



July 9, 2021

Via Electronic Mail

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Re: Tax Allocation Agreements (OCC: Docket ID OCC-2020-0043, Federal Reserve:  
Docket No. R-1746, FDIC: RIN 3064-AF62)

To Whom It May Concern:

The Bank Policy Institute<sup>1</sup> and the Institute of International Bankers<sup>2</sup> (together, the "Associations") welcome the opportunity to comment on the proposal by the Board of Governors of the

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<sup>1</sup> BPI is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans and are an engine for financial innovation and economic growth.

<sup>2</sup> The Institute of International Bankers is the only national association devoted exclusively to representing and advancing the interests of the international banking community in the United States. Its membership is comprised of internationally headquartered banking and financial institutions from over 35 countries around the world doing business in the United States. The IIB's mission is to help resolve the many special legislative, regulatory, tax, and compliance issues confronting internationally headquartered institutions

Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency regarding the proposed requirements for tax allocation agreements between institutions and their holding companies (the “Proposed Rule”).<sup>3</sup> The Associations support the goals of the Proposed Rule to protect the financial condition of the insured depository institutions and OCC-chartered uninsured institutions that would be covered by the rule as well as to minimize losses to the Deposit Insurance Fund in receivership. However, we are concerned that the prescriptive nature of the proposed requirements would remove an institution’s professional judgment and may result in (i) detrimental results for the regulated institution, and (ii) unduly burdensome tracking requirements for the consolidated group.

**I. The proposed rule appropriately requires treatment of a common parent as agent.**

The Associations agree strongly with the main thrust of the Proposed Rule, namely that all institutions should, on a mandatory basis, have written tax allocation agreements confirming the agency status of their common parent when it receives a refund attributable to the subsidiary institution. The Associations’ members have interpreted prior guidance in this area as effectively mandatory, but the Proposed Rule appropriately clarifies that result for all regulated entities.

The Associations note the Proposed Rule uses a variety of terms to refer to a parent of an institution, including “holding company,” “parent holding company,” and “parent company”. However, these terms may not refer to the same entities in every organizational structure and as such the final rule should clarify to which entities the requirements apply.

**II. The final rule should allow for flexibility rather than prescriptive application of a separate entity framework.**

The Proposed Rule would require that certain other tax concepts be explicitly stated in the written tax allocation agreement. To the extent that those statements reflect broad principles derived from the idea that the institution should be treated no less favorably than if it filed taxes on a separate entity basis, then the Associations also agree that the Proposed Rule is desirable and appropriate.

However, some of those statements are more granular and prescriptive, and as to these the Associations urge caution. The agencies are not writing on a clean slate here; detailed tax and U.S. generally accepted accounting principles (“GAAP”) rules have been promulgated in this area.<sup>4</sup> The fact patterns that may arise in the tax context are very complicated and varied, and prescriptive rules may arrive at an illogical answer in some of those situations. If the separate entity theory were extended too far, then it would result in very material administrative burdens without producing materially greater protection of the regulated institution. The institutions should be permitted to continue to exercise professional judgment with respect to interpreting the agreed principles in particular situations. The following examples illustrate certain oversimplifications in the tax analysis.

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that engage in banking, securities and other financial activities in the United States. Through its advocacy efforts the IIB seeks results that are consistent with the U.S. policy of national treatment and appropriately limit the extraterritorial application of U.S. laws to the global operations of its member institutions.

<sup>3</sup> Tax Allocation Agreements, 86 Fed. Reg. 24755 (May 10, 2021).

<sup>4</sup> See 12 U.S.C. §§ 1502, 1552.

First, it should be acknowledged that treating the institution on a separate entity basis could be beneficial or detrimental to the institution, depending on the situation. The agencies give an example where the institution could have carried back a net operating loss (“NOL”) on a standalone basis, but not on a group basis, and thus that separate entity treatment is beneficial. However, there are many other possibilities. For example, if the institution pays foreign income taxes but has no foreign source of income (due to, for example, the apportionment of interest expense), then it would not be entitled to a foreign tax credit on a separate entity basis, notwithstanding that the credit could be taken by the group because other members have foreign source income. Similarly, if the institution would have a heavy apportionment factor to a high tax state on a standalone basis which is moderated by the group’s lesser apportionment to that state, the institution would have paid higher state taxes on a separate entity basis.

Such acknowledgement illustrates that a doctrinaire fixation on separate entity status quickly gives rise to very difficult questions as to the synergistic effect of attributes among group members. Sometimes the group liability is worse than each member’s separate entity liability ( $1+1=3$ ), sometimes better ( $1+1=1.5$ ), and in many situations it is very difficult to decide which attributes produced the difference. For example, foreign tax credits and interest deductions are both desirable tax attributes but each tends to crowd the other out, and particularly as a result of the Tax Cuts and Jobs Act, the crowding out can occur in a non-linear way based on the presence or absence of other attributes.<sup>5</sup> Moreover, financial institutions incur large amounts of nearly offsetting interest income and interest expense, and the tax rules are specifically crafted in the case of financial institutions to analyze interest deductibility in this context. As a result, GAAP has a complex and nuanced methodology to resolve the proper allocation of the benefit of interest deductions, and professional judgment is necessary to analyze each fact pattern. It would not be appropriate for the Proposed Rule to end-run these considerations or create a different set of outcomes.

Second, the Proposed Rule’s treatment of an institution and its subsidiaries as a single entity works correctly in some situations, but not in others. This is true particularly in the context of state taxation, where the institution may not be consolidated with its subsidiaries.

Finally, the Proposed Rule appears to mandate that the application of a prior year overpayment to a subsequent year tax liability be treated in all circumstances as a “refund”, and therefore trigger an obligation to compensate the institution.<sup>6</sup> While this is sometimes the correct answer, there are other times in which this mandate would result in an improper acceleration of compensation to the institution. This treatment may also lead to institutional challenges in tracking and settling these transactions.

As a result of the foregoing, the Associations recommend that the final rule avoid overly prescriptive application of the “separate entity” theory. The Associations’ members understand and agree with that theory, but they need flexibility to apply it correctly in distinct factual situations. At the very least, implementation of these prescriptive rules should be deferred, in order to give the institutions and their advisors time to have a dialogue with the agencies about possible unintended consequences.

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<sup>5</sup> See Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

<sup>6</sup> 86 Fed. Reg. at 24758 n.12.

### **III. The agencies should revisit certain administrative requirements to avoid unintended results.**

The Proposed Rule mandates certain administrative outcomes that are burdensome and unnecessary to protect the regulated institution, which are set forth below.

First, the Proposed Rule strictly mandates timing of payments to and from the institution. For example, the Proposed Rule requires that a parent must “promptly” remit an institution’s tax refund. Instead, these matters should be left to the professional judgment of relevant tax personnel at the institutions, subject to the overarching standard that excessive anticipation or delay of payments could be recharacterized by the agencies as extensions of credit under section 23A or 23B of the Federal Reserve Act.<sup>7</sup> Regulated entities need to maintain some flexibility to promote orderly payment processing.

Second, the Proposed Rule mandates a broad accessibility rule with respect to tax work papers.<sup>8</sup> Work paper access should be limited to the agencies, rather than be extended to commercial predecessors or successors, in order to prevent an inappropriate disclosure of confidential information. Moreover, the agencies should have authority to request only those work papers that are relevant to calculating the institution’s separate entity liability, and its corresponding entitlements under the tax allocation agreement. In addition, the agencies should not be permitted to access any information that would not have been available to the Internal Revenue Service in its examination capacity. Privacy concerns must be respected in this regard.

### **IV. The agencies should not address regulatory capital issues in the final rule.**

Finally, the Proposed Rule covers the treatment of deferred tax assets (“DTAs”) and deferred tax liabilities (“DTLs”) under GAAP, and potential required deviations from GAAP when completing Call Reports, a topic entirely distinct from the matters discussed above. The Associations and their members strongly oppose utilizing this regulatory package to address such issues, which are quite complex. The agencies have described their reasoning in a cursory fashion in the preamble, and a rulemaking on such complex matters should be accompanied by a much more extensive articulation of which transactions are of concern and why.

The following are some examples of the analytical flaws in the regulatory capital analysis.

First, the discussion in the section of the Proposed Rule “Temporary Difference Deferred Tax Items” argues for a GAAP “clarification” that temporary differences must remain with the asset or liability that has generated those temporary differences.<sup>9</sup> The agencies lack the requisite authority to decide the GAAP treatment of such items. Moreover, the agencies’ reasoning is faulty unless the proposed rule is interpreted very narrowly. The agencies illustrate their thinking by citing temporary differences that arise by reason of the tax basis of an asset or liability differing from its GAAP value. The issue is that temporary differences can arise for many other reasons, and in those cases it will not be clear which asset or liability is responsible for the temporary difference, or even whether any asset or liability can be so-identified. For example, temporary differences may result from differing timing rules

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<sup>7</sup> 12 U.S.C. § 371c and 12 U.S.C. § 371c-1.

<sup>8</sup> 86 Fed. Reg. at 24760.

<sup>9</sup> 86 Fed. Reg. at 24760.

with respect to income or expense, even though such items do not factor into asset basis. This is the case with certain types of compensation which may be deducted earlier for tax purposes than for GAAP purposes. In addition, the treatment of liabilities for tax and GAAP purposes is much more complicated than “tax basis differing from GAAP value.” If included in a final rule, this provision should be strictly limited to temporary differences where the basis of an asset differs from its GAAP value. No inference should be drawn as to the rule for other temporary differences.

Second, the discussion in the section titled “Operating Loss and Tax Credit Carryforward DTAs” argues for a Call Report provision that explicitly deviates from GAAP.<sup>10</sup> GAAP forms a view as to carryforwards based on a nuanced and evolved analysis of all of the facts and circumstances of the reporting group’s particular circumstances. As a result, the agencies should not override the GAAP rules absent a very clear demonstration that the GAAP result is deleterious to the safety and soundness of the regulated institution. The agencies’ first concern appears to be that any settlement of NOL or credit carryforwards should be prohibited if it results in any accretion to the institution’s regulatory capital, since such carryforwards receive a 100% haircut in the absence of settlement. Regulated groups should be permitted to improve the institution’s capital position by settling such carryforwards for cash, irrespective of the amount. Such transactions do not deprive the institution of any asset that is given credence for regulatory capital purposes. In actuality, of course, the regulated groups do not seek to settle the carryforwards for pennies on the dollar; when they are settled it is in a manner that is carefully considered to be fair to the institution given all facts and circumstances. Notwithstanding this considered analysis, the Proposed Rule advocates an across-the-board disallowance on the grounds that “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 cash in the form of a capital contribution from a holding company.”<sup>11</sup> However, the settlement may not be reversible, in which case the cash received is exactly of the same quality as a capital contribution. Additionally, even if it is reversible, such reversal would be a subsequent reduction in capital that would only be permissible if a dividend could have been paid. We further note that complying with this proposal may lead to institutional challenges and operational burdens in allocating and tracking carryforwards (which are sensitive to changing income projections and profiles), particularly for large groups with multiple reporting entities.

The agencies also advance a second argument for the prohibition of settlements of carryforwards, which is that the settlement may be calculated at a rate lower than the future tax rates against which the credit may be claimed. The Proposed Rule states that “[a]s a result, an institution that sells or purchases DTAs for NOLs or tax credit carryforwards may receive significantly less than, or overpay for, these DTAs in relation to the amounts at which these DTAs ultimately would have been realized had they not been transferred...”<sup>12</sup> The answer to this challenge, however, should not be to bar all settlements but rather should be to mandate that settlements must be fair to the institution, taking into account all relevant facts and circumstances. For example, a settlement could provide for contingent adjustments (favorable, unfavorable, or both) if the attributes are absorbed in a different rate environment than prevailed at the time of settlement. Therefore, the agencies should allow either that an institution may receive a settlement payment for some or all of its tax attributes or properly record the DTA for such tax attributes on the institution’s books in advance of the attribute being

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<sup>10</sup> 86 Fed. Reg. at 24761.

<sup>11</sup> 86 Fed. Reg. at 24761.

<sup>12</sup> 86 Fed. Reg. at 24761.

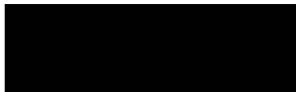
absorbed by the group, if the institution is treated fairly, taking into account all facts and circumstances of such transaction.

The Associations do not raise these regulatory capital questions to seek specific tailoring of this portion of the Proposed Rule, but instead to illustrate the inaccuracies inherent in such an approach. This Proposed Rule is an inappropriate means of dealing with these issues.

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The Associations appreciate the opportunity to comment on the proposal. If you have any questions, please contact the Dafina Stewart at [dafina.stewart@bpi.com](mailto:dafina.stewart@bpi.com) or Briget Polichene at [bpolichene@iib.org](mailto:bpolichene@iib.org).

Respectfully Submitted,



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