April 6, 2021

MEMORANDUM TO: Board of Directors

FROM: Doreen R. Eberley, Director

SUBJECT: Proposed Rule: Interagency Proposed Rule on Tax Allocation Agreements

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Summary: The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are proposing a rule (proposal) regarding tax allocation agreements for banking organizations and savings associations (collectively, institutions)[1] that file an income tax return as members of a consolidated tax filing group (consolidated group). The proposal would promote safety and soundness by preserving depository institutions' ownership rights in tax refunds and ensuring equitable allocation of tax liabilities among entities in a holding company structure. Under the proposal, institutions in a consolidated group would be required to enter into tax allocation agreements with their holding companies and other members of the consolidated group that join in the filing of a consolidated group tax return. The proposal would establish the methodology for tax payment obligations between the institution and its parent holding company within a consolidated group, and would also address how an institution should be compensated for the use of its tax assets (such as net operating losses and tax credits). The proposal would require institutions to include certain provisions in all tax allocation agreements, such as: the timing and amounts of any payments for taxes due to taxing authorities; the acknowledgment of an agency relationship between institutions and their holding companies in a consolidated group with respect to tax refunds received; and a provision stating that documents, including returns, relating to consolidated

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[1] National banks, Federal savings associations and certain uninsured institutions (OCC); state member banks (Board); and state nonmember banks and state savings associations (FDIC).

Concur:

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Nicholas J. Podsiadly
General Counsel

or combined federal, state, or local income tax filings must be made available to an institution or any successor during regular business hours. The proposal would be adopted primarily under section 39 of the Federal Deposit Insurance Act[2] and codified within the agencies' safety and soundness regulations.[3] If adopted as final, the agencies would rescind the interagency policy statement on tax allocation agreements that was issued in 1998 and supplemented in 2014.

Recommendation: FDIC staff recommends that the FDIC Board approve this proposal and authorize its publication in the *Federal Register* with a 60-day public comment period.

Discussion:

I. Background

In 1998, the agencies and the Office of Thrift Supervision[4] adopted the Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure[5] (Interagency Policy Statement) to provide guidance to insured depository institutions (IDIs), their holding companies, and other affiliates regarding the allocation and payment of taxes when these entities file income tax returns on a consolidated basis. The Interagency Policy Statement states that 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 the IDI were a separate taxpayer, and that whenever a holding company receives a tax refund from any taxing authority, and the refund is one that is attributable to its subsidiary IDI, the holding company is acting purely as an agent for the IDI.

In 2014, the agencies issued an Addendum to the Interagency Policy Statement to emphasize that tax allocation agreements should expressly acknowledge an agency relationship between a holding company and its subsidiary IDI to protect the IDI's ownership rights in tax refunds (2014 Addendum).[6]

[2] 12 U.S.C. 1831p-1. The agencies will codify under their respective safety and soundness regulations.
[3] 12 CFR part 364 (FDIC).
[4] The functions of the Office of Thrift Supervision were transferred to the OCC and FDIC in accordance with Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, enacted July 21, 2010.
[5] 63 FR 64757 (Nov. 23, 1998).
[6] 79 FR 35228 (June 14, 2014).

The 2014 Addendum also clarifies that all tax allocation agreements are subject to section 23B of the Federal Reserve Act (section 23B).[7] In addition, the 2014 Addendum provides that tax allocation agreements that do not clearly acknowledge the presence of an agency relationship between the holding company and the subsidiary IDI may be subject to additional requirements under section 23A of the Federal Reserve Act (section 23A).[8] Moreover, the 2014 Addendum clarifies that section 23B requires a holding company to transmit promptly to its subsidiary IDI any tax refunds received from a taxing authority that are attributable to the IDI.

In their supervision of institutions, the agencies have observed that some institutions in consolidated groups lack tax allocation agreements with their holding companies, have agreements that do not have language conforming with section 23A or 23B. In particular, the agencies have reviewed tax allocation agreements that do not require a holding company in a consolidated group to transmit promptly the appropriate portion of a consolidated group's tax refund to its subsidiary institution, resulting in the holding company failing to do so in some instances. Such inaction could adversely affect the safety and soundness of the subsidiary institutions because delayed access to funds could weaken an institution's liquidity profile. Further in its capacity as receiver for failed IDIs, the FDIC has engaged in legal disputes regarding the ownership of tax refunds claimed by holding companies based on losses incurred by IDIs in a consolidated group because the tax allocation agreements did not clearly acknowledge an agency relationship between an IDI and its holding company. These disputes can reduce or prevent

[7] 12 U.S.C. 371c-1.

[8] 12 U.S.C. 371c. Section 23A requires, among other things, that loans and other extensions of credit from an IDI to its affiliate be collateralized properly by a specified amount and subject to certain quantitative limits. Issues concerning compliance with section 23A could arise from instances where a tax allocation agreement does not (i) acknowledge that a holding company in a consolidated group serves as agent for its subsidiary IDI with respect to tax refunds generated by the subsidiary IDI, or (ii) require a holding company in a consolidated group to transmit promptly the appropriate portion of a consolidated group's tax refund to the subsidiary IDI. In such circumstances, the failure of a holding company to acknowledge an agency relationship with respect to tax refunds or to pay promptly the subsidiary IDI its appropriate portion of tax refunds could result in an extension of credit from the subsidiary IDI to its affiliated holding company in the consolidated group. That functional debtor–creditor relationship could result in a covered transaction subject to the requirements of section 23A.

recoveries by the FDIC on behalf of failed IDIs, consequently increase costs to the Deposit Insurance Fund and thus could lead to higher FDIC deposit insurance premiums charged to solvent IDIs.

II. Description of the Proposal

A. Scope of Application

The proposal would apply to any institution supervised by any of the agencies, that files federal and state income taxes in a consolidated group.[9] The proposal would not apply to (1) institutions that file on a separate entity basis or in a group consisting solely of the institution and its subsidiaries or (2) institutions where either the institution or its holding company is not subject to corporate income taxes at either the federal or state level (i.e.., those that have elected S-Corporation status).[10]

B. Tax Allocation in a Holding Company Structure

An IDI, regardless of whether it joins in a consolidated group tax return, is viewed as, and reports as, a separate legal and accounting entity for regulatory purposes.[11] Therefore, an IDI's applicable income taxes should be recorded in its books and records and reflected in the IDI's regulatory reports as if the IDI had filed on a separate entity basis. Furthermore, the amount and timing of payments or refunds should be no less favorable to the IDI as if it were a separate taxpayer, and any practice that is not consistent with this principle may be viewed as an unsafe or unsound practice.

C. Tax Allocation Agreements and Key Terms

The proposal would require all institutions that are subject to Federal or State income taxes and file tax returns as part of a consolidated group to execute a tax allocation agreement that binds each member of the consolidated group and for the board of directors of the institution and its holding company to approve the agreement to ensure the its enforceability by and among institutions in the consolidated group.

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[9] Because the OCC has observed similar problematic tax practices at uninsured institutions that it supervises, the OCC proposes to apply relevant provisions of the proposal to uninsured institutions as well.

[10] S-corporations are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes under Subchapter S of the Internal Revenue Code. *See* 26 U.S.C. 1361 *et seq*.

[11] When an IDI has subsidiaries of its own, the IDI's applicable income taxes on a separate entity basis include the taxes of the subsidiaries of the IDI itself that are included with the IDI in the consolidated group return.

One of the principles of the Interagency Policy Statement is that a tax allocation agreement cannot result in terms less favorable to an institution than if the institution filed its income tax return on a separate entity basis (that is, not as part of a consolidated group). To achieve this result, tax allocation agreements subject to the proposal would be required to establish certain rights and obligations among institutions in the consolidated group.

Agency Relationship: Under the proposal, a consolidated group's tax allocation agreement must specify that an agency relationship exists between the institution and its holding company, including an affiliate of the institution that submits tax returns for the consolidated group with respect to tax refunds. The proposal would clarify that the subsidiary institution must enter into a tax allocation agreement that specifies that the institution owns any tax refund that is created or results from its tax attributes. The tax allocation agreement must state that the holding company receives any tax refund related to the subsidiary institution's tax attributes in trust for the benefit of the subsidiary institution. Further, the holding company would be required to remit the refund promptly to the subsidiary institution and that, notwithstanding any other transactions or agreements to the contrary, the institution must receive any tax refund attributable to its tax attributes.

Tax Payments to a Holding Company. The proposal would prohibit a tax payment by an institution to its holding company in excess of the current period tax obligation of the institution calculated on a separate entity basis. However, the tax allocation may permit an institution to remit less than its current period tax obligation to its holding company. Provided that the holding company will not later require the institution to pay the remainder of the current tax liability, the amount of this unremitted liability should be accounted for as having been paid with a simultaneous capital contribution by the parent to the institution.

In addition, under the proposal, an institution must not remit its current period tax expense (or reasonably calculated estimated tax payment) earlier than when the institution would have been obligated to pay the taxing authority had it filed as a separate entity, based on timeframes established by the taxing authority.

Payments and Hypothetical Tax Refunds from a Holding Company to an Institution. The proposal would also address the timing and amount of tax payments to be received by an institution in a consolidated group from its holding company. First, the proposal would clarify that an institution must be promptly compensated for the use of its losses by the parent at the time the relevant losses are absorbed. For example, in a situation where the institution, as a separate entity, has a net operating loss (NOL) and other members of the group have taxable income, the consolidated group must utilize the institution's tax loss to reduce the consolidated group's current tax liability because consolidated tax return rules require the holding company to utilize the institution's NOL to reduce the group's taxable income and thus its current tax liability.[12] In this situation, the proposal would require the holding company to promptly compensate the institution for the current use of its tax losses at the time the NOL is used. The institution must reflect the tax benefit of the loss in the current portion of its applicable income taxes in the period the loss is incurred.

Second, the proposal would require that an institution must receive from its holding company no less than the tax refund amount it would have received had it filed tax returns on a separate entity basis. For example, this would apply if the institution has a tax loss and would have been able to carry back that loss to a previous year and obtain a tax refund from a taxing authority had it filed income tax returns on a separate entity basis, but there is no ability to obtain an actual refund because other members in the consolidated group had losses that offset the institution's separate tax liability for the previous year(s). Similarly, if the institution makes quarterly tax payments to its holding company in excess of its current tax liability at year end and would obtain a tax refund had it filed on a separate entity basis, the proposal would require that the institution receive from the holding company no less than the tax refund amount the institution would have received as a separate entity from the taxing authority. In this situation, the

[12] 26 C.F.R. §§ 1.1502-11 and 1.1502-12.

holding company would be required to remit the amount due to the institution within a reasonable period following the date the institution would have filed its own return on a separate entity basis.[13]

Consolidated Tax Group Filings. Under the proposal, the tax allocation agreement must require that all materials including, but not limited to, returns, supporting schedules, workpapers, correspondence, and other documents relating to the consolidated federal income tax return and any consolidated, combined, or unitary state or local return, which includes the institution, be made available on demand to the institution or any successor during regular business hours. This requirement must survive any termination of the tax allocation agreement.

D. Regulatory Reporting

Regardless of whether an institution files as part of a consolidated group or as a separate entity, the institution must prepare its regulatory reports[14] on a separate entity basis, as specified in the current instructions for those reports.[15] The proposal would address transactions involving the purported purchase or sale of, or advancement of funds with respect to, an institution's deferred tax assets (DTAs) and deferred tax liabilities (DTLs) (collectively, deferred tax items).[16]

Temporary Difference Deferred Tax Items. Consistent with the separate-entity-basis reporting requirement for institutions, the proposal would clarify that transfers of temporary difference deferred tax items are not consistent with U.S. generally accepted accounting principles (GAAP). This is because separating DTAs and DTLs from the associated assets or liabilities that gave rise to the deferred tax items

[13] If a holding company fails to remit amounts or refunds owed to its subsidiary institution promptly, that inaction may be considered an extension of credit under section 23A. A holding company's failure to remit amounts or refunds owed to its subsidiary institution also could be viewed as a constructive dividend from the institution to the holding company, which would be subject to other requirements under applicable regulations of the agencies. *See* 12 CFR part 5, subpart #, and 5.55(OCC); 12 CFR 303.241(FDIC).

[14] The Consolidated Reports of Condition and Income (Call Reports) (FFIEC 031, FFIEC 041, and FFIEC 051; OMB No. 1557-0081 (OCC), 7100-0036 (Board), and 3064-0052 (FDIC)).

[15] The separate entity method of accounting for income taxes of depository institution subsidiaries of holding companies is discussed in the glossary entry for "Income Taxes" in the Call Report instructions, available at: www.ffiec.gov/ffiec_report_forms.htm.

[16] A DTA or DTL is an estimate of an expected future tax benefit more likely than not to be realized or an expected future tax obligation to be paid, respectively. Deferred tax items are generated by and are intrinsically, and often legally, tied to the activities, assets, and liabilities of the institution.

would depart from one of the primary objectives related to accounting for income taxes, which is to recognize deferred tax items for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns.[17] Accordingly, an institution's purchase, sale, or other transfer of deferred tax items arising from temporary differences is not acceptable under GAAP unless these items are transferred in connection with the transfer of the associated assets or liabilities. Therefore, as described in the *Paperwork Reduction Act* section of the **Supplementary Information**, the agencies plan to revise the Call Report instructions to clarify that transfers of temporary difference deferred tax items as described above are not consistent with GAAP.

Operating Loss and Tax Credit Carryforward DTAs. Similarly to deferred tax items, the proposal would provide that an IDI must not derecognize DTAs for net operating losses (NOLs) or tax credit carryforwards on its stand-alone regulatory reporting financial statements prior to the time when they are absorbed by the consolidated group. Carryforwards are deductions or credits that cannot be utilized on the tax return during a year that may be carried forward to reduce taxable income or taxes payable in a future year.[18] GAAP does not require a single allocation method for income taxes when members of a consolidated group issue separate financial statements.[19] However, the agencies are aware of instances in which institutions have engaged in transactions with affiliates in a consolidated group to purchase, sell, or otherwise transfer deferred tax items, specifically DTAs, other than current period tax losses usable in the consolidated group's tax return for the current period, which would otherwise be NOL carryforward DTAs for the institution. The agencies' regulatory capital rules require the deduction from common equity tier 1 capital of NOL and tax credit carryforward DTAs, net of any related valuation allowances and net of DTLs.[20] While an institution may receive cash from affiliates in exchange for these transfers, the transfer may be reversible and not provide the same quality of regulatory capital as a cash infusion from a holding company. There are also significant valuation uncertainties associated with

[17] ASC Paragraph 740-10-10-1.
[18] ASC Paragraph 740-10-20.
[19] *See* ASC Paragraph 740-10-30-27 (referring to ASC subtopic 740-10).
[20] *See* 12 CFR 3.22(a)(3) (OCC); 12 CFR 217.22(a)(3) (FRB); 12 CFR 324.22(a)(3) (FDIC).

deferred tax items, particularly DTAs for NOLs or tax credit carryforwards, when the underlying tax attributes cannot be used or absorbed by the group in the current period. For these reasons, the agencies have concluded that the IDIs derecognizing DTAs for NOL or tax credit carryforwards on their stand-alone regulatory reports before the period in which they are absorbed by the consolidated group raises significant concerns and would not meet the objectives described in 12 U.S.C. 1831n(a)(1).[21]

Consistent with the finding above, as described in the *Paperwork Reduction Act* section of the **Supplementary Information**, the agencies expect to propose to revise the Call Report instructions to clarify that an institution must not derecognize DTAs for NOLs or tax credit carryforwards on its stand-alone regulatory reports prior to the time when such carryforwards are absorbed by the consolidated group.

III. Incorporation of the Proposal as an Appendix to the Agencies' Safety and Soundness Rules.

As discussed, the agencies would adopt the proposal under the procedures described in section 39 of the FDI Act.[22] The OCC would also propose this rule for uninsured institutions under its general rulemaking authority.[23] The agencies each have procedural rules that implement the enforcement remedies for guidelines prescribed by section 39. Under procedural provisions in these rules, each agency may require an institution that intends to participate in a consolidated tax filing group and does not have an acceptable tax allocation agreement to develop a plan to implement an acceptable agreement consistent with the proposal or to be subject to enforcement actions.[24]

Each agency proposes to incorporate the proposal as an appendix to its relevant safety and soundness rule, located in 12 CFR part 30 (OCC), 12 CFR part 208 (Board) and part 364 (FDIC).

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[21] The establishment of valuation allowances for DTAs for NOL and tax credit carryforwards when required in accordance with U.S. GAAP is not a derecognizing event.
[22] 12 U.S.C. 1831p-1.
[23] 12 U.S.C. 93a.
[24] As of the most recent data, the agencies estimate that 2,604 supervised institutions (including 2,581 insured institutions and 23 uninsured OCC-chartered institutions) will be subject to the proposed rule.[24] Institutions that would be subject to the requirements of the proposal represent 51 percent of all institutions supervised by the agencies, and they hold over 93 percent of total assets of all institutions supervised by the agencies. Overall, due to the fact that the agencies expect most covered institutions to already be in compliance with the proposal, the expected effects on economic output are likely to be small.

Conclusion: Staff recommends that the FDIC Board approve the attached NPR and authorize its publication in the *Federal Register* with a 60-day public comment period.

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