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## Third Circuit Holds That Tax-Sharing Arrangement Creates a Debtor-Creditor Relationship

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**February 10, 2015** - Continuing [a string of decisions](#) interpreting tax-sharing arrangements, the Third Circuit recently held that under California law, a tax-sharing arrangement unambiguously created a debtor-creditor relationship and did not create an agency relationship or a trust relationship. At issue in *In re Downey Financial Corp.* 2015 WL 307013 (C.A.3 (Del.),2015) was the division of over \$370 million in tax refunds held in the holding company's estate, and if its subsidiaries would receive their full portion of the refund or merely an unsecured claim for that portion of the refund.

The Third Circuit held that under California law, the tax-sharing arrangement unambiguously created a debtor-creditor relationship as the lack of any right of the subsidiaries to control the actions of the parent company precluded an agent relationship. Furthermore, the lack of any discussion of trusts, beneficiaries, or trustees precluded a finding that the contract created a trust relationship. This decision contributes to the ambiguity regarding tax-sharing arrangements in bankruptcy, as different circuits applying different state law have reached opposite conclusions from similar language in the agreements.

This ambiguity reinforces the need for any group of companies with a tax-sharing arrangement to clarify the treatment of any refund in bankruptcy to provide certainty to their creditors and to avoid the dissipation of assets litigating the issue in any future bankruptcy proceeding.

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