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In Split from Eleventh Circuit, Ninth Circuit Holds That a Tax-Sharing Agreement Constitutes a Debtor-Creditor Relationship

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May 22, 2014 - In a follow-up to our post on the treatment of tax-sharing arrangements in bankruptcy, the Ninth Circuit held last month in an unpublished decision that a rebate that a holding company received pursuant to an ambiguous tax-sharing agreement ("TSA") created a debtor-creditor relationship between the holding company and its banking subsidiary. In the Matter of: Indymac Bancorp, Inc., (12-56218) (9th Cir., April 21, 2014). As a result, the refund was property of the bankruptcy estate of the holding company, a significant windfall for the holding company and a significant loss to its subsidiary's estate. The Ninth Circuit's decision is in contrast to the twin decisions of the Eleventh Circuit in the fall of 2013,[1] finding that two separate TSAs in unrelated cases created an agency relationship between a holding company and its subsidiary, thereby excluding the refund from the estate. SeeInRe Bamkunited Financial Corp., 12-11392 (11th Cir. Aug. 15, 2013); In Re Netbank, Inc., 12-13965 (11th Cir. Sept. 10, 2013)

As explained in our prior post, when a bankruptcy occurs, one affiliate may be holding the rebate for the entire conglomerate and the distinction between the relationships between the affiliated entities affects how that refund will be treated in bankruptcy. If the TSA created an agency relationship, the refund will be excluded from the estate and the refund will be split as it would in the ordinary course of business. If, however, the TSA create a debtor-creditor relationship, the entire refund becomes property of the estate holding the rebate and the other entities receive only an unsecured creditor claim for that refund – a potentially significant windfall for creditors of the rebate-holding entity and a significant loss of funds for creditors of the other entities of the conglomerate.

The Ninth Circuit distinguished Indymac from the Eleventh Circuit's Netbank decision based on two factors: (i) that the Netbank case involved a TSA with an explicit incorporation of the Interagency Statement on Income Tax

Allocation in Holding Company Structure (which the Indymac TSA did not), and (ii) that California law applied in Indymac rather than the Georgia law that governed Netbank. The Ninth Circuit held that under California law, the TSA did not create a principal-agent relationship – despite specific language that appointed the holding company the subsidiary bank's "agent and attorney-in-fact" because the subsidiary bank did not exercise control over its holding company's activities with respect to any aspect of the tax filing. Separately, the Ninth Circuit held that the TSA's lack of language establishing a trust relationship was explicitly an indication of a debtor-creditor relationship under California law.

This case reinforces the need for a company considering the creation of a TSA to address explicitly how any tax refund will be treated in the event of a bankruptcy. Given the varying decisions from courts on ambiguous TSAs and the potential effects of different state laws, a TSA that does not address how it should be interpreted in bankruptcy creates uncertainty as to where any tax refund may wind up in a bankruptcy, and creates the risk that in a bankruptcy resources of the estate will be wasted on litigation over the interpretation of an ambiguous TSA.

[1] *In* re Bankunited Financial Corp., 12-11392 (11th Cir. Aug. 15, 2013); In Re Netbank, Inc., 12-13965 (11th Cir. Sept. 10, 2013)

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