ALERTS

Tenth Circuit Applies State Law to Resolve Debtor's Claimed Ownership of Tax Refund

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The bankruptcy trustee of a bank holding company was not entitled to a consolidated corporate tax refund when a bank subsidiary had incurred losses generating the refund, held the U.S. Court of Appeals for the Tenth Circuit on May 26, 2020. *Rodriguez v. FDIC (In re United Western Bancorp, Inc.)*, 2020 WL 2702425(10th Cir May 26, 2020). On remand from the U.S. Supreme Court, the Tenth Circuit, as directed, applied "Colorado law to resolve" the question of "who owns the federal tax refund." *Id.*, at *2. The court had initially held for the FDIC, the bank subsidiary's receiver, but, according to the Supreme Court, mistakenly failed to apply state law and relied instead on a Ninth Circuit decision, *In re Bob Richards Chrysler Plymouth Corp.*, 473 F.2d 262,265 (9th Cir 1973). *Id.* The Supreme Court rejected *Bob Richards* as inappropriate federal "common lawmaking," and remanded the case back to the Tenth Circuit. *Id.*

Relevance

Federal courts often have to resolve consolidated corporate tax refund issues in bankruptcy cases. They have not only relied on written tax sharing agreements, but have also implied such agreements based on the actions of a group member. *Capital Bancshares, Inc., v. FDIC*, 957 F, 2d 203, 207 (5th Cir. 1992) ("[C]ourts will not question an allocation which results from an express agreement which is clearly implied"); *Bob Richards*, 473 F.2d at 265 (9th Cir. 1973) (. . . where an agreement can be

fairly implied, as a matter of state corporation law the parties are free to adjust among themselves the ultimate tax liability."); *In re First Financial Corp.*, 269 B.R.481 490 (Bankr. E. D. N.Y. 2001) (same); *In re All Prods. Co.*, 32 B.R. 811, 814 (Bankr E.D. Mich. 1983) (same). *But see In re Coral Petroleum, Inc.*, 60 B.R. 377, 388, 390 (Bankr. S. D. Tex. 1986) (rejected claim by consolidated group member against parent to be compensated for use of its losses to offset group taxable income when no tax sharing agreement existed; *held*, no implied contract to compensate subsidiary group member; bookkeeping alone is insufficient to establish a duty to compensate for the use of the losses; also, "in absence of fraud or goverreaching," decision to compensate group member "for tax savings is a matter of business judgment not to be disturbed by the court," even when parent dominates subsidiary).

Banks and sophisticated lenders often require written tax sharing agreements that are favorable to the group member borrowing funds, but trade creditors usually lack that leverage. As a result, a bankruptcy court may misread or imply a tax sharing agreement when confronting the entitlement issue in the case of a group member under the court's protection, as happened in *Rodriguez*.

Facts

The Internal Revenue Service (IRS) in *Rodriguez* paid a tax refund to the bank holding company, although the tax refund had resulted from losses incurred by its bank subsidiary. The bankruptcy trustee of the holding company sued the FDIC, as receiver for the bank, claiming ownership of the refund. The bankruptcy court granted summary judgment for the trustee, finding that the parent owned the refund, but the district court reversed. In its original decision, the Tenth Circuit, applying *Bob Richards*, affirmed the district court's judgment that the tax refund belonged to the FDIC (the subsidiary's receiver), finding that the parties' tax allocation agreement was "ambiguous." Still, the parent holding company had an agency relationship "with respect to federal tax refunds," held the Tenth Circuit, and had agreed to an "equitable allocation of tax liability." *In re United Western Bancorp, Inc.*, 914 F.3d 1262, 1274 (10th Cir 2019). According to the allocation agreement, tax benefits would be computed "on a separate entity basis for each" member of the affiliated corporate group. *Id.*, at 1270.

Analysis

Ambiguous Agreement. Despite the Supreme Court's holding, the Tenth Circuit said that it had "not ignore[d] Colorado law in [its] original decision." 2020 WL 270 2425, at *2. Reviewing the affiliates' tax sharing agreement, it first found it to be "at best, ambiguous regarding the nature of the relationship that [the parent holding company] and the Bank intended to create with one another." *Id.* On one hand, certain provisions suggested that the parent was the bank's agent in collecting the refund, but other provisions suggested "something other than an agency relationship." *Id.* The court stressed that the relevant provision of the tax sharing agreement was "poorly drafted and ambiguous." *Id.*, at *6.

Clear Resolution Provision. But the group's tax sharing agreement, held the court, explicitly "provides a method for resolving the ambiguity." *Id.* "Any ambiguity in the interpretation hereof shall be resolved, with a view to effectuating such intent [i.e., to provide an equitable allocation of the tax liability of the Group among [the parent] and the Affiliates], in favor of any insured depository institution." *Id.* (quoting agreement). Thus, instead of a debtor-creditor relationship that would give "ownership of federal tax refunds to" the parent, the court construed the tax sharing agreement in favor of the bank subsidiary — an agency relationship "affording ownership of the tax refund to the Bank." *Id.* In the end, Colorado contract law governed the outcome here.

Comment

This dispute arose in a bankruptcy case. But "the determination of property rights" in a debtor's assets is governed by state law. *Butner v. United States*, 440 U.S. 48, 54 (1979). *See also Wellness International Network Ltd. v. Sharif*, 135 S. Ct. 1932, 1952 (2015) ("Identifying property that constitutes the estate has long been a central feature of bankruptcy adjudication.") (dissent on other grounds) (Roberts, Ch. J.), citing *Stern v. Marshall*, 131 S. Ct. 2594, 2619 (2011).

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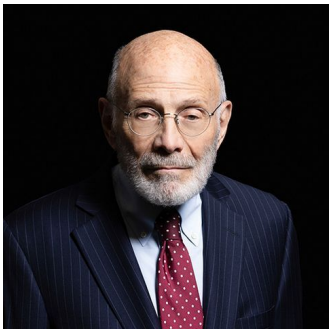

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