

## Capital Bancshares Holds No Refund from NOL of Subsidiary

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The question of who is entitled to an NOL in the context of consolidated return filers has long been fraught with uncertainty, and the answer depends on a variety of issues. A recent case, *Capital Bancshares, Inc. v. Federal Deposit Ins. Corp.*, CA-5, 4/3/92, underscores the need for attention to this important question, particularly when the subsidiary which generated the losses goes bankrupt.

### Background

Capital Bancshares was the common parent of an affiliated group and owned 100% of the stock of a bank. The bank had existed since 1955, but prior to 1980, was the parent of an affiliated group of its own. In 1980, Bancshares was

formed and acquired all of the outstanding common stock of the bank, becoming the parent of the affiliated group. Several additional corporations were added to the group in 1982 and 1984, either as subsidiaries of the bank or as subsidiaries of Bancshares.

In 1986, Bancshares filed claims for refund of taxes paid during 1972 through 1975 and 1981. In October 1987, the FDIC was appointed as liquidator of the bank. At the time the bank was closed, it owned the common stock of all members of the group except for Bancshares and two of its subsidiaries.

After several delays in the processing of the refund claims filed by Bancshares, it finally filed suit in March 1988 in district court for a refund of approximately \$4.6 million attributable to taxes paid by it and its subsidiaries. Various procedural machinations occurred in the suit, including the FDIC's request that any refund be payable to it.

The tax refunds were granted and placed in escrow. Ultimately, the district court granted the FDIC's second motion for summary judgment, ordering Bancshares to pay the refund over to the FDIC. Bancshares appealed.

### Whose Loss?

On appeal, Bancshares argued that in the absence of precedent on who was entitled to the refund due to the NOLs, its allocation should be respected. The Fifth Circuit acknowledged that the courts will not question an allocation that results from an express agreement, or an agreement that is clearly implied. The court, however, stated that Bancshares did not have an allocation scheme.

The court cited several cases for the proposition that the conservator of a bankrupt subsidiary has a right to recover an income tax refund channeled through a parent company filing a consolidated return.

For example, in *In re Bob Richards*, 473 F.2d 262 (CA-9, 1973), the parent had filed a consolidated income tax return for a year in which its subsidiary created a refund for the consolidated return. An unsecured creditor of the subsidiary was owed an amount in excess of the amount of the refund. When the parent received the refund, the subsidiary's creditor asserted that it was entitled to it.

The Ninth Circuit determined that the trustee in bankruptcy was entitled to the refund. According to the court, the trustee acquired whatever rights the bankrupt had in the prospective refund. The mere filing of a consolidated return could not be construed as an assignment of the bankrupt's rights to the parent. The critical factor, according to the Ninth Circuit, was the fact that there was no allocation agreement allowing the parent to keep refunds arising from the subsidiary's losses. (See also *Jump v. Manchester Life & Cas. Management Corp.*, 438 F.Supp. 185 (DC Mo., 1977), *aff'd*, 579 F.2d 449 (CA-8, 1978).)

### FDIC Gets the Loss

Accordingly, the court concluded that the refund should go to the FDIC. The court noted that the loss was entirely

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attributable to the bank. In the absence of a contrary agreement, the court felt compelled to award the refund to the bank, and hence its receiver, the FDIC.

Bancshares also argued that equitable considerations should be applied to give it the refund. After all, Bancshares had borrowed substantially for the benefit of the bank, and Bancshares had even assigned a portion of the tax refund claims to the third-party lenders. The court was unpersuaded.

**No Implied Agreement**

Finally, Bancshares argued that there was an implied agreement as to the use of and entitlement to the losses. Bancshares even produced the affidavits of two CPAs evidencing the existence of such an agreement. Although the court noted that there appeared to have been an inconsistent practice of paying loss subsidiaries for the use of their losses, nothing in the affidavits suggested that there was an implied agreement as to the allocation of tax refunds. ■