



Not So Fast! Sixth Circuit Rescinds Award of Tax Refund to Bankruptcy Estate

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On July 8, 2014, the Sixth Circuit Court of Appeals reversed and remanded the District Court's decision in *FDIC v. AmFin Financial Corporation*, holding that it erred in refusing to consider the FDIC's extrinsic evidence that the parties intended to establish an agency or trust relationship in their tax-sharing agreement ("TSA").

The dispute centered on ownership of a \$170 million tax refund that the IRS issued to the AmFin Financial Corporation ("AFC"), the parent company of a group of banks that filed a consolidated tax return, but which was generated by AmTrust Bank ("AmTrust"), the subsidiary bank whose net operating losses created the refund.

Factual Background

In 2006, AFC entered into a TSA with its affiliates, including AmTrust, to allocate tax liability. Three years later, AFC filed for bankruptcy, which resulted in AmTrust's closure and placement into FDIC receivership. Later that year, AFC filed a consolidated 2008 tax return that generated a \$194 million refund that the IRS issued to AFC. The FDIC asserted that \$170 million of the refund belonged to AmTrust because it resulted from the use of AmTrust's net operating losses to offset the consolidated group's income. While AFC conceded that \$170 million of the refund was generated by losses of AmTrust, it maintained that the refund belonged to AFC's bankruptcy estate.

The District Court Proceedings and Appeal

The District Court held that the TSA unambiguously designated the refund to AFC's bankruptcy estate and refused to allow the FDIC to introduce extrinsic evidence that demonstrated an agency or trust relationship existed between the parties. The Sixth Circuit, however, reversed and remanded the decision, instructing the District Court to consider the evidence concerning the parties' intent in accordance with Ohio trust and agency law.

1. Analyzing the TSA

Unlike the District Court, the Sixth Circuit did not find that the TSA unambiguously established a debtor-creditor relationship entitling AFC to the refund. Like many other tax sharing agreements, the TSA only addressed each affiliate's responsibility to pay for its portion of the tax liability, and excluded any discussion regarding ownership of any resulting refund. Therefore, according to the Sixth Circuit, the District Court's citation of cases in which a TSA directly addressed the distribution of refunds was not dispositive. Additionally, the Sixth Circuit cited an Eleventh Circuit case, *In re BankUnited Financial*

Corp., 727 F.3d 1100 (11th Cir. 2013), that rejected a debtor-creditor relationship where a tax sharing agreement lacked protections for the creditor. *Id.* at 1108. The Sixth Circuit also refused to sustain the District Court's assignment of specialized meaning to common terms such as "payment" and "reimbursement".

2. *Bob Richards' Court Principle*

In its decision to reverse and remand the District Court's decision, the Sixth Circuit also declined to apply the principle stated in *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262 (9th Cir.1973) where the latter court held that, absent any opposing agreement, a tax refund that results from offsetting one affiliate's losses against the income of the consolidated filing group should be allocated to that affiliate member. *Id.* at 265. Rather than applying this federal common law, the Sixth Circuit found that Congress generally permits state law to dictate whether to include property in a bankruptcy estate and that Ohio law should resolve ownership of the tax refund.

Takeaways

The Sixth Circuit's decision in AmFin is instructive in how to draft tax sharing agreements that not only indicate each subsidiary's tax liability in a consolidated group filing, but also expressly state the distribution process for any tax refunds issued to the group.

The FDIC is now requiring that insured depository institutions amend their tax sharing agreements to make explicit that any tax refunds attributable to income earned, taxes paid, and losses incurred by the insured depository institution are the property of and owned by the insured depository institution.

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