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4 Federal Tax Cases To Watch At The US Supreme Court

By **Amy Lee Rosen**

Law360 (September 27, 2019, 6:41 PM EDT) -- From challenging 30-year precedent that requires small-business owners to turn over self-incriminating tax records to determining the ownership of tax refunds among affiliated groups, the U.S. Supreme Court's fall docket contains many interesting cases involving federal tax law.

Ever since 1917, the Supreme Court has traditionally scheduled its new term to begin on the first Monday of October, which falls on Oct. 7 this year.

But before the new term begins, the court will hold several conferences on Oct. 1 over a variety of tax cases, including whether the owners of a Colorado medical marijuana dispensary can successfully overturn a Tenth Circuit **decision** that it cannot deduct its business expenses on its tax returns.

Here, Law360 looks at four federal tax cases to watch in the upcoming term.

In Re Twelve Grand Jury Subpoenas

A petitioner is urging the Supreme Court to overrule a decision from 1988 that requires small-business owners under federal investigation to turn over records that could be incriminating, arguing that 30-year-old doctrine violates the Fifth Amendment .

The Supreme Court distributed the matter, Re Twelve Grand Jury Subpoenas, for conference on Oct. 1. In May, two legal advocacy groups **asked the Supreme Court** to grant the petition because a restriction under Braswell v. U.S. on small-business owners' Fifth Amendment rights unjustifiably expands federal government powers.

In Re Twelve Grand Jury Subpoenas, whose petition was unsealed in March, a small-business owner under investigation for tax evasion and bankruptcy fraud said it should not have to comply with a grand jury subpoena for business records that may be incriminating. The owner refused to turn over records and was held in contempt of court by the Arizona federal district court, and the Ninth Circuit upheld that order in November 2018.

As the law stands, under Braswell the "collective entity doctrine" says corporations are treated differently from individuals for Fifth Amendment purposes. So while individuals have an act-of-production Fifth Amendment privilege, corporations, which can include single-member limited liability companies, do not, according to Evan J. Davis, who is a partner at Hochman Salkin Toscher Perez PC.

"If the Supreme Court uses In Re Twelve Grand Jury Subpoenas to find that records custodians for small entities can assert their own Fifth Amendment act-of-production privilege, then prosecutors and IRS agents who previously used Braswell as an end-run around the Fifth Amendment will have to build cases the hard way, without forcing custodians to incriminate themselves," he said. "The end result could be more search warrants in small-business investigations, more legwork by IRS special agents to gather evidence and fewer prosecutions due to the loss of an easy evidence-gathering crutch."

The case is In Re Twelve Grand Jury Subpoenas, case number 18-1207, in the U.S. Supreme Court.

Neil Feinberg and Andrea Feinberg et al. v. Commissioner of Internal Revenue

Neil and Andrea Feinberg and Kellie McDonald, who own medical marijuana company Total Health Concepts LLC, **asked** the Supreme Court to grant certiorari over their dispute against the Internal Revenue Service in which they argue they are entitled to tax breaks because a federal law that disallowed business deductions does not override Colorado state law.

The Feinbergs are pushing for the Supreme Court to decide whether to overturn a **finding** from the Tenth Circuit in February that upheld a U.S. Tax Court **decision** that said the company's owners owed additional income taxes of more than $170,000 after failing to prove that the IRS incorrectly adjusted their deductions.

In their petition to the Supreme Court, the owners argued that Internal Revenue Code Section 280E — which disallows business deductions for the sale of illegal substances — should not override state law under the preemption analysis if there is no conflict with state law. Since the sale of marijuana is legal under Colorado law, there is no federal violation or conflict of law.

In the past the Supreme Court in the past **has declined** to hear **other challenges** to Section 280E.

Edward A. Zelinsky, a professor at Yeshiva University's Benjamin N. Cardozo School of Law, told Law360 that he finds the Feinberg case interesting because as more states legalize marijuana it is likely that the conflict between state laws and Section 280E will increase. However, he remains skeptical the Supreme Court will grant the petition for certiorari.

"The reason I'm skeptical of their Fifth Amendment claim is that (a) in practice, the federal government isn't enforcing in states where pot has been legalized and (b) the 'penalty' for exercising their Fifth Amendment rights is just a higher income tax than they would otherwise pay," Zelinsky said.

The Feinberg case will be distributed for conference on Oct. 1.

The case is Neil Feinberg and Andrea Feinberg et al. v. Commissioner of Internal Revenue, case number 19-129, in the U.S. Supreme Court.

Keith A. Tucker et al. v. Commissioner of Internal Revenue

Keith A. Tucker, the former CEO of investment firm Waddell & Reed Financial Inc., is

requesting the Supreme Court to explore whether the U.S. Tax Court had properly denied nearly $40 million for losses on foreign currency transactions because the lower courts wrongly found those transactions lacked economic substance.

The Supreme Court has scheduled a conference for Tucker's case on Oct. 11.

His petition in July **set forth that** the economic substance doctrine, which examines whether a transaction has a purpose besides reducing tax liability, was not properly relied upon when the Fifth Circuit **found** a complex foreign currency option investment transaction was designed to produce artificial tax losses.

In early September the government **told** the Supreme Court that the Fifth Circuit correctly found Tucker couldn't claim $40 million in loss deductions because it properly applied the economic substance doctrine and that the decision is consistent with results in other courts.

On Sept. 18, Tucker **responded** that Supreme Court review is appropriate because the Fifth Circuit's decision conflicts with the Sixth Circuit, which has a ruled that a transaction complying with the Internal Revenue Code may be legitimate even if it was just an "elaborate scheme to get rid of income taxes."

The Fifth Circuit upheld a Tax Court **decision from 2017** backing the IRS' denial of a $40 million deduction that Tucker sought based on losses from foreign currency trades, finding that the losses had been artificially generated "by gaming the tax code." The IRS' disallowance of the loss deduction in 2000 resulted in a $15.5 million tax liability as well as a $6.2 million penalty, the opinion said.

Andy Grewal, a professor at University of Iowa College of Law, told Law360 that Tucker demonstrates that the debate over judge-made tax doctrines is far from over.

"Though Congress codified the elements of economic substance doctrine through 7701(o) , it remains unclear when, if ever, courts can properly invoke that doctrine to override federal statutes," he said. "Tucker and other cases will give SCOTUS a chance to opine on that significant issue."

The case is Keith A. Tucker et al. v. Commissioner of Internal Revenue, case number 19-41, in the U.S. Supreme Court.

Simon E. Rodriguez v. Federal Deposit Insurance Corp.

The Supreme Court has **scheduled oral arguments** on Dec. 3 to examine who should receive a $4.1 million tax refund: a folded Colorado bank or the bank's bankrupt parent company.

The trustee for United Western Bancorp Inc., which is in Chapter 7 bankruptcy, petitioned the Supreme Court in April in a bid to overturn district and circuit court decisions that found subsidiary United Western Bank was entitled to the $4.1 million because it endured the losses that formed the basis of the refund.

The dispute started when Bancorp claimed the refund, which stemmed from a $35.4 million loss that United Western Bank incurred in the 2010 tax year. Rodriguez had argued that the tax refund, from the bank's joint tax return, should remain within the estate, and a bankruptcy court had applied Colorado law to find that Bancorp should receive the refund.

However, a **Colorado federal court** and the **Tenth Circuit** used the Bob Richards rule — derived from a Ninth Circuit decision in a case involving a car dealership and its parent — to conclude that a tax refund from a joint return should belong to the party that incurs the underlying losses, unless the parties unambiguously agree otherwise.

The courts then found that United Western Bank, rather than Bancorp, should get the refund.

The Supreme Court **agreed to hear** the case in June.

Victoria J. Haneman, a professor at Creighton University School of Law, called Rodriguez an important case to watch because it will resolve the circuit split over the appropriate rule to apply to determine ownership of a tax refund among affiliated groups.

"Three circuits apply the federal 'Bob Richards' rule [which is] a common law rule from an eponymous 1973 case that generally treats the tax refund as belonging to the subsidiary that generated the losses giving rise to the refund and four circuits believe that ownership should be determined in accordance with state law," she said. "Although affiliated groups commonly have a written agreement to control the way in which a tax refund will be divided, ambiguities in such agreements generate complexity and uncertain results."

Certainty in this area will help creditors of entities within an affiliated group as well as provide relief to affiliated groups, Haneman said.

The case is Simon E. Rodriguez v. Federal Deposit Insurance Corp., case number 18-1269, in the U.S. Supreme Court.

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