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US Supreme Court discards *Bob Richards* rule, holds 'Federal Common Law' does not govern inter-company distribution of tax refunds

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In its February 25, 2020, decision in *Rodriguez v. FDIC*, the US Supreme Court unanimously rejected the "*Bob Richards* rule" (so named for a 1973 Ninth Circuit decision) and held that federal common law does not govern the allocation of tax refunds within a consolidated corporate group in the absence of a tax allocation agreement to the contrary.[1] The decision is likely to have significant implications with respect to inter-corporate disputes over the proper allocation of tax refunds.[2]

BACKGROUND

United Western Bank (the "bank") was a wholly owned subsidiary of a bank holding company, United Western Bancorp, Inc. (the "holding company"). Under the tax code and governing Internal Revenue Service ("IRS") regulations, corporate groups such as United Western are permitted to file tax returns, and pay taxes, on a consolidated basis.[3]

These regulations also permit the government to distribute tax refunds to such groups on a consolidated basis. But they are silent on how such refunds are to be allocated within the corporate group.

Some companies, such as United Western, have specific "tax allocation agreements" that govern the issue. Other companies do not, leaving the individual corporate members within the group without any specific guidance on the amount of a tax refund to which they may be entitled.

While rarely an issue outside of bankruptcy, the allocation question may become more pronounced within bankruptcy, especially when the individual corporate entities might be governed by different bankruptcy or insolvency regimes.

For example, in instances of distress, a bank holding company, eligible to be a debtor in a case under the Bankruptcy Code, may end up in bankruptcy, whereas its related FDIC-insured subsidiary bank, which is ineligible to be such a debtor under the Bankruptcy Code, may be wound down by the FDIC as receiver.[4] In such a circumstance, disputes may arise as to whether the bankrupt holding company or the FDIC, as receiver for the bank, is entitled to the refund.

In some jurisdictions, the *Bob Richards* rule, a federal common law rule of decision, governs the analysis concerning ownership of tax refunds in such a situation. In *Bob Richards*, the court held that, absent an unambiguous agreement or implied agreement to the contrary, "a tax refund resulting solely from offsetting the losses of one member of a consolidated filing group against the income of that same member in a prior or subsequent year should inure to the benefit of that member."[5]

> The Court reasoned there was no need to turn to federal common law to supply a rule of decision under the circumstances presented in *Rodriguez* because state law is the traditional means of handling disputes involving corporate property rights.

In some courts, *Bob Richards* has been applied as a gap-filler, applying only where a tax allocation agreement is absent or ambiguous. In others, it is treated as the presumptive rule that is supplanted only if the parties have expressly agreed to the contrary.

Other courts have rejected *Bob Richards* in its entirety as an improper establishment of federal common law, instead relying exclusively on state law and the federal tax code and related regulations.[6]

THE UNITED WESTERN LITIGATION

In 2011, the holding company filed a consolidated tax return entitling it to a $4 million tax refund. The refund was owed based on a carryback of the bank's 2010 losses to offset that subsidiary's 2008 income. In other words, it was the bank whose losses entitled the corporate group to the refund and not the holding company's.

The same year, the FDIC shut down the bank and stepped in as receiver. And in 2012, the holding company filed for Chapter 11.

Following the appointment of a trustee, Simon Rodriguez, in the holding company's Chapter 11 case, a dispute arose between the FDIC and the trustee over the proper allocation of the refund. The trustee claimed the refund on behalf of the bank holding company, and the FDIC claimed the refund on behalf of the bank.

Each based its claim in large part on its own interpretation of a tax allocation agreement between the parties and applicable IRS regulations. While the litigation concerning ownership of the tax refund was ongoing, in 2015, the IRS paid the refund to the holding company.

In 2016, the bankruptcy court sided with the trustee and held that the full amount of the tax refund was property of the holding company's bankruptcy estate.[7] The district court subsequently reversed, finding instead that the refund was the bank's property (and therefore the property of the FDIC, as receiver).[8]

Each lower court agreed that the *Bob Richards* rule was facially inapplicable due to the existence of the tax allocation agreement, but differed in their interpretation of that agreement.

TAX REFUNDS AND THE *BOB RICHARDS* RULE

The Trustee appealed to the Tenth Circuit, which affirmed, but followed different reasoning from that of the district court. In its decision, the Tenth Circuit reversed the order of the analysis undertaken by the district court, looking first to *Bob Richards* to provide the "general framework" for resolving the dispute under federal common law *before* looking to the meaning of the tax allocation agreement.[9]

Under this mode of analysis, only if the agreement unambiguously *deviated* from the "general rule" set forth in *Bob Richards* would the holding company and its bankruptcy estate be deemed the proper owner of the refund.

The Tenth Circuit ultimately agreed with the FDIC and the district court that the tax allocation agreement's intended handling of any refund was through an agency relationship between the bank and the holding company. Recognizing that this treatment did not differ from the general *Bob Richards* rule, the Tenth Circuit held that the refund belonged to the FDIC.

The Supreme Court granted certiorari on the question as to whether federal common law in the form of the *Bob Richards* rule governed the allocation of a tax refund paid to a consolidated corporate group. In doing so, the court sought to resolve a circuit split, with the Fifth, Ninth, and Tenth Circuits following *Bob Richards*, and the Second, Third, Sixth, and Eleventh Circuits disagreeing and rejecting the application of federal common law to such disputes.

In its unanimous decision, the Supreme Court reversed the Tenth Circuit and held that the *Bob Richards* rule was an improper judicial enactment of federal common law.[10] Justice Gorsuch's opinion for a unanimous court emphasized that it supplied "no rule of decision" in the case itself (vacating the Tenth Circuit's decision and remanding for further proceedings) and instead provided "only a cautionary tale" regarding federal courts' power to "try their hand at common lawmaking."[11]

Starting with *Erie R. Co. v. Tompkins'* admonition that there is "no federal general common law,"[12] the Court explained that federal common law plays only a "modest role" in "limited areas," such as admiralty disputes and certain controversies between states, where the judicial lawmaking must be "necessary to protect uniquely federal interests."[13] Such cases, according to the Court's *Rodriguez* decision, are "few and far between," and the case at bar was not one of them.[14]

> Important questions that arise in inter-corporate tax refund disputes remain unanswered.

Specifically, the Court reasoned there was no need to turn to federal common law to supply a rule of decision under the circumstances presented in *Rodriguez* because state law is the traditional means of handling disputes involving corporate property rights, including in the federal bankruptcy or tax context. In the Court's judgment, the *Bob Richards* rule had improperly deviated from the longstanding rule that the determination of the property rights in the assets of a debtor's bankruptcy estate is generally resolved under state law and that the Internal Revenue Code itself generally "creates no property rights."[15]

Moreover, the Court noted that, as opposed to how tax returns are filed with (and how tax refunds are distributed by) the federal government, each arguably being a compelling federal interest, there was no unique federal government interest in regulating how corporate groups distribute tax refunds among their members, a necessary threshold in any analysis as to whether to fashion a federal common law rule.

In reversing the Tenth Circuit, the Court thus held that it was inappropriate to fashion a federal common rule such as *Bob Richards* to resolve inter-corporate disputes of the nature presented here.

TAKEAWAYS

In *Rodriguez v. FDIC*, the Supreme Court answered the narrow question of whether federal common law determines how tax refunds paid to a consolidated corporate group are distributed among the companies with the group — it does not.

Yet important questions that arise in inter-corporate tax refund disputes remain unanswered. Among those questions is whether trust or agency theories will be gleaned from tax allocation agreements absent the express creation of a trust or fiduciary relationship under applicable state law. And the effect of IRS regulations establishing the filing entity as agent for the rest of the group on the determination of the entitlement to the tax refund remains undecided by the Supreme Court as well.

These and other issues are likely to continue to arise as competing stakeholders fight over what they view as their fair share of their corporate group's tax refund. This further highlights the importance of implementing well-crafted tax allocation agreements so that the rights and responsibilities of each member of a consolidated corporate group are carefully and unambiguously defined.

Notes

[1] *Rodriguez v. FDIC*, No. 18-1269, ___ U.S. ____, 2020 WL 889191, at *4 (Feb. 25, 2020).

[2] Although the Tax Cuts and Jobs Act of 2017 eliminated the tax loss carryback for most businesses, the *Rodriguez* decision remains applicable to other types of tax refunds.

[3] 26 U.S.C. § 1504(a); 26 CFR § 1.1502-77(a), (d).

[4] 11 U.S.C. § 109(b)(2).

[5] *W. Dealer Mgmt., Inc. v. England (In re Bob Richards Chrysler-Plymouth Corp., Inc.)*, 473 F.2d 262, 265 (9th Cir. 1973).

[6] *See, e.g.*, *FDIC v. FBOP Corp.*, 252 F. Supp. 3d 664, 679 (N.D. Ill. 2017) (declining to apply a federal common law rule because "state law property interpreted and applied does not undermine the federal banking regulatory scheme").

[7] *In re United W. Bancorp, Inc.*, 558 B.R. 409, 437 (Bankr. D. Colo. 2016).

[8] *In re United W. Bancorp, Inc.*, 574 B.R. 876, 895 (D. Colo. 2017).

[9] *Rodriguez v. FDIC (In re United W. Bancorp, Inc.)*, 914 F.3d 1262, 1270 (10th Cir. 2019).

[10] *Rodriguez*, ___ U.S. ____, 2020 WL 889191, at *4.

[11] *Id.* at *4.

[12] *Id.* at *4 (quoting *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938)).

[13] *Id.* at *3 (citations omitted).

[14] *Id.* at *1.

[15] *Id.* at *3 (quoting *Butner v. United States*, 440 U.S. 48, 54 (1979) and citing *United States v. National Bank of Commerce*, 472 U.S. 713, 722 (1985) (quoting United States v. Bess, 357 U.S. 51, 55 (1958)), respectively).

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