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Whose Refund Is It? Eleventh Circuit Holds for the Second Time in a Month That Tax Refund Belongs to FDIC as Receiver for Bank and Not to Holding Company's Bankruptcy Estate

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Summary: For the second time in less than a month, the Eleventh Circuit has held that a tax refund belongs to the FDIC, as receiver for the bank, rather than to the bankruptcy estate of the bank's holding company. While the tax sharing agreements at issue in the Eleventh Circuit decisions were in some respects unusual, the Eleventh Circuit also appears to have discredited arguments that had been credited in earlier decisions by district and bankruptcy courts finding that tax refunds were the property of the bank. Thus, these recent Eleventh Circuit decisions create uncertainty with respect to the ownership of tax refunds attributable to failed banks.

We recently issued a Client Alert about the Eleventh Circuit's decision in *Zucker v. FDIC* (*In re BankUnited Fin. Corp.*), ___F.3d ___, No. 12-11392, 2013 WL 4106387 (11th Cir. Aug. 15, 2013). There, in a decision that conflicted with a line of earlier cases, the Eleventh Circuit held that a tax refund attributable to losses incurred by an insolvent bank subsidiary belonged to the FDIC, as receiver for the bank, rather than to the bankruptcy estate of the bank's holding company. The Eleventh Circuit has now issued a second decision addressing the same question, this time in the bankruptcy case of NetBank, Inc. ("NetBank"). Though the *BankUnited* and *NetBank* facts are not the same, the Eleventh Circuit has reached the same conclusion in both cases. *FDIC v. Zucker* (*In re NetBank, Inc.*), __ F.3d __, No. 12-13965, 2013 WL 4804325 (11th Cir. Sept. 10, 2013) ("*NetBank*").

NetBank was the parent company of NetBank, f.s.b. (the "Bank"), as well as a number of other subsidiaries. As authorized by IRS regulations, NetBank filed consolidated tax returns on behalf of itself and all of its subsidiaries, including the Bank and its subsidiaries (the "Bank Group"). All members of the NetBank consolidated tax group entered into a tax sharing agreement (the "TSA") addressing how the tax liabilities of the group would be allocated and paid. *Id*. at *1.

Pursuant to the TSA, NetBank was responsible for preparing and filing consolidated returns on behalf of the group and was given sole discretion with respect to most matters concerning the consolidated returns, including the right to file and settle any claims for refunds. Each member of the consolidated group appointed NetBank "as its agent and attorney-in fact to take such action . . .

as NetBank deemed appropriate." *Id*. at *2-3. If the Bank Group incurred "a net operating loss, a net capital loss or [was] entitled to credits against tax," the TSA further required NetBank to pay the Bank not later than 30 days after the date on which a credit was allowed or refund was received "no less than the amount the Bank would have received as a separate entity (including its subsidiaries), regardless of whether the consolidated group [was] receiving a refund." *Id*. at *2. The TSA further stated that its purpose was to allocate "the tax liability in accordance with the Interagency Statement on Income Tax Allocation in a Holding Company Structure," and thus that tax settlements between NetBank and the Bank Group should "result in no less favorable treatment to the Bank Affiliated Group than if it had filed its income tax return as a separate entity." *Id*. at *3.

On September 28, 2007, the Office of Thrift Supervision closed the Bank and appointed the FDIC as receiver. On that same day, NetBank filed for Chapter 11. *Id*. at *1. Thereafter, both the FDIC, as receiver for the Bank, and NetBank's bankruptcy estate filed for a tax refund attributable to losses of the Bank. NetBank's bankruptcy estate commenced an adversary proceeding in its bankruptcy case seeking a declaration that the refund was property of the estate, and the FDIC counterclaimed. On cross-motions for summary judgment, the bankruptcy court ruled in favor of NetBank, holding that the TSA created merely a debtor-creditor relationship between NetBank and the Bank. *See Zucker v. FDIC* (*In re NetBank*), 459 B.R. 801 (Bankr. M.D. Fla. 2010). In other words, the bankruptcy court decided that any refund to be received by NetBank, but attributable to losses incurred by the Bank Group, was the property of NetBank's bankruptcy estate and that the Bank Group held only a general unsecured claim in NetBank's bankruptcy case for the amount of the refund.

In reaching this conclusion, the bankruptcy court relied on the broad discretion that the TSA gave to NetBank in connection with the consolidated tax returns and the processing of any refunds, the fact that NetBank could be obligated to pay the Bank regardless of whether or not NetBank received a refund, and the absence of any language in the TSA requiring NetBank to segregate any refund or restrict its use of the proceeds. The district court summarily affirmed, noting that the bankruptcy court's decision was consistent with the "strong majority view." *Zucker v. FDIC* (*In re NetBank*), 2012 WL 2383297, at *1 (M.D. Fla. June 25, 2012).

The Eleventh Circuit, however, rejected the bankruptcy court's analysis. It held that the TSA was ambiguous with respect to ownership of the tax refunds. *NetBank*, 2013 WL4804325, *4. Relying on Georgia law regarding contract interpretation, the court of appeals resolved the ambiguity by considering the "background of the contract and the circumstances under which it was entered into, particularly the purpose for the particular language to be construed." *Id*. at 4-6. In the Eleventh Circuit's view, the Interagency Policy Statement was key to all of these factors: It not only provided the background for the contract, but the TSA expressly provided that the intent of the parties was to comply with the Policy Statement. The Policy Statement, in turn, states that a parent receives refunds from a taxing authority as "'agent' on behalf of the group members" and counsels against entering into a tax allocation that would grant the parent ownership of refunds attributable to the Bank. *Id*. at 5. Based on the language of the TSA and the Policy Statement, the court of appeals concluded that the parties to the TSA intended to create an agency relationship with respect to refunds attributable solely to the Bank Group-*i.e.*, the parties intended that NetBank would hold such refunds as agent for the Bank Group. It therefore entered judgment for the FDIC.

In concluding that the TSA created an agency relationship, the Eleventh Circuit acknowledged that the TSA contained some provisions that appeared to be inconsistent with that conclusion-most notably, the obligation of NetBank to pay the Bank an amount equal to any tax refund to which the Bank Group would have been entitled if it had filed a separate tax return even if NetBank in fact did not receive a refund from the IRS. While concluding that this was a factor causing the TSA to be ambiguous, the court declined to address whether NetBank's obligation to pay the Bank the amount of any such hypothetical refund would be more than a general unsecured debt, as that case was not before the court. The Eleventh Circuit also held that the absence of language in the TSA requiring NetBank to hold any refund attributable to the Bank's losses that NetBank actually received in trust or escrow was not decisive, as it was "offset entirely by the similar absence of any language indicative of a debtor-creditor relationship-e.g., provisions for interest and collateral." *Id*. at *6.

The reference to the Interagency Policy Statement in the NetBank TSA-which, as far as we can tell, was not included in the tax sharing agreements in earlier cases resolving disputes over tax refunds-was a critical factor for the Eleventh Circuit. Thus, like the *BankUnited* decision, the Eleventh Circuit decision in *NetBank* might be seen as limited to its facts. (In *BankUnited*, as we noted in our prior Client Alert, the tax sharing agreement contained an unusual term providing for the bank subsidiary, rather than the parent holding company, to make any tax payments on behalf of the consolidated group and to allocate to the members of the consolidated group any tax refunds received on behalf of the consolidated group.) But in its critique of the bankruptcy court's opinion in *NetBank*, the Eleventh Circuit also rejected as unpersuasive the argument that the absence of trust or agency language in the TSA required a finding of a debtor-creditor relationship, an argument that some of the earlier decisions holding that tax refunds belonged to the holding company's bankruptcy estate had credited. This suggests that the Eleventh Circuit might find an agency or trust relationship even when construing tax sharing agreements without the somewhat atypical provisions found in the *NetBank* and *BankUnited* cases.

As we concluded in our *BankUnited* Client Alert, time will tell what effects the *NetBank* decision will have on these tax refund issues moving forward. Will other courts limit these Eleventh Circuit decisions to their respective facts? Or will they follow the Eleventh Circuit's repeated approach to the interpretation of tax sharing agreements that do not clearly and unambiguously state who owns tax refunds that are received by the holding company but that are attributable to losses suffered by the insolvent bank subsidiary? Stay tuned.

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