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SCOTUS to Decide Who Gets a Consolidated Group's Tax Refund When a Bankruptcy Intervenes?

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The U.S. Supreme Court heard oral arguments on December 3, 2019 in *Simon E. Rodriguez v. Federal Deposit Insurance Corp.*, 18-1269 (Sup. Ct.). At dispute in the case is whether a $4.1 million tax refund belongs to a failed bank (the FDIC, as receiver for defunct United Western Bank) or its corporate parent in bankruptcy (Rodriguez, as trustee for United Western Bancorp Inc.). The Supreme Court granted *certiorari* in *Rodriguez* to decide whether state law or federal common law decides who owns the tax refund, but at oral argument, it became apparent that the issue may not be the subject of, in the words of Justice Ginsburg, "adversarial confrontation" and thus improper to decide in the context of this case. At oral argument, it became immediately apparent that the Court may never reach the question for which *certiorari* was granted as neither side defended federal common law known as the *Bob Richards* rule. Instead, both sides merely argued the issue of whether the Tenth Circuit correctly applied state law. Still, some of the judges seemed interested in proceeding nonetheless so it is impossible to tell at this time just what the Court will do. A substantive decision in the case would likely resolve the split between four circuit courts of appeal that have determined that ownership of a tax refund paid to an affiliated group belongs to the subsidiary even in the event of a

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parent bankruptcy (5th, 9th, 10th, and 11th– although the 11th rejected the *Bob Richards* rule discussed below), and three circuits that have held that the refund is property of the parent company's bankruptcy estate (2nd, 3rd, and 6th).

If ultimately decided, the case could have a significant impact on whether a parent or its subsidiary receives a refund or pays a tax liability in the event of insolvency. The court's analysis on entitlement of the bank holding company or its subsidiary to the refunds under prior Section 172 of the Internal Revenue Code (which allowed a corporation to carry back net operating losses for up to two taxable years) would apply to any corporate family bankruptcy filing and thus is currently very important. This same analysis could certainly be applied to allocating tax liabilities between corporate families as well. Many disputes in the past over tax refunds between a bank's holding company and the FDIC from the last financial crisis have been resolved, but this issue could become very important in the banking context again if we had another significant economic crisis. It is noteworthy, however, that the Tax Cuts and Jobs Act eliminated the carry back on net operating losses, which will limit tax refunds by holding companies in the future.

The seven circuit decisions that may be affected by *Rodriguez* all arose as a result of the last banking crisis. The facts and issue were essentially the same in those cases (including a bankruptcy proceeding where we represented FDIC that eventually was decided by the 11th Circuit Court of Appeals: *In re NetBank*, 729 F.3d 1344 (11th Cir. 2013)) as they are in *Rodriguez*: the bank holding company filed for bankruptcy and a trustee was eventually appointed. The holding company's operating bank subsidiaries were not eligible for bankruptcy and typically fell under FDIC receivership. During good times, the holding companies typically filed consolidated federal income tax returns for their subsidiaries, and administered the refunds and liabilities. Post-bank crash, tax refunds were often due to the consolidated

banking family. The issue in these cases was which party gets the tax refund: the holding company that filed the consolidated tax return and received the refund, or the subsidiary that actually experienced the losses?

Usually, like there was in this case, there was a Tax Sharing Agreements (TSA or sometimes called a TAA) between the holding company and its subsidiaries that might contain terms that bear on the ownership of the tax refunds, one way or the other. The subsidiary bank typically argues, like the FDIC does here, that the TSA establishes that the holding company acted on behalf of the bank subsidiary as a trustee or agent, and any ambiguity among the parties should be construed in its favor and therefore the refund attributable to the subsidiary's losses didn't become part of the holding company's bankruptcy estate and must be paid to the subsidiary. Further, if the TSA doesn't provide such guidance or is ambiguous, the subsidiaries and FDIC contend that court is required to ascertain the intent of the parties in entering into the TSA, and at least until now, had argued that the court should apply the principle first enunciated in *In re Bob Richards Chrysler–Plymouth Corp.*, 473 F.2d 262, 265 (9th Cir. 1973), that "[a]bsent any differing agreement[,] 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."

On the other hand, the holding company argues, like Rodriguez as trustee does in this case, that the TSA established a debtor-creditor relationship between the parties and the holding company is entitled to the refund, and the subsidiary must file a claim in the holding company's bankruptcy (which is likely worth only pennies on the dollar). Further, the bank holding companies and their trustee's like Rodriguez argue that the property of the bankruptcy estate under the bankruptcy code is construed broadly and includes the tax refund, and that *Bob Richards* is just

federal common law that is not controlling or proper in this instance. The Bankruptcy Code defines "property of the estate" as "comprised of all the following property, wherever located: . . . all legal or equitable interests of the debtor in property as of the commencement of the case." See 11 U.S.C. § 541(a)(1). Federal law creates the bankruptcy estate, but state law defines the debtor's property rights. *Butner v. United States*, 440 U.S. 48 (1979). The Supreme Court also has held that section 541(a) should be construed broadly with respect to what constitutes property of the estate. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 (1983).

In the *Rodriguez* case, the Colorado bankruptcy court ruled in favor of the bankruptcy trustee, finding that the TAA did not create a trust or agency under Colorado law, and instead finding the parent and subsidiary had a debtor/creditor relationship. The decision was reversed on appeal to the district court, however, finding that the Tenth Circuit had previously adopted the *Bob Richards* rule, and that the TAA on whole supported the subsidiary's (FDIC's) right to the refund. The Tenth Circuit affirmed the district court, also first saying that it had adopted *Bob Richards* previously, and that the terms of the TAA, the holding company was an agent for the subsidiary bank. It is unclear from the Tenth Circuit's opinion if it relied on the *Bob Richards* rule or not in reaching its decision in favor of the FDIC.

Procedurally, the Court now has at least three options. First, and possibly most likely, the justices could dismiss the case because *certiorari* was improvidently granted (DIG the petition), in which event the Tenth Circuit's decision in *Rodriguez* would stand, and the circuit split would continue. Second, the Court could affirm based on the record before it, without overruling *Bob Richards*, which also may not truly resolve the circuit split. Or, the Court could remand the case to the Tenth Circuit, either (i) with an instruction that *Bob Richards* is bad law/overruled and to review the case again, this time without any reliance on *Bob*

Richards; or (ii) simply asking the Tenth Circuit to clarify whether it was relying on *Bob Richards* when it reached its decision.

In view of the foregoing intersection between federal tax and bankruptcy law, and the complex procedural issue, the result in *Rodriguez* should be quite interesting.
