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Banking Agency Guidance on Tax Allocation Agreements

On June 13, the federal banking agencies (the "Agencies")[1] issued final guidance on income tax allocation agreements between bank holding companies and their insured depository institution subsidiaries ("IDIs"). The guidance is in the form of an Addendum to the 1988 Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure (the "Interagency Policy Statement"), which advises IDIs and their holding companies regarding the payment of taxes on a consolidated basis.

The Addendum (available here) instructs IDIs and their holding companies to review and revise their tax allocation agreements to ensure that those agreements (1) expressly acknowledge that the holding company receives a tax refund from a taxing authority as agent for the IDI, and (2) are consistent with the requirements of Sections 23A and 23B of the Federal Reserve Act. The Addendum includes a sample paragraph that IDIs can insert in their tax allocation agreements to satisfy the guidance. IDIs and holding companies must implement the provisions of the Addendum as soon as reasonably possible and not later than October 31, 2014.

Background

In 1998, the Agencies issued the Interagency Policy Statement to provide guidance to IDIs and their holding companies and other affiliates ("Consolidated Groups") regarding the payment of taxes on a consolidated basis.[2] One of the principal goals of the Interagency Policy Statement is to permit Consolidated Groups to file consolidated tax returns, while protecting the ownership rights of IDIs in tax refunds. The Interagency Policy Statement states that (1) tax settlements between an IDI and its holding company should be conducted in a manner that is no less favorable to the IDI than if it were a separate taxpayer; and (2) a holding company receives a tax refund from a taxing authority as agent for the IDI.

Since adoption of the Interagency Policy Statement, disputes have arisen between holding companies in bankruptcy and failed IDIs regarding the ownership of tax refunds generated by the IDIs. In some of these cases, courts have found that tax refunds generated by an IDI were the property of its holding company, based on the language in the agreements which the courts interpreted as creating a debtor-creditor relationship. The purpose of the Addendum is to avoid those situations.

Related practice areas:

Financial Services Regulation

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Provisions of the Addendum

The Addendum provides that tax allocation agreements must expressly acknowledge an agency relationship between a holding company and its subsidiary IDI in order to protect the IDI's ownership rights in tax refunds. IDIs and their holding companies are directed to review their tax allocation agreements and revise them as necessary to ensure that they explicitly acknowledge that an agency relationship exists between the holding company and its subsidiary IDIs. The Addendum includes a sample paragraph that can be inserted in a tax allocation agreement to satisfy this obligation.[3]

The Addendum also clarifies how certain of the requirements of Sections 23A and 23B of the Federal Reserve Act ("FRA") apply to tax allocation agreements. The Addendum indicates that all tax allocation agreements are subject to the requirements of Section 23B of the FRA. In general, Section 23B requires affiliate transactions to be made on terms and under circumstances that are substantially the same, or at least as favorable to the IDI, as comparable transactions involving nonaffiliated companies or, in the absence of comparable transactions, on terms and circumstances that would in good faith be offered to nonaffiliated companies. Tax allocation agreements should require the holding company to promptly forward any payment due the IDI under the tax allocation agreement and to specify the timing of such payment.

Agreements that allow a holding company to hold and not promptly transmit tax refunds received from a taxing authority to an IDI would be inconsistent with the requirements of Section 23B and subject to supervisory action. For tax allocation agreements that do not clearly acknowledge that an agency relationship exists, additional requirements may apply under Section 23A of the FRA. For example, if under the agreement a loan by an IDI to its holding company were to be created, the collateralization requirements of Section 23A would apply.

IDIs and their holding companies should review the guidance in the Addendum and make any necessary revisions to their tax allocation agreements as soon as possible and in any event prior to October 31, 2014.

[1] The Agencies are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

[2] 63 Fed. Register 64757 (November 23, 1988).

[3] The [holding company] is an agent for the [IDI and its subsidiaries] (the "Institution") with respect to all matters related to consolidated tax returns and refund claims, and nothing in this agreement shall be construed to alter or modify this agency relationship. If the [holding company] receives a tax refund from a taxing authority, these funds are obtained as agent for the Institution. Any tax refund attributable to income earned, taxes paid, and losses incurred by the Institution is the property of and owned by the Institution, and shall be held in trust by the [holding company] for the benefit of the Institution. The [holding company] shall forward promptly the amounts held in trust to the Institution. Nothing in this agreement is intended to be or should be construed to provide the [holding company] with an ownership interest in a tax refund that is attributable to income earned, taxes paid, and losses incurred by the

Institution. The [holding company] hereby agrees that this tax sharing agreement does not give it an ownership interest in a tax refund generated by the tax attributes of the Institution.

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