Federal Banking Agencies Propose Inter-Affiliate Tax Allocation Agreement Regulations

May 12, 2021

On April 22, 2021, the Federal Reserve Board ("FRB"), Federal Deposit Insurance Corporation ("FDIC") and Office of the Comptroller of the Currency ("OCC") (together, the "Agencies") invited comment on a proposed rule that updates and codifies existing guidance for tax allocation agreements between and among banks, affiliates and parent holding companies (the "Proposed Rule").[1] The Proposed Rule was published in the *Federal Register* on May 10, 2021, with the comment period ending July 9, 2021.

Many banking organizations already deploy inter-affiliate agreements to apportion tax assets and liabilities within a consolidated group, but approaches to managing tax matters vary widely. The Proposed Rule would, for the first time: (i) ***require*** federally regulated banks that file tax returns as part a consolidated filing group to execute tax allocation agreements with other members of the group; and (ii) ***set forth minimum standards and mandatory provisions*** for such agreements. Two policy rationales appear to support the new requirements: ensuring fair and equitable treatment of banking entities that generate tax assets for a consolidated group and preventing use of the bank to finance tax liabilities on off-market terms.

Background. In 1998, the Agencies, including the now-disbanded Office of Thrift Supervision, adopted a policy statement providing income tax allocation guidance to insured depository institutions (the "1998 Statement").[2] An addendum followed in 2014 (the "2014 Addendum").[3] Together, these guidance documents attempted to clarify insured banks' ownership rights in tax refunds when they file as part of a consolidated group.

Specifically, the 1998 Statement made clear that an insured bank filing in a consolidated tax group should receive treatment at least as favorable as it would if it filed returns on a standalone basis. The 2014 Addendum further explained that inter-affiliate tax allocation agreements should expressly acknowledge an agency relationship between

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1 Joint Press Release, "Agencies invite comment on proposed rule for income tax allocation agreements", (Apr. 22, 2021), *available* here.

2 63 Fed. Reg. 64757 (Nov. 23, 1998).

3 79 Fed. Reg. 35228 (June 19, 2014).

the insured bank and its holding company—to ensure prompt transfer of any tax refund due to the bank but paid to the holding company. Failure to acknowledge an agency relationship would subject a tax allocation agreement to requirements under Sections 23A and 23B of the Federal Reserve Act, including as codified in Federal Reserve Board Regulation W.[4]

The 1998 Statement and 2014 Addendum were issued as interagency guidance and, therefore, do not have binding effect. Similar principles animate the Proposed Rule, which, on adoption, would carry force of law.[5] According to the Agencies, such a step is required because some banking organizations have not adopted tax allocation agreements at all and, among those that have, supervisors have observed gaps in compliance with the earlier guidance.

Application and Scope. All federally-regulated banks that file federal or state income taxes in a consolidated group would be subject to the Proposed Rule, not only banks, as in the earlier guidance.[6] For these purposes, a consolidated group refers to a bank, its parent, and any affiliates that file tax returns as a consolidated, combined, or unitary group.

Key Provisions. The Proposed Rule establishes minimum structural, governance, and operational requirements for covered tax allocation agreements, including that:

- The bank's board of directors must approve the agreement and any amendments;
- Compensation for use of a bank's tax assets must be paid at the time of absorption and, similarly, tax refunds attributable to a bank must be transferred promptly to the bank; and
- A bank's deferred tax items, including those attributable to net operating loss, should be reflected in regulatory reports on a separate entity basis.

Tax allocation agreements also must include specific substantive provisions. For example, agreements must:

- State clearly that an agency relationship exists between the bank and its holding company with respect to tax funds received;

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[4] Section 23A and 23B deal with loans and other extensions of credit from an insured depository institution to its affiliate. *See* 12 U.S.C. 371c, 12 U.S.C. 371c-1, and implementing Regulation W at 12 CFR Part 223.

[5] The 1998 Statement and 2014 Addendum would be rescinded by the Proposed Rule.

[6] The proposed rule would not apply to banks or holding companies not subject to federal or state income taxes, such as S-corporations.

- Provide that any portion of a tax refund related to a bank's tax attributes is held in trust by the holding company for the benefit of the bank;

- State that all materials related to the consolidated federal, state or local returns must be made available on demand to the bank during regular business hours; and

- Prohibit tax payments by the bank to the holding company or affiliates—

  - in excess of current period tax obligations or estimated expenses calculated on a separate entity basis;

  - for the settlement of deferred tax liabilities of the bank; or

  - made earlier than would have been required to pay the relevant taxing authority had the bank filed as a separate entity.

We will continue monitoring developments as the Proposed Rule proceeds to final form and provide updates as warranted.

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