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Still The Least Dangerous Branch: Supreme Court Unanimously Rules That Federal Common Law Does Not Govern Corporate Tax Refund Distribution

On February 25, 2020, the United States Supreme Court issued a unanimous opinion vacating a decision by the U.S. Court of Appeals for the Tenth Circuit applying federal common law to determine the allocation of a corporate tax refund among group members.¹ The Court, disfavoring an expansive use of federal common law, rejected the nearly half-century old “**Bob Richards Rule**,”² which had been crafted by prior court decisions, in the absence of a specific statute, to compel allocation of a tax refund for a corporate group to the group member responsible for the losses that led to the refund—unless a tax allocation agreement unambiguously specified a different result.

BACKGROUND AND PRIOR DECISIONS

United Western Bancorp (the “**Parent**”), owned United Western Bank, a bank placed in receivership (the “**Bank**”) during the Great Recession. Parent filed a consolidated tax return on behalf of itself and the Bank. Parent, who found itself in bankruptcy, claimed a \$4.1 million refund, which stemmed from losses the Bank incurred. Parent argued that it should have received the refund under the parties’ tax allocation agreement, while the FDIC, as receiver for the Bank, claimed it was entitled to the refund under the Bob Richards Rule.

As originally adopted by the Ninth Circuit, the Bob Richards Rule provided that, in the absence of a tax allocation agreement, a refund belongs to the group member responsible for the losses that led to it. But over time, certain courts expanded the rule into a general rule applied in all cases unless the parties had entered into an allocation agreement that unambiguously addressed the refund issue.

Embracing this expansion of the Bob Richards Rule, the Tenth Circuit affirmed a district court decision awarding the tax refund to the FDIC—



receiver of the subsidiary—rather than the bankruptcy estate of its corporate parent. In doing so, the Tenth Circuit joined the Fifth and Ninth Circuits. Four other circuits—the Second, Third, Sixth, and Eleventh—had rejected the Bob Richards Rule, at least in the presence of a tax allocation agreement.

THE SUPREME COURT'S DECISION

In an opinion authored by Justice Neil Gorsuch, the Court reiterated the longstanding aphorism that there is “no federal general common law.”³ While the Court acknowledged that there are areas of law in which federal judges “may appropriately craft the rule of decision”—such as admiralty disputes and controversies between States—none of those interests arise in the question of distribution of a tax refund. The federal government has an interest in regulating how it receives taxes from corporate groups, and in extinguishing its liability to a group when it pays refunds to a group member, which it does through tax regulations applicable to corporate consolidated income tax returns.⁴ The federal government, however, has no corresponding interest in determining how a consolidated corporate tax refund is distributed among group members. Further, corporations are “creatures of state law,” and even though the dispute arose in the context of a federal bankruptcy, and involved a federal tax dispute, the Court did not find an overarching federal interest that would require imposition of a judicial rule.

In overruling the Tenth Circuit, the Court emphasized that federal courts should pause before applying federal common law. “[W]e did not take this case to decide how this case should be resolved under state law or to determine how IRS regulations might interact with state law. We took this case only to underscore the care federal courts should exercise before taking up an invitation to try their hand at common lawmaking,” Justice Gorsuch wrote.⁵

CONCLUSIONS AND FUTURE IMPLICATIONS

The decision is an important reminder that affiliates should take care in drafting agreements regarding the sharing of corporate tax refunds, as the Bob Richards Rule can no longer be relied on as a default rule in the face of an ambiguous agreement allocating tax refunds. The decision will also likely make federal courts more hesitant to apply judge-made rules where a statute, regulation, or state law may provide the answer. This decision could have wider implications in many other contexts.

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- ¹ *Rodriguez v. Fed. Deposit Ins. Corp.*, 589 U.S. ____ (2020).
 - ² *In re Bob Richards Chrysler-Plymouth Corporation*, 473 F.2d 262 (9th Cir. 1973).
 - ³ *Rodriguez*, 589 U.S. at *3 (quoting *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938)).
 - ⁴ See Treas. Reg. §§ 1.1502-6,-12,-13, and -77(d)(5).
 - ⁵ *Rodriguez*, 589 U.S. at *6.