied the FDIC's motion to amend its complaint to reflect extrinsic evidence regarding AFC and AmTrust's intent with respect to refunds under the TSA.

The Sixth Circuit reversed and remanded. The Court of Appeals disagreed with the district court's conclusion that the TSA was unambiguous with respect to the ownership of tax refunds. It rejected AFC's reliance on the loss carryback refund provision in the TSA, holding that the provision spoke only to the allocation of liability among the members of the tax group, and not to the ownership of a refund. Citing the Eleventh Circuit's decision in *BankUnited*, the Court noted that "the TSA says nothing about tax refunds received by AFC on behalf of the group and includes no protections for the putative creditor, as one would expect if the parties intended a debtor-creditor relationship." *Id*. at *4. It concluded that

> "persuasive case law supports our conclusion that the use of terms such as 'reimbursement' and 'payment' need not create a debtor-creditor relationship, especially when the TSA contains no provisions to protect the creditor subsidiary's interest in the refund while it remains under AFC's control."

Id.

Finding that the TSA was ambiguous, the Sixth Circuit went on to address the FDIC's contention that, since the TSA was silent on the issue of tax refunds, the Court should apply the principle enunciated in *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262, 265 (9th Cir. 1973), and hold that the refund belonged to AmTrust. In *Bob Richards*, the Ninth Circuit had held that, absent any agreement to the contrary, a tax refund resulting from offsetting losses of one member of a consolidated filing group against the income of that same member in a subsequent year should inure to the benefit of that member. The Sixth Circuit, however, declined to apply the *Bob Richards* principle, holding that it was a federal common law rule and that federal common law should be applied only when there is a significant conflict between state law and some federal policy or interest.[1] The Court found that there was no such conflict in *AmFin* because federal precedent has recognized that state law determines whether property should be included in or excluded from a bankruptcy estate. The Court thus concluded that Ohio law should determine who owns the tax refund. Rejecting AFC's objections based on Ohio law to the use of the extrinsic evidence proffered by the FDIC, the Court held that the district court had erred in granting AFC judgment on the pleadings and disallowing the FDIC's proffer of extrinsic evidence. The Sixth Circuit reversed and remanded the case to the district court for further proceedings consistent with the Court's opinion. It instructed the district court to consider extrinsic evidence concerning the parties' intent and Ohio agency and trust law.

While the Sixth Circuit did not finally decide the ownership of the tax refund, in finding the TSA ambiguous the Court followed the Eleventh Circuit's *BankUnited* approach, rejecting the notion that language in a tax sharing agreement providing an obligation to pay or reimburse unambiguously establishes a debtor-creditor relationship. Consistent with all the previous decisions on this issue, the Court also made clear that the parties to a tax sharing agreement are free to contractually determine the ownership of any refund received by the parent company on behalf of the consolidated tax group, and that the language of the agreement, if clear, will control. Whether other courts in the future will follow the Eleventh and Sixth Circuits with respect to the construction of tax sharing agreements or will adhere to the approach taken by the lower courts and the Ninth Circuit remains to be seen.

Another recent development, however, may diminish the importance of this apparent conflict among the courts. In June of this year, the Department of the Treasury, the Federal Reserve Board of Governors and the FDIC issued an Addendum to the Interagency Policy Statement on Income Tax Allocation in Holding Company Structure. That Addendum mandates that insured depository institutions that are part of a consolidated tax group include in any tax sharing agreement among the members of the consolidated group language providing that the parent company acts as an agent for the institution with respect to any tax refunds and that refunds attributable to the institution shall be held in trust by the holding company for the benefit of the institution. Assuming that bank holding companies and their bank subsidiaries include the required language in their tax sharing agreements, courts may find that language unambiguous and hold that any tax refunds attributable to losses of a bank are its property.

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[1] One of the three judges on the panel wrote a separate concurring opinion in which he indicated

that he would apply *Bob Richards* where the TSA is ambiguous and the ambiguity cannot be resolved under state law.

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