Federal Taxation

by Robert Beard*

In 2013, several interesting federal tax cases were decided in the United States Court of Appeals for the Eleventh Circuit and in the United States Tax Court with decisions appealable to the Eleventh Circuit.[1] These cases addressed the scope of the Internal Revenue Code (I.R.C.) § 83,[2] the economic performance rules, and ownership of tax refunds in bankruptcy.[3]

I. DAVIS V. COMMISSIONER

In *Davis v. Commissioner*,[4] Allen Davis, the primary taxpayer in this case, was the former CEO of an S corporation, CNG Financial Corporation (CNG), engaged in the payday lending business.[5] After resigning as CEO, Davis continued to participate in the management of CNG as a consultant. Due to his experience in the financial industry, CNG's lenders expected Davis to continue to be employed with CNG, and the termination of his employment with the company would have been an event of default under some of CNG's credit agreements. In 2001, Davis's wife, Judith, filed for divorce and requested that he transfer half of his CNG shares to her as part of the property settlement. Davis threatened to resign from his consultant role with the company if his proportionate interest was reduced. Davis's resignation would have created serious business difficulties for CNG.[6]

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1. For an analysis of federal taxation cases decided during the prior survey period, see Robert Beard, *Federal Taxation, Eleventh Circuit Survey*, 64 MERCER L. REV. 953 (2013).
2. I.R.C. § 83 (2012).
3. Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended.
4. 716 F.3d 560 (11th Cir. 2013).
5. *See id.* at 563; Davis v. Comm'r, 102 T.C.M. (CCH) 1927, 1928-29 (2011).
6. *Davis*, 716 F.3d at 563, 567.

To resolve the impasse, the parties agreed that Davis would transfer half of his shares to Judith but would receive an option to purchase the same amount of shares from the company at an exercise price of $16 million, which appears to have been the fair market value (FMV) of the shares at the time. Davis would agree to continue consulting for CNG. Immediately afterwards, and as part of the same plan, CNG would redeem the shares from Judith for a cash payment of $16 million. Shortly before this plan was put into effect, Davis proposed a modification of the plan. Instead of receiving the option directly from CNG, Davis proposed that he receive the option from Judith (the Judith option) in connection with the transfer of shares to her in the divorce settlement. As before, Davis would agree to continue to serve as a consultant. When the transferred shares were redeemed by CNG, the company would also assume her obligations under the option agreement (the Allen option). Thus, Davis would end up with the same option from CNG for the same number of shares at the same exercise price, but the option would have come into being as part of the divorce settlement. The modification was apparently intended to avoid any implication that the option was compensatory.[7]

The modified plan was put into effect. At the time of its assumption by the company, the option was also modified to permit a cashless exercise procedure, pursuant to which the FMV of CNG shares would be determined by a formula price, and Davis could elect to receive a reduced number of shares in lieu of paying the option price. In 2004, the year at issue, Davis exercised the CNG option using the cashless exercise procedure and received shares worth approximately $37 million. The Internal Revenue Service (IRS) asserted that the option exercise constituted a taxable transfer of property for the performance of services and that the $37 million value of the shares should be treated as ordinary compensation income under § 83.[8]

Section 83(a) provides that a transfer of property in connection with the performance of services gives rise to compensation income equal to the excess of the FMV of the property received over the amount, if any, paid for the property, so long as the property is not subject to a "substantial risk of forfeiture" (SRF).[9] If the property is subject to an SRF, when the SRF lapses, the recipient has compensation income that is equal to the FMV of the property at the time the SRF lapses over the

7. *See id.* at 563-64.

8. *Id.* at 564. CNG claimed a compensation deduction on the issuance of the stock. To ensure that the transaction was treated consistently, the IRS also issued a notice of deficiency challenging the S corporation's compensation deduction. *Id.*

9. I.R.C. § 83(a).

amount, if any, paid for the property.[10] Section 83(b) permits the recipient to make an election (a § 83(b) election) to disregard any SRF and include income at the time of transfer.[11] Treasury Regulation § 1.83-7[12] provides a special rule for options (other than statutorily defined incentive stock options) to acquire property that are granted to an employee or independent contractor in connection with the performance of services.[13]

In this case, the grant of the option is not treated as a transfer of property.[14] Therefore, there is no current compensation income.[15] Instead, if and when the option is exercised, the option recipient has income equal to the excess of the FMV of the property received on exercise over the price paid.[16] A very narrow exception applies if the option has a "readily ascertainable" FMV.[17] If the option has a readily ascertainable FMV, the grant of the option is treated as a § 83 event, and the subsequent exercise does not have any compensation implications.[18]

The main issue in the Tax Court was whether the Allen option was granted "in connection with" the performance of services as required by § 83.[19] The court quickly concluded that the option was indeed issued in connection with the performance of services.[20] The court noted that, under controlling precedent, property need not be transferred strictly as compensation for § 83 to apply.[21] Rather, there merely needs to be some connection between the transfer and the past, present, or future provision of services by the transferee.[22] In this case, the court relied on testimony from another family member involved in the business and the fact that CNG's credit agreement required Davis to remain involved in the business to conclude that CNG intended the option transfer to

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10. *Id.*
11. I.R.C. § 83(b)(1).
12. Treas. Reg. § 1.83-7 (2013).
13. *See* Treas. Reg. § 1.83-7(a).
14. *See Davis*, 716 F.3d at 566 (citing Treas. Reg. § 1.83-3(a)(2) (2013)).
15. *See id.* (citing Treas. Reg. § 1.83-3 (2013)).
16. *See id.*; *see also* I.R.C. § 83(a); Treas. Reg. § 1.83-3.
17. I.R.C. § 83(e)(4).
18. *See id.*
19. *Davis*, 102 T.C.M. (CCH) at 1930. The court also considered the appropriate valuation for the stock issued when the option was exercised. *Id.* at 1931. The court concluded that the formula used in the cashless exercise procedure was the correct standard for the stock's FMV. *Id.* at 1931-32.
20. *Id.* at 1932.
21. *Id.* at 1931.
22. *See id.*

induce David to keep working with CNG.[23] The court also noted that the option agreement required Davis to notify CNG if he made a § 83(b) election.[24] The court read this provision to imply that the parties intended the option agreement to be governed by § 83.[25]

The Eleventh Circuit affirmed the Tax Court's decision on appeal.[26] The appellate court had no difficulty concluding that the record provided ample support for the Tax Court's finding that the Allen option was service related.[27] The court also noted the significance of the provision in the Allen option requiring notice to CNG if Davis made a § 83(b) election.[28]

At the appellate level, the taxpayer made a new argument that the Tax Court had not addressed.[29] The taxpayer claimed that the transfer of the Judith option was exempt from gain recognition under I.R.C. § 1041,[30] which is a non-recognition rule applicable to transfers incident to divorce.[31] The court rejected this argument, accepting that the issuance of the Judith option as part of the property settlement was subject to § 1041, but finding that the subsequent exercise of the Allen option was not incident to the divorce.[32] The court cited, PLR 20101-6031, an IRS private letter ruling[33] in which the IRS held that compensatory stock options issued by a third party and transferred in a property settlement from the original recipient to an ex-spouse were covered by § 1041 on the transfer, but that the transferee would have ordinary income when the option was exercised.[34] The court's citation to this private letter ruling is somewhat puzzling. The fact that the options in the ruling were issued prior to the divorce by a third party is a significant distinguishing detail.[35] Gain or loss can be recognized when an option, which is property, is transferred from one holder to another.[36] On the other hand, issuance of an option is typically treated

23. *Id.*
24. *Id.*
25. *Id.*
26. *Davis*, 716 F.3d at 563.
27. *Id.* at 567.
28. *Id.*
29. *Id.* at 569.
30. I.R.C. § 1041 (2012).
31. *Davis*, 716 F.3d at 569; *see also* I.R.C. § 1041(a).
32. *Davis*, 716 F.3d at 569-70.
33. I.R.S. Priv. Ltr. Rul. 10-16-031 (Apr. 23, 2010).
34. *Davis*, 716 F.3d at 569; *see also* I.R.S. Priv. Ltr. Rul. 10-16-031.
35. *Compare Davis*, 716 F.3d at 563, *with* I.R.S. Priv. Ltr. Rul. 10-16-031.
36. *See* I.R.C. § 1234 (2012).

as an open transaction, which does not give rise to gain or loss until the option is exercised or lapses.[37]

The court tried to square this circle by stating, in dicta, that Davis would have had ordinary income at the time of exercise even if he had retained the Judith option and exercised it later.[38] This conclusion is clearly correct given the Tax Court's factual findings, but its relevance to the § 1041 issue is hard to understand. Consider the result if Judith had transferred stock or other property to Davis instead of an option (still in connection with services). Would the court conclude that § 1041 would prevent the recognition of compensation income on this transfer? Likely not. Non-recognition provisions, § 1041 included, typically dictate only that "[n]o gain or loss shall be recognized" on a specified transaction.[39] They do not override other Code sections, like § 83, that do not deal with gain or loss.[40]

Assuming § 83 would apply to a transfer of non-option property incident to divorce, there is no place left for § 1041 to have any application in the option case. Income is deferred until the option is exercised, but Treasury Regulation § 1.83-7 already mandates that result.[41] If the option timing rule did not apply, compensation income would probably be recognized. Thus, the better conclusion is that § 1041 had no relevance in this case, as § 83 is simply beyond the scope of the non-recognition provision.

Curiously, both opinions also cited a provision in the option agreement that required Davis to give notice to CNG if he filed a § 83(b) election as evidence that the parties intended the option to be granted in connection with the performance of services.[42] This inference is somewhat surprising, because the facts in the Eleventh Circuit opinion indicate that a § 83(b) election would not have been appropriate for the Allen option.[43] A taxpayer who makes a § 83(b) election disregards any SRF in determining when income is taken into account under § 83.[44] However, nothing in the facts indicates that the Allen option was subject to an SRF.[45] Moreover, even in the absence of an SRF, options are subject to the special timing rule of Treasury Regulation § 1.83-7, which provides that income is deferred until the option is exercised, unless the

37. *See* Simmonds Precision Prods., Inc. v. Comm'r, 75 T.C. 103, 117-18 (1980).
38. *Davis*, 716 F.3d at 570.
39. *See, e.g.*, I.R.C. § 1041.
40. *See, e.g.*, I.R.C. § 83.
41. Treas. Reg. § 1.83-7(a).
42. *Davis*, 716 F.3d at 565.
43. *See id.* at 564.
44. *See* Treas. Reg. § 1.83-2 (2013).
45. *See Davis*, 716 F.3d at 564.

option has a readily ascertainable FMV.[46] The regulations set a very high bar for readily ascertainable FMV, which only publicly traded options (as opposed to options on stock that is publicly traded) can usually meet.[47] On the facts of this case, it is virtually certain that the Allen option did not have a readily ascertainable FMV.[48] As a result, even if the Allen option were subject to an SRF, a § 83(b) election would have had no effect, as the compensation event would be deferred until the option was exercised under Treasury Regulation § 1.83-7.[49]

These facts suggest that the inclusion of the notice provision did not reflect a concrete understanding of the parties that the issuance was subject to § 83. More likely, the notice provision was deadwood mistakenly carried over from another agreement, or perhaps a belt-and-suspenders provision intended to ensure that CNG was aware of Davis's tax reporting position, even the implausible ones. While the notice provision was certainly not decisive given the ample factual support for application of § 83, the weight that both courts gave this factor emphasizes the importance to drafters of avoiding sloppy language that might be seized upon later by a hostile revenue agent.[50]

Another interesting element of the *Davis* case is that an alternative structuring of the transaction likely would have produced the desired tax results. The overall effect of the 2002 transactions was (1) Davis exchanged 188.86 shares of CNG stock for an option to acquire the same number of shares for $16 million, and (2) Judith received $16 million in cash from CNG as a redemption payment.[51] Almost the same results could be achieved if CNG had lent Davis $16 million against 188.86 shares of CNG stock on a non-recourse basis and Davis had transferred this cash to Judith in the property settlement. Economically, a non-recourse loan secured by property is similar to an option to purchase that property for the balance of the loan.[52] This structure would also defer any built-in gain in the CNG shares.[53] This gain was presumably recognized by Judith when CNG redeemed her stock.[54] In addition, a non-recourse loan would have given Davis a much stronger position under § 83. While the § 83 regulations provide that a *transfer* of property paid for with non-recourse financing may be equivalent to an

46. Treas. Reg. § 1.83-7(a).
47. Treas. Reg. § 1.83-7(b).
48. *See Davis*, 716 F.3d at 564.
49. Treas. Reg. § 1.83-7.
50. *See Davis*, 716 F.3d at 565.
51. *Id.* at 564.
52. *Cf. In re* Buchferer, 216 B.R. 332, 339 (Bankr. E.D.N.Y. 1997).
53. *See Davis*, 716 F.3d at 564; *see also* I.R.C. § 302 (2012).
54. *See Davis*, 716 F.3d at 564; *see also* I.R.C. § 302.

option and may carry the same tax consequences,[55] in this hypothetical transaction, no property would be transferred to Davis. The property encumbered by the non-recourse loan would be long-held stock of CNG. Revenue Ruling 2007-49 (Situation 1),[56] which ruled that previously held stock of an employee that was made subject to a service-related vesting restriction did not become § 83 property because there was no transfer of the stock to the employee, supports this no-transfer position.[57]

II. SURIEL V. COMMISSIONER

Suriel v. Commissioner[58] involved the application of the economic performance rules to payments to a settlement fund made on behalf of another.[59] Vibo, an S corporation, was a cigarette importer. Vibo imported cigarettes produced by Protabaco, an unrelated foreign manufacturer, and sold them in the United States.[60]

The backdrop to the *Suriel* case was the adoption and modification of the Master Settlement Agreement (the MSA), which resolved lengthy tobacco-liability litigation between forty-six states and major tobacco-product manufacturers (TPMs).[61] For purposes of the MSA, a TPM was either a manufacturer that produced cigarettes intended to be sold in any MSA state or the first purchaser of cigarettes not originally intended for sale in an MSA state who intended to sell the cigarettes in an MSA state.[62] Under this definition, Protabaco was a TPM, but Vibo was not.[63] The MSA offered TPMs two alternatives. First, manufacturers could sign the MSA and become "participating manufacturers."[64] Participating manufacturers would be required to make payments into a settlement fund to resolve the states' negligence, antitrust, and other claims.[65] The parties stipulated that the MSA settlement fund as a "Qualified Settlement Fund" (QSF) described the meaning of the treasury regulation.[66]

55. Treas. Reg. § 1.83-3(a)(2) (2013).
56. Rev. Rul. 07-49, 2007-2 C.B. 237.
57. *Id.*
58. 141 T.C. No. 16 (2013).
59. *See id.* at 33-34.
60. *Id.* at 2-3, 5.
61. *Id.* at 3-6.
62. *Id.* at 6.
63. *Id.*
64. *Id.* at 7.
65. *Id.* at 8.
66. *Suriel*, 141 T.C. at 8; *see also* Treas. Reg. § 1.468B-1(a).

TPMs that did not sign the MSA would be "nonparticipating manufacturers" (NPMs).[67] In connection with the MSA, the states enacted legislation requiring NPMs to make payments into escrow accounts that would be used to satisfy any judgments the states obtained against NPMs.[68] An NPM could become a participating manufacturer at any time by signing the MSA, but the manufacturer would be required to make catch-up contributions to the settlement fund for the years when it was an NPM.[69] These catch-up payments were due over a twelve-year period, starting with the first year after the manufacturer signed the MSA.[70]

For the first five years the MSA was in effect, the statutes enacted by the states requiring escrow payments from NPMs contained a loophole that, according to the Tax Court, "gave NPMs an unfair competitive advantage over TPMs participating in the MSA."[71] During this period, neither Protabaco nor Vibo was a participating manufacturer. Under the MSA's definitions, Protabaco was an NPM. Vibo agreed contractually to make Protabaco's required escrow payments under the relevant NPM statutes on Protabaco's behalf. At the end of 2003, the statutory loophole was closed, and in 2004 Vibo signed the MSA. Since Vibo was not technically a TPM, the MSA was amended to provide that Vibo would be considered a TPM to allow it to become a participating manufacturer. Vibo was also treated as a TPM with respect to cigarettes it had sold previously; thus, it was obligated to make catch-up payments for the period it was an NPM. None of the MSA documents imposed any payment obligations on Protabaco.[72]

At the same time Vibo signed the MSA, Vibo and Protabaco entered into an exclusive manufacturing and distribution agreement (the Distribution Agreement) pursuant to which Vibo agreed to use Protabaco as its exclusive manufacturer, and Protabaco agreed to use Vibo as its exclusive importer. The Distribution Agreement recited that Vibo was making "a considerable long term investment" by undertaking payment obligations under the MSA.[73]

In 2004, the year it signed the MSA, Vibo deducted its entire catch-up payment liability as part of its cost of goods sold, even though none of

67. *Suriel*, 141 T.C. at 9.
68. *Id.*
69. *Id.* at 12-13.
70. *See id.*
71. *Id.* at 10.
72. *Id.* at 10, 12-14, 27-28.
73. *Id.* at 5, 11.

the catch-up payment was actually made in 2004. In fact, Vibo's business went south, and it never made any catch-up payments.[74]

The IRS challenged the claimed deduction.[75] The ultimate issue was when economic performance of the catch-up payments occurred.[76] In general, three requirements must be met for an accrual-method taxpayer to deduct an expense.[77] First, all events necessary to establish liability for the expense must have occurred.[78] Second, the amount of the liability must be determinable with reasonable certainty.[79] Third, economic performance must have occurred.[80] The economic performance rules are intended to prevent taxpayers from artificially accelerating deductions by satisfying the first two mechanical tests.[81] I.R.C. § 461[82] and the regulations provide different economic performance triggers depending on the nature of the expense.[83] For example, for deductions attributable to the use of property by the taxpayer (as in the case of the lease), the economic performance occurs as the property is used.[84] Thus, rental deductions, regardless of when they would otherwise accrue, can only be taken ratably over the term of the lease (if not later).[85]

The parties in *Suriel* disagreed about the nature of the underlying transaction and the economic performance rule that should be applied. The taxpayer claimed that its obligation to the QSF should be viewed as Protabaco's liability that it assumed as part of the consideration payable for cigarettes under the Distribution Agreement.[86] Under the economic performance rule for property provided to the taxpayer, economic performance occurs as property is provided.[87] The government argued that Vibo's obligations were its own liabilities and that the economic performance rule for payments to QSFs should apply.[88] This rule provides that economic performance for such payments occurs only when

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74. *See id.* at 14.
75. *See id.* at 2.
76. *Id.* at 33.
77. Treas. Reg. § 1.461-1(a)(2)(I) (2013).
78. *Id.*
79. *Id.*
80. *Id.*; *see also* I.R.C. § 461(h) (2012).
81. *C.f. Suriel*, 141 T.C. at 33.
82. I.R.C. § 461 (2012).
83. *See* I.R.C. § 461; Treas. Reg. § 1.461-4 (2013).
84. Treas. Reg. § 1.461-4(d)(3)(i).
85. *See id.*
86. *See Suriel*, 141 T.C. at 18.
87. Treas. Reg. § 1.461-4(d)(2)(i).
88. *See Suriel*, 141 T.C. at 18.

the payments are actually made[89] since no payments to the QSF were ever made, no deductions would be allowed.[90]

The taxpayer attacked the IRS's characterization on two grounds. First, the taxpayer argued that Protabaco, as the actual tobacco manufacturer, was truly the TPM, and that Vibo's status as such under the MSA was a "legal fiction" designed to facilitate its payments into the settlement fund.[91] Second, Vibo argued that it entered the MSA at the behest of Protabaco and in effect assumed Protabaco's liability to make QSF payments in connection with the Distribution Agreement.[92]

The Tax Court invoked the *Danielson* rule, which generally provides that taxpayers are bound to the form of their transactions.[93] Both of the taxpayer's arguments were defeated because the transaction documents did not support them. For example, the Tax Court dismissed the taxpayer's contention that Vibo's status as a TPM was a legal fiction because nothing in the MSA documents supported it.[94] To the contrary, the documents specifically provided that Vibo was a TPM and that Protabaco was not.[95] Likewise, the Tax Court found no evidence that Protabaco had any liability under the MSA for Vibo to assume.[96] In addition, no credible evidence was presented that Protabaco requested or caused Vibo to join the MSA.[97]

Given the importance of the transaction form in this decision, it is interesting to consider whether a different structure could have produced a different result. Specifically, consider the following alternative arrangement. Instead of Vibo signing the MSA, Protabaco could have become a signatory and could have become obligated to make current and catch-up payments to the QSF.[98] As part of the exclusive manufacturing and distribution agreement, Vibo could have agreed to make an offsetting, periodic payment to Protabaco equal to its liability under the MSA for that period. Under these facts, it would likely be difficult for the IRS to argue that the QSF economic performance rules should

89. Treas. Reg. § 1.468B-3(c)(1) (2013).
90. *See Suriel*, 141 T.C. at 18; *see also* Treas. Reg. § 1.468B-3(c)(1).
91. *Suriel*, 141 T.C. at 22.
92. *See id.* at 27-28.
93. *Id.* at 16 (citing Commissioner v. Danielson, 378 F.2d 771 (3d Cir. 1967)).
94. *See id.* at 22.
95. *Id.* at 6.
96. *Id.* at 27.
97. *See id.* at 26.
98. The Tax Court's opinion does not explain, nor does the Author know, whether there were non-tax reasons why Protabaco was not the signatory to the MSA, as suggested here.

apply.[99] It would not follow, however, that Vibo would be able to immediately deduct the amount of the liability. Treasury Regulation § 1.461-4(d)(6)(iv)[100] provides that, where a contract calls for property or services to be provided to the taxpayer at multiple times, economic performance occurs proportionately as the property or services are provided.[101]

The opinion suggests that the Distribution Agreement was open-ended and did not call for a specific quantity of cigarettes to be delivered.[102] The regulations do not clarify how the proportionate economic performance rule should be applied when the overall quantity of goods to be provided is not fixed. One reasonable approach would be to estimate the total amount delivered and deem economic performance to occur based on the estimate. If this approach were adopted, Vibo would have been able to deduct its catch-up payment liability over time as cigarettes were delivered under the Distribution Agreement.[103]

III. ZUCKER V. FDIC

The decisions in *Zucker v. FDIC (In re BankUnited Financial Corp.)*[104] and *FDIC v. Zucker (In re NetBank, Inc.)*[105] addressed the ownership of consolidated group tax refunds in bankruptcy.[106] While the details of these cases relate more to bankruptcy law and contract interpretation and are thus beyond the scope of this Article, the subject of these cases and their outcomes are significant for tax practitioners.

Both cases arose from bankruptcies of bank holding companies (BHCs).[107] A typical BHC consists of a parent corporation (the holding company) that owns one or more banks or other financial entities. Crucially, the bank subsidiary is the only entity that is an insured

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99. The Tax Court suggested, but did not say, that this alternative structure might have been successful:

> While it may have been possible for Protabaco to settle with the settling States and then pass on the MSA costs to Vibo in the form of increased prices, that did not happen. [Suriel] must be taxed in accordance with the transaction he and Vibo consummated, not a transaction he might have consummated but did not.

Suriel, 141 T.C. at 26-27.

100. Treas. Reg. § 1.461-4(d)(6)(iv) (2013).

101. *Id.*

102. *See Suriel*, 141 T.C. at 22.

103. *See* Treas. Reg. § 1.461-4(d)(6)(iv).

104. 727 F.3d 1100 (11th Cir. 2013).

105. 729 F.3d 1344 (11th Cir. 2013).

106. *See In re Netbank, Inc.*, 729 F.3d at 1345-46; *In re BankUnited Fin. Corp.*, 727 F.3d at 1104.

107. *See In re Netbank, Inc.*, 729 F.3d at 1346; *In re BankUnited Fin. Corp.*, 727 F.3d at 1102.

depositary institution. When a bank fails and goes into receivership, the holding company will typically file for bankruptcy. The trustee of the bankruptcy estate will marshal the assets of the holding company to pay its creditors. The bank, on the other hand, will usually be taken into receivership by the Federal Deposit Insurance Corporation (FDIC). The FDIC will marshal the assets of the bank to minimize losses to the deposit insurance fund. Thus, the bankruptcy trustee and the FDIC can be adversaries competing for their share of the BHC's resources.

Though BHCs have more complicated internal dynamics than most corporate families, for return-filing purposes, they are treated like any other affiliated group of corporations. Specifically, the consolidated return regulations permit the holding company to file a consolidated return for the entire group, provided the subsidiaries initially consent to be included in the return.[108] The tax liability for the whole group is reported on a single return.[109] The regulations treat the group's aggregate tax liability as a joint and several liability of the entire group.[110] When a refund is due, federal tax law says little about who owns the refund.[111]

A bank that has reached the point of insolvency does so by losing money. These losses are typically deductible for income tax purposes.[112] To the extent that these losses exceed income for a year, they will give rise to a net operating loss (NOL).[113] NOLs can generally be carried back to the previous two taxable years, potentially giving rise to refunds for taxes paid in those prior years.[114] Under the American Recovery and Reinvestment Act of 2009,[115] NOLs for 2008 and 2009 could be carried back for up to five years, increasing their value even more.[116]

These factors combine to create high-stakes controversies when BHCs fail. The consolidated group will usually have large refunds from its NOLs, and the controlling tax law says little about who owns these refunds.[117] Unlike in most non-financial bankruptcies, the holding company and its bank subsidiaries will have sharply diverging interests.

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108. Treas. Reg. § 1.1502-77 (2013).

109. *See* Treas. Reg. § 1.1502-2 (2013).

110. Treas. Reg. § 1.1502-6 (2013).

111. *See* Treas. Reg. § 1.1502-77(a)(2)(v); Treas. Reg. § 301.6402-7(c) (2013).

112. I.R.C. § 172(a) (2012).

113. I.R.C. § 172(c) (2012).

114. I.R.C. § 172(b)(1)(A) (2012).

115. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (codified as amended in scattered sections of U.S.C. tits. 26 & 42).

116. I.R.C. § 172(b)(1)(H)(i)(I) (2012).

117. *See* Treas. Reg. § 1.502-77(a)(2)(v); Treas. Reg. § 301.6402-7(c).

The resolution of these disputes in both *NetBank* and *BankUnited* turned on the language of the taxpayers' tax-sharing agreements (TSAs).[118]

In both decisions, the holding company received a refund check from the IRS that was attributable in large part to NOLs generated by the bank. In both cases, the relevant TSAs clearly required the holding company to pay the refund over to the bank. However, the parties disagreed about the nature of this obligation. The holding companies argued that it was a mere contractual debt.[119] In bankruptcy, such debts can be written down. The FDIC alleged that the TSAs created an agency relationship, whereby the holding companies received the refund payments to be held in trust and delivered to the banks.[120] Under this view, the refund would not be property of the bankrupt holding company and would have to be paid over in its entirety to the bank.[121]

The Eleventh Circuit scrutinized the relevant TSAs to determine which view was correct.[122] Applying ordinary contract law, the court determined that, under the TSAs, the holding companies received the refunds as agents for the banks.[123] Other courts faced with the same issue have often reached the opposite conclusion.[124] Because the *NetBank* and *BankUnited* opinions rely heavily on the specific language of the TSAs at issue, it is hard to say whether these decisions reflect a trend in Eleventh Circuit law or merely reflect the particular language of these TSAs.

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118. *See In re Netbank, Inc.*, 729 F.3d at 1345-46; *In re BankUnited Fin. Corp.*, 727 F.3d at 1103.

119. *See BankUnited Fin. Corp. v. FDIC* (*In re* BankUnited Fin. Corp.), 462 B.R. 885, 887-88, 896-97 (Bankr. S.D. Fla. 2011); *Zucker v. FDIC* (*In re* Netbank, Inc.), 459 B.R. 801, 805, 808-09 (Bankr. M.D. Fla. 2010).

120. *See In re BankUnited Fin. Corp.*, 462 B.R. at 896-97; *In re Netbank, Inc.*, 459 B.R. at 809.

121. *See In re BankUnited Fin. Corp.*, 462 B.R. at 900.

122. *See In re Netbank, Inc.*, 729 F.3d at 1347; *In re BankUnited Fin. Corp.*, 727 F.3d at 1104-05.

123. *In re NetBank, Inc.*, 729 F.3d at 1352; *see In re BankUnited Fin. Corp.*, 727 F.3d at 1108-09.

124. *See, e.g., In re* Team Fin., Inc., 2010 Bankr. LEXIS 1493 (Bankr. D. Kan. Apr. 27, 2010); *In re* First Central Fin. Corp., 269 B.R. 502 (Bankr. E.D.N.Y. 2001).

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