The relief described hereinbelow is SO ORDERED.

Signed June 01, 2011.

ROBERT D. BERGER
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

In re:

FRANKLIN SAVINGS CORPORATION,

DEBTOR.

CASE NO. 91-41518
CHAPTER 11

MEMORANDUM OPINION AND ORDER DENYING DEBTOR'S MOTION FOR SUMMARY JUDGMENT ON ITS OBJECTION TO THE INTERNAL REVENUE SERVICE'S CLAIM

Debtor Franklin Savings Corporation (Debtor or FSC) moves for summary judgment on its objection to the Internal Revenue Service's Amended Proof of Claim and Request for Payment of $7,096,121.87 in taxes, interest, and penalties.[1] The Court has jurisdiction.[2]

[1] The Objection is Doc. No. 586. The Motion is Doc. No. 1425; the Support Brief is Doc. No. 1426. Debtor appears by R. Pete Smith of McDowell, Rice, Smith & Buchanan. United States (IRS) appears by Robert D. Metcalfe, U.S. Department of Justice, Tax Division.

[2] 28 U.S.C. §§157(a), (b)(2)(B) and §§1334(a), (b). There is no objection to venue or jurisdiction.

11.06.01 Franklin Savings IRS SJ.wpd

Nature of the Case

Debtor objects to the IRS's administrative expense claim for three years of post-petition taxes. Summary judgment is appropriate if there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law.[3] A genuine issue of material fact is a factual dispute that may affect the outcome of the case and leave a reasonable trier of fact able to find in favor of either party.[4] In applying this standard, the Court views the factual record and draws all reasonable inferences in the light most favorable to the nonmovant.[5]

Procedural History

On October 13, 1998, the IRS filed its third Request for Payment of Internal Revenue Taxes as an administrative expense for tax periods ending June 30, 1993, through June 30, 1995.[6] Debtor objects to the tax claim because it is based on Federal financial assistance[7] received by Franklin Federal Savings Association (FFSA), which Debtor contends should not have been included in its consolidated tax returns under IRC §1504(a) for the years in issue. The IRS counters IRC §597 and its implementing regulations require FFSA's income and that of its predecessor, Franklin Savings Association (FSA), be included in Debtor's consolidated tax returns because both were members of FSC's affiliated group.[8] The Debtor has not met its burden to show it is entitled to judgment as a matter of law.

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[3] Fed. R. Civ. P. 56(c). *See* Fed. R. Bankr. P. 7056, incorporating Fed. R. Civ. P. 56.

[4] *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

[5] *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 587 (1986).

[6] Claim No. 48, which amended Claim No. 47, which amended Claim No. 37.

[7] 26 U.S.C. §597(c). Future references to Title 26 in the text shall be to the IRC section only. Federal financial assistance is commonly abbreviated "FFA"; however, the acronym is too similar to Debtor's and other institutions' acronyms used herein, so FFA will not be used in this opinion unless it appears in direct quotations.

[8] An affiliated group is also referred to as a consolidated group. *See* 26 C.F.R §1.597-4(f). Future references to the regulations implementing 26 U.S.C. §597 shall be to the Treasury Regulation number only.

Findings of Uncontroverted Fact

Beginning in 1985, FSC and members of its affiliated group, including FSA and other subsidiaries, elected to file consolidated income tax returns. FSC owned more than 80 percent of FSA's stock, and FSA owned more than 80 percent of the other subsidiaries' stock. Thus, FSA's income and that of the subsidiaries were included in FSC's consolidated returns.

On February 15, 1990, the Office of Thrift Supervision (OTS) appointed the Resolution Trust Corporation (RTC) Conservator of FSA. The RTC thereby succeeded to the rights of FSA stockholders, and FSC no longer owned FSA's stock by operation of law. Debtor filed for relief under Chapter 11 on July 26, 1991.

On July 16, 1992, the OTS changed the RTC's oversight of FSA from a conservatorship to a receivership. The OTS also approved the RTC's request to form a new federal mutual savings association, FFSA. FFSA is a "bridge bank" and has no stock.[9] The RTC transferred FSA's assets and liabilities to FFSA. The RTC immediately became the Conservator of FFSA. FFSA received Federal financial assistance during the FSC tax years ending on June 30, 1993, through June 30, 1995.

Between 1994 and 1996, Debtor filed Form 1120 Corporation Income Tax returns for taxable years ending June 30, 1993, 1994, and 1995. Each return identified FFSA as an FSC affiliated group member. Ernest M. Fleischer, in his capacity as Chairman of FSC's Board of Directors, signed the returns.

On October 29, 1997, Debtor and its subsidiaries filed Form 1120X Amended U.S. Corporation Income Tax Returns for taxable years ending June 30, 1993, through June 30, 1995.

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[9] Treas. Reg. § 1.597-1(b).

Each amended return again specifically identified FFSA as an affiliated group member and detailed how Federal financial assistance was treated.[10] The IRS examined the amended returns and recommended they be accepted – resulting in a tax abatement of approximately $160 million. These returns were not prepared from Debtor's own records, but from Debtor's receipt of amended returns from the receiver. The IRS $7,096,121.87 claim, as computed through August 10, 1998, is based on these 1997 amended returns.

In 2004, the United States District Court for the District of Kansas held "FSC was deprived of its ownership of [FSA's] stock when the RTC was appointed conservator;" and "[o]n February 15, 1990, the RTC succeeded by operation of law to 'all rights, titles, powers, and privileges . . . of any stockholder,'" and "upon appointment of the RTC as conservator, FSC no longer possessed good, legal, or rightful title to the stock, and therefore it no longer 'owned' its stock in FSA."[11] In the district court case, Debtor had objected to the OTS's proof of claim seeking over $271,000,000 as a deficit caused by FSC's alleged breach of a capital maintenance commitment.

In July 2008, Debtor filed a second set of amended returns for the taxable years ending June 30, 1993, through June 30, 1995, based on the 2004 district court decision. The amended returns eliminated FSA and FFSA as members of FSC's affiliated group and eliminated FSC's tax liability. The IRS has not accepted these amended returns and has not abated any taxes.

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[10] Doc Nos. 1445 and 1449, Declaration of Robert D. Metcalfe ¶¶ 5-7, at 1-2, Ex. G-I.

[11] *Franklin Savings Corp. v. Office of Thrift Supervision*, 303 B.R. 488, 498 (D. Kan. 2004).

Controverted Fact

One controverted fact is whether FSA received Federal financial assistance during its conservatorship under the RTC between February 15, 1990, and the fiscal year ending on June 30, 1993. The parties agree FFSA received Federal financial assistance during the fiscal years ending June 30, 1993, 1994, and 1995, after FFSA was created on July 16, 1992.

The IRS asserts FSA received Federal financial assistance prior to the fiscal year ending on June 30, 1993, based on an IRS worksheet prepared when examining the Debtor's amended tax returns filed in 1997. The worksheet states the "6/30/93 FFA provided represented the book balance, i.e., included all FFA received in 93 and *prior* years."[12] Debtor counters FSA never received Federal financial assistance based on Ernest Fleischer's supplemental affidavit.[13] Fleischer's affidavit is supported by FSA standalone tax returns and other IRS worksheets not quoted in the IRS affidavit.[14] The controverted fact is over the narrow question of whether the $779,000 in Federal financial assistance reported for FFSA for fiscal year ending June 30, 1993, includes a prior year balance from the FSA conservatorship, which ended with the transfer of assets and liabilities to FFSA in July 1992.

Analysis and Conclusions of Law

A. IRC §597, not IRC §§1501-1504, controls when a Federal agency takes control of a financial institution.

IRC §1501 allows the parent of a corporate affiliated group to file a consolidated income tax return if the affiliated group is owned and controlled by at least 80 percent stock ownership

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[12] Doc. No. 1445 ¶ 17, at 8, supported by Dick Declaration, Doc. No. 1448 ¶ 7, at 2, and Ex. C thereto.

[13] Doc. No.1461, at 6. Debtor denies that FSA or FFSA received Federal financial assistance during the fiscal year that ended on June 30, 1992, or any prior year. Doc. No. 1461, at 4.

[14] Doc. No. 1461, Ex. 31.

under the parent corporation.[15] The group's tax liability is based on its consolidated taxable income, which is determined by aggregating the separate income or loss of each member. The deductions and losses generated by one corporation in the group may be used to offset income generated by other members.

However, when a Federal regulatory agency assumes control over a financial institution, taxes are determined under IRC §597 and its implementing regulations. IRC §597(a) states taxes and surtaxes on "any transaction in which Federal financial assistance is provided with respect to a bank or domestic building and loan association shall be determined under regulations prescribed by the Secretary." Treas. Reg.§ 1.597-4(f) provides control of a financial institution by a Federal agency does not terminate the institution's membership in an affiliated group, regardless whether the institution received Federal financial assistance in any particular year.[16] The examples in Treas. Reg. § 1.597-4(h) illustrate membership continues for institutions placed into conservatorship.[17] The only exception is an affirmative election under Treas. Reg.

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[15] 26 U.S.C. §1504(a).

[16] **(f) Rules applicable to members of consolidated groups--(1) Status as members.** Unless an election is made under paragraph (g) of this section, Agency Control of an Institution does not terminate the Institution's membership in a consolidated group. Stock of a subsidiary that is canceled by Agency is treated as held by the members of the consolidated group that held the stock prior to its cancellation. If an Institution is a member of a consolidated group immediately before it transfers deposit liabilities to a Bridge Bank, the Bridge Bank succeeds to the Institution's status as the common parent or, unless an election is made under paragraph (g) of this section, as a subsidiary of the group. If a Bridge Bank succeeds to an Institution's status as a subsidiary, its stock is treated as held by the shareholders of the transferring Institution, and the stock basis or excess loss account of the Institution carries over to the Bridge Bank. A Bridge Bank is treated as owning stock owned by its associated Residual Entities, including for purposes of determining membership in an affiliated group.

[17] **Examples.** The following examples illustrate the provisions of this section:

Facts. Corporation X, the common parent of a consolidated group, owns all the stock (with a basis of $4 million) of Institution M, an insolvent Institution with no Consolidated Subsidiaries. At the close of business on April 30, 1996, M has $4 million of deposit liabilities, $1 million of other liabilities, and assets with an adjusted basis of $4 million and a fair market value of $3 million.

Example 1. Effect of receivership on consolidation. On May 1, 1996, Agency places M in receivership and begins liquidating M. X does not make an election under § 1.597-4(g). M remains

(continued...)

§ 1.597-4(g) to terminate affiliate group status, which adjusts tax liabilities and imposes a toll charge to reflect the amount of Federal financial assistance necessary to restore the troubled financial institution's solvency at the time of the election. Congress intended Federal financial assistance be included in the affiliated group's income to the extent the affiliated group benefitted from use of the troubled institution's losses – even if the losses occurred in years preceding the receipt of Federal financial assistance.[18]

Under normal IRC §1501 consolidated return rules, if the parent does not satisfy the 80 percent stock ownership requirement, a subsidiary may not be included in the consolidated return. However, if the parent loses its stock ownership by Federal intervention, IRC §597 determines tax liability – even if Federal financial assistance is not immediately received by the troubled institution. The implementing regulations provide institutions in conservatorship and bridge banks remain members of the affiliated group unless the parent elects otherwise. The regulations further Congressional intent to insure the eventual receipt of Federal financial assistance offsets the losses claimed by other affiliated group members. Thus, failed institutions

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[17](...continued)
a member of the X consolidated group after May 1, 1996. Section 1.597-4(f)(1).

Example 2. Effect of Bridge Bank on consolidation--(i) Additional facts. On May 1, 1996, Agency places M in receivership and causes M to transfer all of its assets and deposit liabilities to Bridge Bank MB.

(ii) Consequences without an election to disaffiliate. M recognizes no gain or loss from the transfer and MB succeeds to M's basis in the transferred assets, M's items described in section 381(c) (subject to the conditions and limitations specified in section 381(c)) and TIN. Section 1.597-4(d)(1). (If M had a deferred FFA account, MB would also succeed to that account. Section 1.597-4(d)(1).) MB continues M's taxable year and succeeds to M's status as a member of the X consolidated group after May 1, 1996. Section 1.597-4(d)(1) and (f). MB and M are treated as a single entity for income tax purposes. Section 1.597-4(e).

[18] IRC § 597(b)(3) expressly requires "[n]o regulations prescribed under this section shall permit the utilization of any deduction (or other tax benefit) if such amount was in effect reimbursed by nontaxable Federal financial assistance."

are taxed on assisted acquisitions, and neither former owners nor new acquirers obtain tax benefits for costs borne by the taxpayer or insurance systems. The legislative history notes:

> The committee intends that Federal financial assistance generally will be deemed to have been received by the financially troubled institution immediately before the acquisition even in those situations where the assistance is paid directly to the acquiring institution. Although most financial assistance received by, or paid with respect to, financially troubled financial institutions would be treated as taxable, such assistance will be deemed to be received by the financially troubled financial institution at the time the assets of such institution are sold or transferred. As a result, the financial assistance generally will be offset by the net operating losses and built-in losses of the financially troubled financial institution. Therefore, the committee, in general, expects that an acquired financially troubled financial institution will have to net tax liability resulting from the receipt of (or deemed receipt) of financial assistance.[19]
>
> The committee recognizes that the net operating losses and built-in losses of the financially troubled institution may not always be sufficient to offset the amount of financial assistance received (or deemed received) by the troubled institution. This may occur, for example, in cases in which the financially troubled financial institution was a member of an affiliated group of corporations filing a consolidated return and the net operating losses of such institution were used to offset the income of other members of the affiliated group. In such a case, the financially troubled institution (or the affiliated group in which the institution is a member) may have net tax liability as a result of receiving financial assistance. In most cases, the committee considers this an appropriate result because other members of the affiliated group have received the benefit of the losses of the financially troubled financial institutions in prior years.[20]
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> [T]he regulations to be issued by the Treasury Department are to provide for the proper treatment of Federal financial assistance and appropriate adjustments to basis or other tax attributes such that the financial institution (or a related person) not receive both tax deductions for losses and expenses and an exclusion from gross income of amounts received from the regulatory insurance agencies to reimburse the institution (or its successors) for such losses and expenses.[21]

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[19] H.R. REP. NO. 101-54 (pt. 2), at 27 (1989) (footnotes omitted).

[20] *Id.* at 27 n.12.

[21] *Id*. at 28.

The overall regulatory scheme is designed to match the income includible upon the receipt of Federal financial assistance with the realization of the institution's losses, regardless how the Federal agency resolves the failed institution (whether by an immediate assisted acquisition, use of a bridge bank or otherwise).[22]

B. FSA remained an FSC affiliated group member after the conservatorship.

Debtor argues IRC §597 is never triggered because FSA did not receive Federal financial assistance, and FSA was disqualified from being an affiliated group member when it entered conservatorship in 1990. Debtor contends FSA's conservatorship deprived FSC of all rights, titles, powers, and privileges of a stockholder in FSA and cites the 2004 district court decision. Without any meaningful stock ownership, Debtor maintains FSA ceased as an affiliated group member under IRC §1504's ownership requirement. Debtor asserts the IRS is barred by collateral estoppel from relitigating whether FSC retained ownership and control of FSA after the appointment of the conservator.

When a troubled institution enters conservatorship, normal consolidated tax return rules cease to apply. The law presumes trouble financial institutions taken over by a Federal agency will receive Federal financial assistance at some point in its rehabilitation. Treas. Reg. § 1.597-4 does not address every process by which a distressed institution may receive assistance. For example, the two-step regulatory process in this case, first the placement of FSA in a conservatorship followed a couple of years later by the transfer of assets and liabilities to a bridge bank, is not expressly contemplated by the regulations implementing IRC § 597. However to find this omission fatal when the intent of Congress and the IRS is clear would

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[22] *See Treatment of Acquisition of Certain Financial Institutions; Certain Tax Consequences of Federal Financial Assistance to Financial Institutions*, 57 Fed. Reg. 14804-1 (proposed April 23, 1992) (to be codified at 26 C.F.R. 1.597-1 through 1.597.7).

create a loophole contrary to the statutory purpose and the broad language deeming distressed financial institutions as continuing members of an affiliated group. Thus, IRC §597 applies, and the institution in conservatorship continues as an affiliated group member unless the parent affirmatively elects otherwise. Debtor did not elect to terminate the affiliated group pursuant to Treas. Reg. § 1.597-4(g). Thus, FSA remained a member of the affiliated group and any Federal financial assistance received by FSA and FFSA is properly included in the Debtor's consolidated return.

Collateral estoppel does not apply because there is no identity of issues in the district court case and this case.[23] In the OTS litigation, the Court was required "to evaluate whether FSC retained control of FSA for purposes of the capital maintenance commitment notwithstanding the OTS's appointment of the RTC as conservator of FSA. . . ."[24] In this case, the Court determines whether IRC §597 or IRC §1504 governs whether FSA's and FFSA's income should be included in Debtor's consolidated returns. If IRC §597 is the controlling law, as it is, IRC §1504 ownership and control requirements are immaterial. The issues are not identical because IRC §597 determines Debtor's tax liability and not IRC §1504. Debtor's argument under IRC §1501 and 1504, standing alone, does not entitle Debtor to judgment as a matter of law.

Further, the parties dispute whether FSA received Federal financial assistance prior to fiscal year ending June 30, 1993, during which year FSA's assets and liabilities were transferred

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[23] *Moss v. Kopp*, 559 F.3d 1155, 1161 (10th Cir. 2009) (collateral estoppel will bar a claim if four elements are present, one of which is that "the issue previously decided is identical with the one presented in the action in question . . . .").

[24] *Franklin Savings Corp. v. Office of Thrift Supervision*, 303 B.R. at 496.

to the bridge bank, FFSA. It is undisputed that FFSA received Federal financial assistance. If FSA also received Federal financial assistance, then the linchpin of Debtor's argument fails.

C. FFSA succeeded FSA as an FSC affiliated group member.

In the event the troubled financial institution's assets and liabilities are transferred to a bridge bank, the bridge bank succeeds to the institution's status as an affiliated group member – regardless whether the bridge bank issues stock.[25] IRC §597 regulations exempt bridge banks from the affiliated group requirements contained in IRS §1504 and include mutual savings associations as members of the affiliated group. IRC §597 regulations take precedence over the regular consolidated return regulations.[26] To the extent IRC §1502 regulations require a consolidated group member issue capital stock, those regulations conflict with IRC §597 regulations which do not require a bridge bank to have outstanding stock.[27] IRC §597 and its implementing regulations include bridge banks in the affiliated group to accomplish Congressional intent.

> In the case of an Institution that is a member of a consolidated group, the legislative history indicates that Congress intended that FFA be included in the income of the Institution or consolidated group, at least to the extent the consolidated group benefitted from use of the Institution's losses. In order for the FFA to be included in the income of the transferor or its consolidated group, the

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[25] 26 C.F.R. § 1.597-4(f).

[26] 26 C.F.R. § 1.597-4(f)(3). Treas. Reg. § 1.597-1(a) incorporates the definitions of Treas. Reg. 1.1502-1 only to the extent the context does not otherwise require.

[27] 26 C.F.R. §1.597-1(b). The term Bridge Bank means an Institution that is organized by Agency to hold assets and liabilities of another Institution and that continues the operation of the other Institution's business pending its acquisition or liquidation, and that is any of the following–

(1) A national bank chartered by the Comptroller of the Currency under section 11(n) of the Federal Deposit Insurance Act (12 U.S.C. 1821(n)) or section 21A(b)(10)(A) of the Federal Home Loan Bank Act (12 U.S.C. 1441a(b)(10)(A)) or any successor sections;

(2) A Federal savings association chartered by the Director of the Office of Thrift Supervision under section 21A(b)(10)(A) of the Federal Home Loan Bank Act (12 U.S.C. 1441a(b)(10)(A)) or any successor section; or

(3) A similar Institution chartered under any other statutory provisions.

In this case, subsection (2) applied to the OTS's formation of FFSA, a mutual savings bank. As to the history of mutual savings banks, *see Dougherty v. Carver Fed. Sav. Bank*, 112 F.3d 613 (2nd Cir. 1997).

> Bridge Bank must succeed to the transferor's status, including its status in any consolidated group.[28]

Bridge banks are interim devices used by regulators and insurers to continue the transferor's business pending acquisition or liquidation. Bridge banks do not have outstanding stock representing a real paid-in equity interest. Former owners of a failed institution do not have an actual interest in the bridge bank. The stock they are deemed to own under §1.597-4(f) is fictional in regard to them. Examples (2) and (3) of Treas. Reg. §1.597-5(f) illustrate when an acquisition occurs, the assets and liabilities (which were first transferred to the bridge bank) are transferred to a new investor. The bridge bank then issues stock to the new investor; there is no transfer of existing stock of the bridge bank. Even for bridge banks having the capacity to issue stock, the receiver is not required to issue such stock, and the bridge bank is not controlled by stockholders in the conventional sense.[29] Mutual savings associations are not excluded from being bridge banks. Such an interpretation would contravene the Secretary's intent when drafting IRC §597's implementing regulations to ensure the bridge bank's form is "tax neutral."[30] The conservatorship triggered IRC §597, and FSA remained an affiliated group member. Because FSA remained a group member, FFSA succeeded as a member of the FSC affiliated group. FFSA was organized as a corporation by charter. Debtor's arguments to the contrary based upon a technicality of FFSA's corporate form would frustrate Congressional intent and allow the FSC affiliated group to benefit from FSA's and FFSA's prior losses, even though the bridge bank received Federal financial assistance.

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[28] 57 Fed. Reg. 14804-01, 14807 (proposed April 23, 1992) (to be codified at 26 C.F.R. 1.597-1 through 1.597.7).

[29] Jerred G. Blanchard, Jr., *The Taxation of Federally Assisted Acquisitions of Troubled Financial Institutions*, 44 TAX LAW. 1037, 1063 (1991).

[30] 57 Fed. Reg. 14804-01, 14805.

D. IRC §597 regulations are valid and do not contradict the statutes.

Generally, a "regulation can trump another regulation, but a regulation can never trump the Code itself."[31] Section 597 regulations are a valid exercise of regulatory authority granted by IRC §597(a), and, as legislative regulations, they are entitled to a high degree of deference.[32]

The general rules regarding Treasury Regulations validity are stated in *Goodson-Todman Enterprises, LTD.*:[33]

> It has long been recognized that the Internal Revenue Service is the primary authority in construing the Internal Revenue Code. There is a strong presumption in favor of the validity of Treasury regulations. This deference increases when, as here, there was a specific grant of authority to promulgate regulations. A challenger to a Treasury regulation will prevail, however, if he establishes that a regulation is unreasonable or plainly inconsistent with the Code itself.
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> It is thus apparent that the deference paid to Treasury regulations is not boundless. The Commissioner's interpretation of the Code is subject to review by the courts, whose "duty . . . is 'to find that interpretation which can most fairly be said to be imbedded in the statute, in the sense of being most harmonious with its scheme and with the general purposes that Congress manifested.'. . . "
>
> A Treasury regulation may therefore be declared invalid only if it is unreasonable or clearly contrary to the language or spirit of the statute it purports to implement. The deference which is the basis for this standard implies that the failure of a regulation to provide for every single exceptional case would not be an adequate ground for invalidation.[34]

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[31] *Robbins v. Bentsen*, 41 F.3d 1195, 1198 (7th Cir. 1994).
[32] *Pepcol Mfg. Co. v. Commissioner,* 28 F.3d 1013, 1015 (10th Cir. 1993).
[33] *Goodson-Todman Enter., Ltd. v. Commissioner*, 784 F. 2d 66 (2nd Cir. 1986).
[34] *Id.*, 784 F.2d at 73-74 (citations omitted).

The Tenth Circuit held, "The role of the judiciary in reviewing Treasury regulations 'begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner.'"[35]

Debtor argues an IRS regulation cannot include a non-stock mutual savings association in an affiliated group because it contradicts IRC §1504(a), which requires 80 percent stock ownership for inclusion in an affiliated group. Debtor relies on cases which address the consistency between one IRC section and its own implementing regulations. For example, in *Product Reporter Co.*, the court found an inconsistency between the Tax Code's allowance of a deduction of contributions to employee profit-sharing plans and a regulation which disallowed the deduction if the plan lacked a definite predetermined formula determining the profits to be shared.[36] Likewise, in *Kaufman*, the applicable IRC section excluded life insurance proceeds from taxable income even if paid in installments.[37] The IRS assessed a tax based on a regulation which only excluded from gross income the amount paid "solely by reason of the death of the insured, " i.e., the initial installment payment.[38] The court held the periodic payments were excluded from income since Congress intended to exclude payments under life policies whether made in lump sums or installments. In both cases, the inconsistency arose between the IRC section and its implementing regulations.

In this case, the alleged inconsistency is between regulations implementing IRC §597 and an entirely different Tax Code section, IRC §1504. The general rule a regulation must be

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[35] *Pepcol Mfg. Co. v. Commissioner*, 28 F.3d 1013, 1015 (10th Cir. 1994).
[36] *Commissioner v. Produce Reporter Co.*, 207 F.2d 586 (7th Cir. 1953).
[37] *Kaufman v. United States*, 131 F.2d 854 (4th Cir. 1942).
[38] *Id*. at 856.

consistent with the statute it implements does not invalidate Treas. Reg. §1.597-4 based on an alleged conflict with IRC §1504.

The regulation is a valid exercise of IRS authority conferred by Congress.[39] Based upon IRC §597, its legislative history, and the preamble to the proposed implementing regulations, Treas. Reg. 1.597-4(f) is properly interpreted to include a non-stock mutual savings association as an affiliated group member and is a reasonable implementation of §597. Further, it accomplishes the legislative mandate that the regulations not "permit the utilization of any deduction (or other tax benefit) if such amount was in effect reimbursed by nontaxable Federal financial assistance."[40]

E. The Debtor is taking inconsistent positions.

A taxpayer is not permitted to reduce his tax bill by reporting one thing is true, and then, after expiration of the statute of limitations, recanting and taking a different position on a later return.[41] The duty of consistency applies when there has been (1) a factual representation by the taxpayer, (2) relied upon by the Commissioner, and (3) an attempt by the taxpayer after the statute of limitations has run to change the previous representation or to characterize the situation in such a way as to harm the Commissioner.[42] "If this test is met, the Commissioner may act as if the previous representation, on which he relied, continued to be true, even if it is not."[43]

In cases where a troubled financial institution is a member of an affiliated group, there may be a mismatching of Federal financial assistance and loss carryover or built-in losses,

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[39] 26 U.S.C. §597(a).
[40] 26 U.S.C. § 597(b)(3).
[41] Steve R. Johnson, *The Taxpayer's Duty of Consistency*, 46 TAX L. REV. 537, 538 (1991).
[42] *Herrington v. Commissioner*, 854 F.2d 755 (5th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989).
[43] *Id.* at 758.

because the losses may have been applied against income of other members in prior years. As a result, the group may have taxable income in a later year in which Federal financial assistance is received. Section 1.597-4 benefits failing institutions by deferring taxation on their rehabilitation until assistance is provided or losses realized on the failed institution's assets. Further, the troubled institution and the bridge bank are treated as a single entity. The transfer of assets and liabilities from the institution to the bridge bank is not a taxable event, so the bridge bank's activities must be taken into account on the group's consolidated returns. If the bridge bank were not a continuing member of the group, the transfer from the institution to the bridge bank would be a taxable sale of assets for the amount of liabilities assumed.[44]

Debtor included both FSA and FFSA in its consolidated returns. Debtor did not change its representations regarding FSA's membership after the 1990 conservatorship, nor did Debtor elect to disaffiliate either FSA or FFSA from its group. Debtor's inclusion of these entities in its consolidated returns is a matter of fact even though Debtor argues it was a misunderstanding of the law. FSA and FFSA were properly included under the law. FSA and FFSA were treated as a single entity and remained members of the affiliated group. To change its representation now, Debtor would have to report the gain on the sale in the amount by which the liabilities assumed by FFSA exceeded the basis of the assets transferred. Debtor benefitted from FSA's prior losses. Debtor cannot later deconsolidate to avoid the taxes caused in part by Federal assistance.

Conclusion

For the foregoing reasons, Debtor's motion for summary judgment is DENIED. IRC §597 and related provisions, not IRC §1501, control whether FFSA's and FSA's income, if any, should be included in Debtor's consolidated returns for fiscal years ending on June 30, 1993,

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[44] 26 C.F.R. §1.597-5.

through 1995. FSA remained a member of Debtor's affiliated group after the 1990 conservatorship pursuant to Treas. Reg. 1.597-4(f). FFSA succeeded to membership in Debtor's affiliated group even if FSA received no Federal financial assistance. Notwithstanding IRC §1504, a non-stock mutual savings bank may be a member of an affiliated group for purposes of IRC §597. Treas. Reg. §1.597-4(f) is a valid exercise of IRS regulatory authority. The Debtor is not taking consistent positions with the returns in question and prior returns.

IT IS SO ORDERED.

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ROBERT D. BERGER
U.S. BANKRUPTCY JUDGE
DISTRICT OF KANSAS