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U.S. Supreme Court: Tax refund dispute when no tax allocation agreement of corporate members

The U.S. Supreme Court today held that a federal common law rule that certain courts have applied to determine which party owns a federal tax refund is not "a legitimate exercise of federal common lawmaking." The Supreme Court vacated and remanded the case to the Tenth Circuit.

The case is: *Rodriguez v. FDIC,* No. 18-1269 (S. Ct. February 25, 2020). Read the Supreme Court's **opinion** [PDF 86 KB]

Summary

This case concerns a dispute over which member of an affiliated group of corporations that files a consolidated federal income tax return is entitled to a federal tax refund.

In this case, a bank encountered financial difficulties and eventually entered receivership, with the Federal Deposit Insurance Corporation (FDIC) taking control. The bank's parent entity faced its own financial difficulties, and was forced into bankruptcy (lead by a trustee, Rodriquez). When the IRS issued a $4 million tax refund relating to the consolidated tax return, each of the newly assigned caretakers (the trustee and the FDIC) claimed the money.

The Internal Revenue Code and related regulations describe how the IRS will pay a consolidated group's designated agent a tax refund, but do not provide how the consolidated group members are to distribute the money among themselves.

Many consolidated groups have developed tax allocation agreements that specify what share of a group's tax liability each member will pay and the share of any tax refund that each member will receive. When there is no tax allocation agreement, courts normally have turned to state law, but some federal courts have crafted their own federal common law—referred to as the *Bob Richards* rule (named for a Ninth Circuit case)—that provides that absent a tax allocation agreement, the tax refund belongs to the group members responsible for the losses that led to the refund.

After hearings in the bankruptcy court and federal district court, the present case was decided by the Tenth Circuit which, because there was no tax allocation agreement, applied an expansive version of the *Bob Richards* rule.

Today, the U.S. Supreme Court (in a unanimous opinion written by Justice Gorsuch) rejected the *Bob Richards* rule and vacated and remanded the case back to the Tenth Circuit. The Supreme Court held that the *Bob Richards* rule was not a legitimate exercise of federal common lawmaking because one of the conditions for such lawmaking is that it must be necessary to protect uniquely federal interests—which were not present in this case. In reaching its holding, the Court observed that state law is "well-equipped to handle disputes involving corporate property rights…that involve federal bankruptcy and a tax dispute."

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