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July 9, 2021

SUBMITTED ELECTRONICALLY AND DELIVERED VIA FEDEX TO:

Office of the Comptroller of the Currency  
Chief Counsel's Office  
Attention: Comment Processing  
400 7th Street SW  
Suite 3E-218  
Washington, DC 20219

Ann E. Misback  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW  
Washington, DC 20551

James P. Sheesley  
Assistant Executive Secretary  
Attention: Comments—RIN 3064—AF62/Legal ESS  
Federal Deposit Insurance Corporation  
550 17th Street NW  
Washington, DC 20429

RE: Proposed Regulations on Tax Allocation Agreements (OCC Docket ID OCC-2020-0043; Federal Reserve Docket No. R-1746 and RIN 7100-AG14; FDIC RIN 3064—AF62)

Dear Sir or Madam:

We respectfully submit this letter on behalf of Barclays Bank PLC (**Barclays**) and its subsidiary U.S. insured depository institution, Barclays Bank Delaware, in response to the request for comments in the Notice of Proposed Rulemaking (**NPR**) and corresponding proposed rules issued by 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**) with respect to tax allocation agreements among members of a consolidated tax filing group for tax purposes (**consolidated group**).<sup>1</sup>

Specifically, this letter responds to the request for comments set forth in the preamble to the NPR (**NPR Preamble**) with respect to a specific component of the treatment of deferred tax assets (**DTAs**) arising from tax loss and tax credit carryforwards (**Carryforward DTAs**) that are transferred for cash by the depository institution to the parent or other members of the consolidated group before their use by other such members. We understand the impetus informing the crux of the proposed rules as well as the NPR's default rule delaying derecognition of transferred tax Carryforward DTAs in these transactions on separate entity regulatory reports until the consolidated group fully uses the Carryforward DTAs. Based on considerations outlined below, however, we request that the agencies consider an enhancement that would add a rule to permit current derecognition of Carryforward DTAs—where the underlying attributes and corresponding DTAs are transferred by the depository institution to other consolidated group members and the relevant tax allocation agreements contain specified contractual provisions—in order to ensure that the institution's regulatory capital is accurately reported and liquidity is maintained.<sup>2</sup> We describe such proposal in more detail below.

## I. Background

The NPR builds upon prior guidance issued by the agencies with respect to tax allocation agreements among members of a consolidated group, requiring such groups to enter into tax allocation agreements, prescribing certain mandatory provisions that must be included in the agreements, and adopting related requirements with respect to proper compensation and payment obligations for tax attributes and refunds. These provisions are intended to “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.”<sup>3</sup>

We fully agree that tax allocation agreements strengthen the safety and soundness of regulated institutions by ensuring that consolidated tax filing arrangements and practices are not adverse to their interests. We understand that the proposed rules are intended to further the

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<sup>1</sup> 86 Fed. Reg. 24,755 (May 10, 2021). The NPR was first made available to the public on April 22, 2021, and later published in the Federal Register on May 10, 2021.

<sup>2</sup> Despite issues articulated in the NPR Preamble (described below) about the “quality” of the cash received in Carryforward DTA derecognition transactions, it does not appear that the agencies are proposing any change to full current recognition of such cash received as an unencumbered, gross asset on the depository institution's balance sheet for regulatory capital reporting purposes. Instead, it appears that the agencies are addressing this broad concern by delaying derecognition of the Carryforward DTA, which otherwise reduces capital and thus offsets the net regulatory capital benefit from the recognition of the cash as an unencumbered gross asset for regulatory capital reporting purposes. To the extent that the agencies are proposing to not fully recognize the cash received in Carryforward DTA derecognition transactions as an unencumbered gross asset, we submit that the agencies should clarify this position but also permit full recognition of such cash as an unencumbered gross asset if the contractual provisions in the tax allocation agreement described in this letter are fully adopted.

<sup>3</sup> 86 Fed. Reg. at 24,755.

mandate of the Federal Reserve Act that transactions between a depository institution and its affiliates be made on terms that are substantially the same, or at least as favorable to the institution, as comparable transactions involving nonaffiliated companies. Barclays's own tax sharing agreements reflect these principles for its regulated insured depository institution in the United States (Barclays Bank Delaware), and it will otherwise conform to the new requirements as need be.

## II. Carryforward DTA Delayed Derecognition Proposed Rules

The NPR also adds special rules for the regulatory reporting of transfers of tax loss and tax credit carryforwards. With respect to these rules, we request the agencies consider adding alternative tax allocation agreement provisions as means to address their concerns.<sup>4</sup>

As the NPR Preamble recognizes, tax carryforwards generally include deductions and credits that cannot be used on a taxpayer's current year tax return to offset income (because the deductions exceed the income or the credits exceed the taxes due or are otherwise limited) but such deduction or credits may be carried over to future tax years to offset taxable income (in the case of deductions) or directly reduce tax payments (in the case of credits) due in those future years.<sup>5</sup> Such tax carryforwards create DTAs for financial accounting purposes as required by U.S. GAAP rules, and applicable regulatory capital rules require that depository institutions deduct such Carryforward DTAs (net of valuation allowances and allocated deferred tax liabilities) from common equity tier 1 capital. As the NPR Preamble further recognizes, to mitigate the effect of such capital deductions, depository institutions may transfer for a cash payment the underlying tax carryforwards (and associated DTAs) to their consolidated group parent prior to the use of the tax carryforwards. Such transfer of the carryforward attribute and associated DTA for cash is recognized by GAAP as a "derecognition" event that eliminates the Carryforward DTAs from the depository institution's balance sheet for U.S. GAAP purposes, thus mitigating the corresponding regulatory capital deduction and increasing the cash on the institution's separate balance sheet.<sup>6</sup>

The NPR Preamble identifies certain concerns with respect to such transfers by institutions to affiliates that derecognize Carryforward DTAs. Fundamentally, the NPR Preamble states that the Federal Deposit Insurance Act (**FDIA**) provides that the accounting principles applicable to reports or statements required to be filed with the agencies by insured depository institutions should result in reports of condition that "accurately reflect the capital of such institutions, facilitate effective supervision of the institutions, and facilitate prompt

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<sup>4</sup> The NPR also proposes that certain timing DTAs cannot be subject to settlement under a tax allocation agreement and instead must remain appropriately reflected at the level of the institution. 86 Fed. Reg. at 24,761-62. This proposal is consistent with current U.S. GAAP accounting requirements for timing DTAs, and we support this approach.

<sup>5</sup> 86 Fed. Reg. at 24,761.

<sup>6</sup> *Id.* at 24,761.

corrective action to resolve the institutions at the least cost to the Deposit Insurance Fund.”<sup>7</sup> The NPR Preamble states that the agencies are concerned that these objectives may not be met with respect to Carryforward DTA derecognition transactions because such transactions “may not accurately reflect an institution’s capital and may increase the cost to the Deposit Insurance Fund” if the institution later fails and the receiver cannot fully recover the value of these DTAs.<sup>8</sup>

The NPR Preamble identifies two reasons animating this fundamental concern over improper reporting of capital in the case of Carryforward DTA derecognition transactions. First, any cash received by the depository institution for the transfer of the DTA may be “reversible” and thus not provide the same quality of regulatory capital as a pure capital contribution from the parent holding company of the consolidated group.<sup>9</sup> We understand the agencies’ concern in this case is that, in the event of a breakup of the consolidated group, the institution could be subject to “put back” risk and be required to reacquire a portion of the Carryforward DTAs, which would negate the benefits of the initial cash settlement. Second, the NPR Preamble cites concerns with respect to “significant valuation uncertainties” associated with Carryforward DTAs when the carryforward tax attributes are used in the future and applicable tax rates or limitations on such carryover attributes may change.<sup>10</sup> In this case, we understand the agencies’ concern about a change in tax law, such as an increase in tax rate or altered attribute limitations, that could affect the value of Carryforward DTAs and result in an institution receiving significantly less for the transfer of a Carryforward DTA than the amount that would have been ultimately realized had such underlying tax attribute not been transferred.

To address these concerns and ensure that the objectives of the FDIA are met, the agencies have proposed to revise the regulatory reporting (via changes to the Call Report instructions) of such Carryforward DTA derecognition transactions to clarify that an institution must not derecognize DTAs for tax carryforwards on its separate-entity regulatory reports prior to the time the consolidated group absorbs such carryforwards.<sup>11</sup> The NPR Preamble acknowledges that this treatment diverges from current U.S. GAAP accounting pursuant to which a Carryforward DTA is derecognized where settled for cash with the consolidated group parent who then becomes the owner of the Carryforward DTAs and subject to the risk on these Carryforward DTAs.<sup>12</sup>

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<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 24,760-61.

<sup>12</sup> *Id.* at 24,761.

### III. Suggested Additions to Proposed DTA Derecognition Rule

We understand and appreciate the agencies' need to address potential regulatory capital and liquidity considerations and the identified valuation and "put-back" issues with respect to Carryforward DTA derecognition transactions that are explained in the NPR Preamble.

We respectfully submit, however, that the transfers for cash by depository institutions of Carryforward DTAs improve the safety and soundness of the U.S. banking system and should be encouraged as prudent and beneficial. The transfer of Carryforward DTAs by a depository institution to its consolidated group parent or other members helpfully converts an uncertain tax attribute that may or may not be used in the future to current holdings of cash. Significantly, the institution that generated the Carryforward DTA receives the substantial advantage of receiving cash currently for these tax attributes and is no longer exposed to the vagaries of an asset that is illiquid, nearly impossible to hedge, and subject to idiosyncratic risk (particularly in times of distress). Instead, these risks are transferred to other members of the consolidated group in prudent fashion. In fact, the liquidity of the depository institution is immediately enhanced by the cash received in exchange for an uncertain tax attribute that may never be used in the event of insolvency or other distress of the depository institution or consolidated group.

Given these liquidity and safety and soundness benefits to the depository institution from transferring loss DTAs, we respectfully suggest that, as an enhancement to the default delayed DTA derecognition rule, the agencies permit current derecognition of transferred Carryforward DTAs if the consolidated group of which the relevant institution is part expressly includes the following specified tax allocation agreement provisions:

- **To address the put-back issue, the tax allocation agreement would provide that any Carryforward DTA that is transferred back to the institution prior to full use must be re-transferred at no cost (i.e., as a capital contribution):** Any potential concern over the "reversible" nature of a DTA transfer for cash could be fully mitigated if the agencies required that, should the institution re-acquire the Carryforward DTAs, such a transfer could only be effectuated as a capital contribution with *no payment or refund of cash*. In other words, if the institution must re-acquire an attribute or associated DTA from the consolidated group parent or other group member, the tax allocation agreement could specify that parent or member must waive any right to compensation from the institution and thus effectively contribute the DTA to the capital of the institution. This would ensure that the benefits of the upfront settlement of the DTA would never be "reversible."
- **To address any potential valuation uncertainties, the tax allocation agreement would provide for compensatory payments to be made to the institution upon material changes in the value of Carryforward DTAs:** Any potential issues with valuation fluctuations or uncertainties could also be fully mitigated with tax allocation provisions that provide for compensatory payments to be made to the institution if the value of a Carryforward DTA increases by a material amount within a specified time frame—e.g., within 18 months (any such compensatory payment could be calculated to

take into account present value considerations).<sup>13</sup> For example, the provisions could require compensatory payments to the institution for transferred deductions if tax rates increase but would provide for no payments to or from the institution if tax rates decrease. Such provisions would help ensure the bank would not be at risk of receiving significantly less for the transfer of a Carryforward DTA than the amount that would have been ultimately economically realized had such underlying tax attribute not been transferred.<sup>14</sup>

We submit that such specified tax allocation agreement provisions fully address any issues with Carryforward DTA derecognition transactions that are discussed in the NPR Preamble and, importantly, also materially improve the liquidity, safety and soundness of the relevant institutions. As described above, transfers of Carryforward DTAs by depository institutions for cash ultimately support safety and soundness: The tax allocation agreement provisions above ensure that the consolidated parent is solely and fully economically exposed to future revaluations of the Carryforward DTA upon transfer of the Carryforward DTA, while the institution that receives cash in for this transfer is protected from any vagaries in the value or utilization of such Carryforward DTAs. The contractual provisions specified above also ensure that the institution retains its cash from the Carryforward DTA transfer with no reversal risk and with the right to additional cash in the future if values increase. Such provisions ensure that regulatory capital is accurately reflected for regulatory reporting purposes and liquidity is enhanced, enhancing the safety and soundness of the U.S. banking system.

Thank you for your consideration, and we would welcome the opportunity to discuss any comments or questions about the requested regulations at your earliest convenience. You may reach Brian Christiansen at 202-371-7852 and [brian.christiansen@skadden.com](mailto:brian.christiansen@skadden.com), and Chris Bowers at 202-371-7060 and [chris.bowers@skadden.com](mailto:chris.bowers@skadden.com).

Sincerely,



Brian Christiansen



Chris Bowers

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<sup>13</sup> We note that, whereas changes in Federal tax rates could be material, changes in state tax rates generally have a de minimis impact on Carryforward DTA values. Therefore, we recommend that tax allocation agreements would require compensation for reasonably anticipated changes in the Federal tax rate. However, for state tax rate changes, the tax allocation agreement could require compensation for net state effects only when the rate change exceeds a reasonable, pre-determined amount (such as, for example, a two percentage point increase to a relevant state tax rate (e.g., from 4% to 6%)).

<sup>14</sup> To avoid the creation of a covered credit transaction for purposes of section 23A of the Federal Reserve Act and its implementing Regulation W, the contractual provisions would require the affiliate to make any required cash payment to the depository institution promptly upon a determination that any such payment is required.