
Attaching Property Held As Tenancy by the Entirety: The Response to *Craft*

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Caroline Ciraolo and Shannon Chilcoate discuss tenancy by the entireties in light of the Supreme Court decision in *Craft*, review commentary on *Craft* and explain the IRS's position.

Introduction

On April 17, 2002, the Supreme Court issued its opinion in *S.L. Craft*¹ and, in so doing, created a new rule of federal law by which the IRS may, based on the federal tax debt of a single taxpayer, attach property held as tenancy by the entirety. Since *Craft*, commentators and the courts have analyzed the decision. The purpose of this article is to review the reactions to *Craft* and the response of the IRS issued on September 11, 2003, in Notice 2003-60.²

Tenancy by the Entirety—A Historical Review

Tenancy by the entirety is a form of concurrent property ownership unique to married couples, where title is said to be vested completely in both the husband and wife.³ To form a tenancy by the entirety, the traditional unities of joint tenancy must exist (interest, title, time and possession), along with a fifth unity, that of person (encompassed in the marriage).⁴

Tenancy by the entirety was originally driven by the common law idea that married women could not control property during marriage.⁵ Even though property owned as tenancy by the entirety ("entireties property") was technically titled to both the husband and wife, the husband had power over all rights associated with the property.⁶ Motivating this unequal control was the common law concept that upon marriage, the wife became the ward of her husband.⁷ The women's rights movement in the 19th century succeeded in establishing the capacity of mar-

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ried women to control property.⁸ This equalization of power was viewed by some jurisdictions as nullifying the need for tenancy by the entirety.⁹

Tenancy by the entirety exists today in 25 jurisdictions: Alaska,¹⁰ Arkansas,¹¹ Delaware,¹² District of Columbia,¹³ Florida,¹⁴ Hawaii,¹⁵ Illinois,¹⁶ Indiana,¹⁷ Kentucky,¹⁸ Maryland,¹⁹ Massachusetts,²⁰ Michigan,²¹ Mississippi,²² Missouri,²³ New Jersey,²⁴ New York,²⁵ North Carolina,²⁶ Ohio,²⁷ Oregon,²⁸ Pennsylvania,²⁹ Rhode Island,³⁰ Tennessee,³¹ Vermont,³² Virginia³³ and Wyoming.³⁴ In its modern form, tenancy by the entirety is often characterized by the rights and protections it affords, foremost of which is the indestructible right of survivorship of each spouse.³⁵ In addition, each spouse has a right to possess, use and

are prohibited from reaching entireties property to satisfy the debts of one spouse.³⁹ However, a handful of jurisdictions have adopted a partial or modified bar approach, allowing creditors to reach entireties property for the debts of the liable spouse, usually subject to the rights of the nonliable spouse.⁴⁰

The Federal Tax Lien

Under the Internal Revenue Code, the federal government is granted a broad lien against a delinquent taxpayer's property:

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor

of the United States upon *all property and rights to property*, whether real or personal, belonging to such person.⁴¹

This lien arises when the IRS assesses a tax liability and, after notice and demand, the taxpayer fails to pay.⁴² The effective date of the lien is the date of assessment and the lien remains in existence until either the liability is fully satisfied or becomes unenforceable by passage of time.⁴³

The IRS may seek to enforce its lien through an administrative levy of the taxpayer's interest.⁴⁴ Alternatively, it may seek judicial

foreclosure of the entire property pursuant to Code Sec. 7403.⁴⁵ In a Code Sec. 7403 proceeding, the IRS must show that it has a lien on the property it seeks to foreclose—in other words, that the asset is property or a property right of the taxpayer. If the lien attaches, the court determines whether the property should be sold under the factors suggested in *L.M. Rodgers*.⁴⁶ If those factors are satisfied, the court then “determine[s] both the relative interests in the property of the parties involved and the priority of the parties’ interests to any proceeds.”⁴⁷

The Supreme Court analyzed the phrase “all property or rights to property” in *R. Aquilino*,⁴⁸ a case involving a general contractor that owed federal taxes and funds to its subcontractors. The subcontractors asserted that their mechanics’ liens were entitled to priority over the federal tax lien, because the amounts owed were “trust funds” held by the contractor on behalf of the subcontractors, not “property or rights to property” of the contractor under Code Sec. 6321. In remanding the case back to the trial court for further review, the Court recognized that, “state law controls in determining the nature of the legal interest which the taxpayer had in property,” and that federal law simply determined the priority of the federal tax lien over other creditors.⁴⁹ The Court stated, “[t]his approach strikes a proper balance between the legitimate and traditional interest which the State has in creating and defining the property interest of its citizens, and the necessity for a uniform administration of the federal revenue statutes.”⁵⁰ In rejecting the notion that a taxpayer’s property interests should be defined by federal rather than state law, the Court observed that such an approach

Tenancy by the entirety was originally driven by the common law idea that married women could not control property during marriage.

enjoy the property, as well as the right to protect the property from entry by third parties.³⁶ Entireties property cannot be partitioned by the unilateral acts of either spouse, nor can one spouse convey an individual interest in the property to a third party.³⁷

While it is generally accepted that creditors can reach entireties property to satisfy joint liabilities of the husband and wife, disagreements arise as to whether entireties property may be attached to satisfy the debt of only one spouse.³⁸ Most states that recognize tenancy by the entirety are full-bar jurisdictions, in which creditors

would require courts “to ascertain a taxpayer’s property rights under an undefined rule of federal law” and allow for the recognition of a property right which did not exist under state law.⁵¹ Thus, under *Aquilino*, “[b]efore a federal tax lien can attach, state law must determine whether one has sufficient interests in property to satisfy the provisions of § 6321 of the Code.”⁵²

As noted, 25 jurisdictions recognize tenancy by the entirety, where property is held not by a husband and wife as joint owners, but by the marital unit, and may not be conveyed or partitioned by the act of one spouse except in the case of divorce, death or incompetence.⁵³ Prior to *Craft*, federal courts respected this form of ownership and the firmly established principle that a federal tax lien against one taxpayer did not attach to entireties property because the taxpayer’s interest therein was not “property” or a “property right.” For example, in *L.G. Hutcherson*,⁵⁴ the Eighth Circuit rejected an attempt to attach entireties property:

We are invited to depart from this rule of property in Missouri because the existence of the rule and its application to tax liens may make the collection of delinquent tax claims more difficult. We do not conceive it to be an appropriate exercise of power and authority of a federal court to strike down a rule of property, not repugnant to any law of the United States, long established in the state, and upon which many valued property rights are based.⁵⁵

Thus, entireties property remained immune to attachment to

satisfy the debts of a single debtor until the Supreme Court issued its decision in *Craft*.

The *Craft* Litigation

In May 1972, Don and Sandra Craft purchased property in Michigan and held it as tenants by the entirety (“the property”).⁵⁶ Mr. Craft failed to file federal income tax returns for years 1979 through 1986. In response, the IRS prepared substitute returns on his behalf and assessed unpaid taxes, penalties and interest of \$482,446.73.⁵⁷ When Mr. Craft failed to pay, the IRS filed a Notice of Federal Tax Lien in March 1989.⁵⁸

In August 1989, the Crafts transferred the property to Mrs. Craft through the execution of a quitclaim deed for one dollar.⁵⁹ In June 1992, Mrs. Craft attempted to sell the property and a title search revealed the tax lien.⁶⁰ The IRS agreed to release its lien in exchange for the escrow of half of the proceeds (\$59,944.10), pending a determination of the IRS’s right thereto.⁶¹ Mr. Craft died in August 1998.⁶²

In April 1993, Sandra filed a quiet title action against the United States in the U.S. District Court for the Western District of Michigan.⁶³ In response, the government claimed that its lien attached to Mr. Craft’s interest in the property, despite the property being held in tenancy by the entirety, and that the conveyance from the Crafts to Mrs. Craft was fraudulent.⁶⁴ The District Court granted the government’s motion for summary judgment, holding that when the Crafts transferred the property to Mrs. Craft, the tenancy by the entirety was severed, and each spouse then owned a separate one-half interest in the

property.⁶⁵ Therefore, the federal tax lien attached to Mr. Craft’s one-half interest in the property at the moment of severance, and the government was entitled to half of the value of the property.⁶⁶

Both parties appealed, and the Sixth Circuit reversed, holding that under Michigan law, one spouse does not have a separate interest in property held as tenancy by the entirety; hence, the federal tax lien could not attach to the property in question.⁶⁷ The Sixth Circuit remanded to the District Court for consideration of the government’s fraudulent conveyance claim.⁶⁸

On remand, the District Court found that no fraudulent conveyance can occur where state law exempts the property from the reach of creditors.⁶⁹ However, the District Court noted that during his insolvency period, Mr. Craft made property tax and mortgage payments that reduced the mortgage and enhanced the value of the property.⁷⁰ The District Court recognized that under Michigan law, relief may be granted without a specific finding of fraudulent intent where, during insolvency, entireties property is enhanced at the expense of creditors.⁷¹ The District Court held that the payments constituted a fraudulent conveyance under state law and awarded the government a lien on proceeds equal to Mr. Craft’s payments during insolvency.⁷²

Again, both parties appealed.⁷³ The government once again claimed that a federal tax lien attached to Mr. Craft’s interest in the entireties property.⁷⁴ The Sixth Circuit dismissed the government’s appeal on the grounds that its prior decision rejecting this argument was the law of the case.⁷⁵ The court then reaffirmed the District Court’s determination that Mr.

Craft's property tax and mortgage payments constituted a fraudulent act under Michigan law.⁷⁶

The Supreme Court granted *certiorari* to consider the government's claim that a federal tax lien could attach to Mr. Craft's separate interest in the entirety property.⁷⁷ In a 6-3 decision, the Court reversed the Sixth Circuit, holding that a husband's interest in entirety property constitutes "property" or "rights to property," which allows for attachment of a federal tax lien.⁷⁸ Writing for the majority, Justice O'Connor stated that while the issue of whether Mr. Craft's interest in the entirety property constituted "property and rights to property" under Code Sec. 6321 was a matter of federal law, the answer to this federal question relied heavily on state law.⁷⁹

In analyzing state law to determine Mr. Craft's rights in the property, Justice O'Connor emphasized that the Court's obligation was "to consider the substance of the rights state law provides and not merely the labels the State gives these rights or the conclusions it draws from them."⁸⁰ Using the common "bundle-of-sticks" analogy to describe property rights, the Court noted under Michigan law, Mr. Craft had the following "sticks" with respect to the entirety property:

- The right to use the property
- The right to exclude third parties from it
- The right to a share of income produced from it
- The right of survivorship
- The right to become a tenant in common with equal shares upon divorce
- The right to sell the property with his wife's consent and to receive half the proceeds from such a sale

- The right to place an encumbrance on the property with his wife's consent

- The right to block his wife from selling or encumbering the property unilaterally⁸¹

The Court next turned to the federal question of whether these rights rose to the level of "property" or "rights to property" for purposes of Code Sec. 6321.⁸² Relying on *R.F. Drye, Jr.*,⁸³ Justice O'Connor noted that in determining this issue, the focus of consideration is the breadth of control Mr. Craft could have exercised over the property.⁸⁴ Although it acknowledged that he did not possess the right to unilaterally alienate the property, the Court stated that the absence of such a right does not preclude a finding that Mr. Craft possessed "property and rights to property" within the meaning of Code Sec. 6321.⁸⁵

Finally, the Court addressed Michigan's express exemption of entirety property from the reach of creditors for a spouse's individual debt.⁸⁶ Justice O'Connor stated that Michigan's exemption was irrelevant to the Court's decision, as the interpretation of Code Sec. 6321 was a federal question to be decided on federal law, and "exempt status under state law does not bind the federal collector."⁸⁷ The Court concluded that Mr. Craft's rights to the entirety property were sufficient to represent "property" or "rights to property" under the broad federal tax lien statute.⁸⁸

Justice Thomas, joined by Justices Stevens and Scalia, dissented, stating that he would limit a taxpayer's interest in property to those recognized by state law.⁸⁹ Justice Thomas focused his analysis on the language of Code Sec. 6321, under which a "federal tax lien attaches to 'all

property and rights to property, whether real or personal, belonging to' a delinquent taxpayer."⁹⁰

Justice Thomas stated that under Michigan law, the marital unit, and not individual spouses, owns entirety property and therefore, the property could not and did not "belong to" Mr. Craft.⁹¹ Hence, the property was not subject to attachment under Code Sec. 6321.⁹²

Justice Thomas next responded to the majority's assertion that Michigan's treatment of entirety property was irrelevant because federal tax law is not bound to follow state "legal fictions" concerning property ownership.⁹³ Justice Thomas asserted that a clear line could be drawn between state laws that *define* property and property rights (which federal law needs to follow) and state laws that attempt to *exempt* property interests from liens after the fact (which federal law does not need to follow).⁹⁴ He suggested that the majority, in holding that the IRS could overlook state defined property rights, created a new federal common law of property, an area historically left to the states.⁹⁵

Offering an alternative to the majority's "bundle of sticks" approach, Justice Thomas focused on the ripeness of Mr. Craft's interest in the property.⁹⁶ Thomas opined that Mr. Craft's rights in the entirety property, as identified by the majority, represented, "at most, a contingent future interest, or an 'expectancy' that has not 'ripen[ed] into a present estate.'"⁹⁷ Moreover, any rights that Mr. Craft possessed in the entirety property were ostensibly lost upon the execution of the quitclaim deed, which severed the tenancy by the entirety.⁹⁸ Therefore, since the government's lien rights parallel that of the taxpayer's rights in the property, the IRS had no claim to

the property once the tenancy by the entirety was severed.⁹⁹ Justice Thomas concluded that “Mr. Craft had neither ‘property’ nor ‘rights in property’ to which the federal tax lien could attach.”¹⁰⁰

Justice Scalia, joined by Justice Thomas, wrote a separate dissenting opinion to assert that the majority opinion invalidated the traditional protections offered by the tenancy by entirety to the detriment of stay-at-home spouses.¹⁰¹

The Practitioners’ Response

Since *Craft*, commentators have lined up to speak to its impact. Most have taken the view that *Craft* is a landmark decision that not only creates a new federal common law of property, but sounds the death knell for tenancy by the entirety.¹⁰² As one author put it:

It is one thing to hold that state law determines the nature of the interests that one has in property, that is, state law classifies the property; it is another to hold that state law merely determines the various rights or “sticks” that one possesses. In basing its application of § 6321 on the rights or “sticks” the Court indicates that Mr. Craft possessed, the Court has departed from its prior position in *Aquilino*. The decision diminishes the significance of state law almost to the point where very little attention need be paid to it. Under the Court’s ruling, the focus is simply on a federal interpretation of state law. It now seems that the property law of the states will be whatever the federal courts say it is in matters pertaining to controversies with a federal

tax lien. One commentator has taken the position that Drye’s characterization of state property law for federal tax lien purposes as a federal question offends the concept of federalism.

The opinion in *Craft* refers to the need to consider the substance of the rights granted by state law and “not merely the labels the State gives these rights or the conclusions it draws from them.” ***

The *Craft* Court acknowledged that the ownership of property, however, in tenancy by the entirety is not merely a label, but an actual form of concurrent ownership of property which has unique attributes and specific characteristics which apply to the tenants.

It is inconsistent to contend that state law defines the interests that people have in property and then overlook the classifications designated by state law and say that what really counts is the bundle of rights or “sticks” that one possesses.¹⁰³

Mr. Baker suggests, as do others, that Congress act in the wake of *Craft* with legislation affirming states’ rights “to determine the nature of property interests created by various forms of ownership under their law.”¹⁰⁴

At the other end of the spectrum, some observers applaud *Craft* and argue that the abolishment of tenancy by the entirety is an appropriate step toward elimi-

nating tax evasion.¹⁰⁵ Prior to *Craft*, one author predicted and advocated for its result on the grounds that “[t]he (tenancy by the entirety) creates an opportunity for taxpayer manipulation and abuse ... [and] creates an avenue whereby strategically inclined taxpayers can underpay their taxes without hazard of collection by the IRS.”¹⁰⁶ Notwithstanding these premonitions, there is little empirical evidence to support the fears of rampant

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tax evasion through the use of entireties property. Moreover, at least one of these commentators recognizes a degree of validity to the dissenting opinions: “While the dissenters’ position makes perfect legal sense, the majority’s interpretation is closer to a layman’s expectations and understandings of the nature of property and makes good common sense.”¹⁰⁷ This, of course, raises the inevitable question of whether *Craft* is a classic example of bad facts making bad law.¹⁰⁸

The Judicial Response

Within weeks of the *Craft* decision, the U.S. Bankruptcy Court for the Middle District of Louisiana made reference thereto when addressing the issue of property subject to the attachment of a federal tax lien under Code Sec. 6321:

The federal tax lien statutes do not create property rights, but rather attach consequences, federally defined, to rights which are created under state law.¹⁰⁹ Resort must first be made to underlying state law to determine the existence

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and nature of an interest to which the federal tax lien could be asserted.¹¹⁰ If the taxpayers' interest under state law is considered "property" or a "right to property," the tax lien attaches to that interest, and "the tax consequences thenceforth are dictated by federal law."¹¹¹

It is interesting that the court cites both *Craft* and *Aquilino*, even though the former appears to overrule the latter on the very issue at hand. This demonstrates the confusion *Craft* causes between competing federal and state roles in defining an individual's interest in property.

Shortly thereafter, the U.S. Bankruptcy Court for the District of Maryland was asked to determine whether wedding rings were property held as tenancy by the entirety under Maryland law and therefore, exempt from process and the debtor's bankruptcy estate under 11 USC §522(b)(2)(B).¹¹² In *Bell-Breslin*, the court explained the history of tenancy by the entirety, using in large part the Fourth Circuit's opinion in *In re Ford*.¹¹³ Although the court found that the rings were not entreties property,

it confirmed the well-established principle that entreties property is not subject to the claims, either through levy or forced sale, of a debtor's individual creditors. Following this statement, the court briefly cited the *Craft* decision: "*Cf. U.S. v. Sandra Craft*, 535 U.S. 274 (2002) (federal tax lien held to attach to one spouse's interest in T/E property and IRS may levy the property)."¹¹⁴ Note, however, that in *Craft*, the

Supreme Court only opined that a federal tax lien attaches to entreties property; it did not address the IRS's enforcement rights *vis à vis* entreties property.¹¹⁵

The first significant analysis of the *Craft* decision came months later in *In re Ryan*,¹¹⁶ involving the valuation of a debtor's interest in entreties property. Rhode Island is a "modified bar jurisdiction," in which creditors may not levy or sell entreties property, but may attach the property by filing a lien and may sell the contingent future expectancy interest that the debtor holds through right of survivorship.¹¹⁷ Under this framework, the bankruptcy trustee attempted to sell Mr. Ryan's interest in his personal residence, held as entreties property with his nondebtor spouse. The unencumbered equity in the residence was valued at \$155,000. Mr. Ryan objected on various grounds, including that he was entitled to exempt his future interest under 11 USC §522(b)(2) and the Rhode Island Homestead Act,¹¹⁸ which, at the time of his election in 2000, allowed him to exempt his homestead estate, up to \$100,000, from attachment, levy or sale for the payment of debts.

In affirming the decision of the Bankruptcy Court, the District Court first observed the problems with selling a future interest:

It should be noted that the contingent nature of the expectancy interest presents a dubious future return for Sullivan [the buyer of Ryan's interest]. Were Ryan's wife to survive him, the tenancy by the entirety would be extinguished along with all of Ryan's interest in it. In that eventuality, Ryan's wife would "take free and clear of the attachment, which would then be of no further force and effect."¹¹⁹

The court nevertheless rejected Mr. Ryan's claim for exemption because his position was based on an erroneous valuation of his interest in the entreties property.¹²⁰ Mr. Ryan argued that his interest should be valued at \$77,500, or 50 percent of the property's equity.¹²¹ The court disagreed, noting that a tenancy by the entirety is a "unitary title" under which "each spouse is guaranteed an equal right to the full interest in the property, and thus each interest must be valued at 100%."¹²² Notwithstanding its decision, the court acknowledged that the Supreme Court in *Craft* "refused to address the issue of valuation, and therefore left unanswered the question of whether, for the purpose of a federal tax lien, each tenant by the entirety possessed something other than 100% of the equity."¹²³

The *Ryan* decision foreshadowed the problems courts will face when valuing an interest of one spouse in entreties property for purposes of Code Sec. 6321. The first court to hit this issue

head on appears to be the U.S. Bankruptcy Court for the Eastern District of Pennsylvania. In *M.V. Basher*,¹²⁴ the court was faced with determining the value of the government's secured claim, based on the attachment of a federal tax lien to the debtor's interest in entirety property. The only evidence presented at trial was the uncontradicted testimony of the debtor's expert that the interest had no value due to the lack of market for expectancy interests. In response, the IRS argued that the value of the debtor's interest should be 50 percent of the equity, and that to accept the debtor's value would render *Craft* meaningless.¹²⁵ The court rejected both approaches, finding that while there must be some value to the debtor's interest, it could hardly be 50 percent since a tenant by the entirety "requires the consent of the spouse to alienate his or her share through sale or gift or place encumbrances thereon."¹²⁶ Looking to *Craft*, the court observed that the Supreme Court "not only failed to provide any guidance on how the property rights would be valued but expressly refused to decide whether the survivorship interest in and of itself was a present interest."¹²⁷ To resolve the dispute, the court ordered the parties to fully brief the issue and address which party bears the burden of proof.¹²⁸

In the 2003 *Basher* case (*Basher II*),¹²⁹ the court was again unable to reach a decision. It rejected the debtor's valuation of zero because under chapter 13 of the Bankruptcy Code, questions of valuation are determined from the perspective of the debtor, not a third-party purchaser.¹³⁰ The court recognized that, al-

though the debtor's disposition of the property was restricted, his interest had to have some value because he was using and enjoying the property without restriction.¹³¹ Furthermore, to value the debtor's interest at zero would lead to an illogical result: "Aggregating the two spousal interests under the Debtor's theory would yield a property without any value."¹³² However, the court also rejected the IRS's position that the debtor's interest should be valued at 50 percent of the available equity, on the grounds that, because the debtor's wife was younger and had a longer life span, "an equal allocation of equity in the Residence would overstate the IRS' claim although not seemingly in a significant amount."¹³³ Because both parties failed to provide sufficient evidence to support their positions, and the court believed that "the IRS has some burden to establish the nondebtor's interest," the court once again directed them to reconsider their positions and report back. In guiding the parties toward what it hoped would be a final resolution, the court stated:

In fixing value on the Debtor's interest in the Residence, I have rejected the Debtor's theory that it is to be based on the value to be obtained for a survivorship interest in the open market. However, neither do I accept the IRS' valuation at 50% of the equity in the Residence as it does not appear to give any consideration to the impact of the lesser value of Debtor's survivorship interest *vis à vis* Marcella [his wife].¹³⁴

In a case arising in the jurisdiction responsible for *Craft*, the

Sixth Circuit characterized the *Craft* decision as a new rule of federal law and determined that it applied retroactively to open cases pending at the time it was decided.¹³⁵ While the court recognized that the Supreme Court did not address the issue of enforcement, it nonetheless found that since *Craft* determined that a federal tax lien attaches to entirety property, the property is clearly subject to levy pursuant to Code Sec. 6331, including seizure and sale under Code Sec. 6335(c).¹³⁶ Moreover, since the IRS was pursuing an administrative levy under Code Sec. 6331, it was not required to seek judicial intervention under Code Sec. 7403 or to satisfy the equitable factors set forth in *Rodgers*, which are designed to protect the nondebtor spouse's interests.¹³⁷ The court remanded the matter to the district court for a valuation of the government's interest in the entirety property.¹³⁸

In the bankruptcy arena, trustees have attempted to use *Craft* to overturn a debtor's right to exempt entirety property under 11 USC §522(b)(2)(B). For example, in *In re Knapp*,¹³⁹ the trustee argued that, pursuant to the reasoning that *Craft* applied to Code Sec. 6321, the debtor's interest in entirety property should be included in the bankruptcy estate and subject to sale by the trustee for the benefit of the debtor's creditors.¹⁴⁰ The court disagreed, noting that "the power of the federal tax collector to disregard state exemptions has not been expanded to other creditors and the Bankruptcy Code explicitly incorporates exemptions allowable under state law."¹⁴¹ The court held that because North Carolina recognizes tenancy by the entirety and bars state law creditors from

attaching such property, the debtor is entitled to exempt such property from the bankruptcy estate under 11 USC §522(b)(2)(B), notwithstanding *Craft*.¹⁴² The court rejected the trustee's theory that his position as a hypothetical judicial lien creditor or a hypothetical *bona fide* purchaser under 11 USC §544(a) equates to that of the IRS.¹⁴³ Despite the clear holding in *Knapp*, trustees continue in their attempts to terminate a debtor's right to exempt entireties property from the bankruptcy estate. Thus far, these attempts have failed.¹⁴⁴

The IRS's Response

Prior to *Craft*, the IRS repeatedly acknowledged the protection afforded to entireties properties from federal tax liens.¹⁴⁵ Immediately following *Craft*, however, it was clear that the government had a valuable new weapon in its arsenal and questions arose as to how the IRS would respond.¹⁴⁶ Some of these questions were answered on September 11, 2003, when the IRS released Notice 2003-60.¹⁴⁷

In Notice 2003-60, the IRS reviews general principles upon which it will rely in addressing *Craft*-related issues, beginning with: "[F]or purposes of section 6321, a taxpayer's property and rights to property have always included any rights that taxpayer may have in entireties property under state law." The IRS therefore rejects the view that *Craft* represents new federal law. The IRS then answers some of the questions raised since *Craft* was decided.

Although the IRS takes the position that a federal tax lien, for which a notice has been filed, has priority over any interest of a subsequent purchaser,

holder of security interest, a mechanic's lienor or a judgment lien creditor (*i.e.*, the class of persons protected by Code Sec. 6323(a)), the IRS will not assert its lien "where doing so may disturb the settled expectations of certain classes of persons who may have been under the belief that a federal tax lien arising from the liability of only one spouse does not attach to entireties property."¹⁴⁸ However, this only protects those in full-bar jurisdictions and only if the interests were created before *Craft* was decided. In modified or partial bar jurisdictions, where a creditor has always been permitted to attach the debtor-spouse's interest in entireties property, the IRS will assert its lien against those protected by Code Sec. 6323(a), "as long as those interests were acquired after notice of the federal tax lien was filed."¹⁴⁹

In the case of a divorce, where entireties property was transferred to the nontaxpayer spouse before *Craft*, the IRS maintains that its lien attaches to the transferred property. Nonetheless, the IRS will, "as a general rule, if the transfer occurred before *Craft*, treat the transfer as one for value and will not assert its lien against the property in the hands of the ex-spouse of the taxpayer" unless the transfer was fraudulent.¹⁵⁰ If the transfer occurs after *Craft*, the IRS maintains that the property remains encumbered in the hands of the ex-spouse.

Where the taxpayer donates property to a third party after a federal tax is assessed against the donor, the donee acquires the property subject to the federal tax lien. The IRS advises that, "transfers to donees that occurred before *Craft* will be evaluated on a case-by-case basis to determine

whether the equities favor or disfavor the IRS asserting the federal tax lien against property held by a donee." Factors considered will include the donee's reliance on the fact that the property was unencumbered and subsequent improvement of the property acquired. Another factor will be the relationship of the donee to the debtor-taxpayer.

The IRS assures that it will not use *Craft* to rescind accepted offers in compromise, terminate installment agreements or revoke certificates of discharge and subordination. It also will not "routinely amend bankruptcy proofs of claim" filed pre-*Craft*, but may do so under certain circumstances "depending on the value of the property, and the status of the bankruptcy case."¹⁵¹ In the future, the IRS will consider entireties property when filing proofs of claim and may revisit a prior determination that an account is currently not collectible.¹⁵²

As to transfers of entireties property post-*Craft*, the IRS contends that a federal tax lien will encumber "a one-half interest in the hands of the transferee, regardless of whether the transferee is a donee or gives value."¹⁵³ This valuation will apply in the context of private foreclosures, bankruptcy cases and Offers in Compromise.¹⁵⁴

In accordance with *In re Ryan*,¹⁵⁵ the IRS confirms that a federal tax lien will not survive the death of the taxpayer because his or her interest is extinguished by operation of law. The surviving spouse takes the property unencumbered by the federal tax lien. However, "if the property has been conveyed to a third party, the federal tax lien will be deemed to encumber a

one-half interest in the hands of the transferee and will not be affected by the subsequent death of either spouse." The IRS likewise contends that where a mortgage is obtained subsequent to the filing of a federal tax lien, the lien has priority over the bank's interest. However, if the taxpayer survives the nonliable spouse, the tax lien becomes the senior lien against the entire property. If the taxpayer predeceases the nonliable spouse, then his or her interest is extinguished, along with the federal tax lien, and the mortgage lien becomes the first lien on the property.

The IRS next addresses how it will enforce its liens post-*Craft*. It advises that, while it has the right to "administratively seize and sell a taxpayer's interest in real and personal property held in a tenancy by the entirety," it recognizes the difficulty in finding a buyer for such interests, since it may only sell the taxpayer's interest (unlike in a judicial action under Code Sec. 7403, discussed below).¹⁵⁶ "Therefore, the Service has determined that an administrative sale is not a preferable method of collection with respect to [real or personal property held as] entires property."¹⁵⁷ The IRS warns, however, that it will levy on "cash and cash equivalents held as entires property," where the taxpayer has the right to withdraw the funds.¹⁵⁸ "While the taxpayer's spouse, as the other account holder, may have an administrative or judicial claim under sections 6343(b) or 7426, respectively, see *United States v. National Bank of Commerce*, 472 U.S. 713 (1985), the amount realizable by the Service is not, at the outset, depressed as it is in the case of administrative sales."¹⁵⁹

In "appropriate cases," the IRS advises that it will seek to foreclose on a federal tax lien under Code Sec. 7403, which allows the IRS to sell the entire property, as long as the *Rodgers* factors are satisfied.¹⁶⁰ The IRS recognizes that the court will determine the respective interests of the parties (including the nonliable spouse) pursuant to Code Sec. 7403(c), but, as noted, the IRS contends that it is entitled to 50 percent of the proceeds of sale, after taking into account the amount of senior liens. This valuation will also be used where a taxpayer or senior lien holder requests a certificate of discharge pursuant to Code Sec. 6325(b)(2)(A), or a certificate of discharge is requested an owner of the property other than the taxpayer pursuant to Code Sec. 6325(b)(4).¹⁶¹

Where taxpayers "seek subordination of a federal tax lien in connection with refinancing mortgages on entires property," the IRS will look to Code Sec. 6325(d)(2) and will generally grant the request if the refinancing "ultimately will enhance the taxpayer's equity or facilitate the collection of the tax from other property or income of the taxpayer."¹⁶² However, if the taxpayers are refinancing to obtain cash for other debts (either as a "cash out" or home equity loan), the IRS will look to Code Sec. 6325(d)(1) and will, as a general rule, "issue a certificate of subordination upon payment of one-half the amount of the lien or interest to which the federal tax lien will be subordinated."¹⁶³

Unfortunately, despite the issuance of Notice 2003-60, significant questions remain. For example, after the IRS forecloses on entires property and seizes the portion determined to be the debtor spouse's interest therein, what is the nature of the funds that remain? Does the foreclosure by the IRS dissolve the tenancy by the entirety? If so, it appears that the remaining funds would be converted to individual property

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of the nonliable spouse, subject to that spouse's creditors. If not, and the remainder maintains its status as entires property, does this mean the IRS can come back for seconds? It appears that the only court that has addressed this issue to date chose to punt rather than answer the question.¹⁶⁴

Conclusion

As Notice 2003-60 indicates, the IRS is taking *Craft* and running with it. Yet issues that significantly impact an individual's rights to property remain unaddressed. One can only hope that Congress will act swiftly to protect the well-established concept of tenancy by the entirety and prevent further encroachment upon states' rights to define property interests. In the meantime, state legislatures should take note of the *Craft* decision, and act to preserve their constituents' long-held property rights and creditor protections.

ENDNOTES

- 1 S.L. Craft, SCt, 2002-1 USTC ¶ 50,361, 535 US 274, 122 SCt 1414.
- 2 Notice 2003-60, IRB 2003-39 (Sept. 11, 2003).
- 3 CORNELIUS J. MOYNIHAN & SHELDON F. KURTZ, INTRODUCTION TO THE LAW OF REAL PROPERTY, at ch. 9, §6 (3d ed. 2002); 2 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND, at 182 (9th ed. 1783) ("If an estate in fee be given to a man and his wife, they are neither properly joint-tenants, nor tenants in common; for husband and wife being considered one person in law, they cannot take the estate by moieties, but both are seised of the entirety ... the consequence of which is, that neither the husband nor the wife can dispose of any part without the assent of the other, but the whole must remain to the survivor.")
- 4 4 THOMPSON ON REAL PROPERTY, THOMAS EDITION, at §33.06(b) (David A. Thomas Ed. 1994 & Supp. 2003).
- 5 *Id.*, at §33.05.
- 6 7 POWELL ON REAL PROPERTY, at §52.01[2] (Michael Allan Wolf Ed. 2003). The husband lacked only the power to defeat his wife's right of survivorship.
- 7 THOMPSON, *supra* note 4, at §33.06(b).
- 8 *Id.*, at §33.05.
- 9 MOYNIHAN & KURTZ, *supra* note 3, at ch. 9, §7.
- 10 Alaska Stat. §34.15.140.
- 11 *Parrish v. Parrish*, 151 Ark. 161, 235 SW 792 (1921) (holding that the Married Women's Property Act did not abolish T by E).
- 12 Del. Code Ann. tit. 25, §309, tit. 12, §703.
- 13 D.C. Code Ann. §§42-516, 42-1901.3, 42-2005, 46-601.
- 14 Fla. Stat. Ann. §§689.11, 708.10.
- 15 Haw. Rev. Stat. §§509-1, -2.
- 16 750 Ill. Comp. Stat. 65/22; 765 Ill. Comp. Stat. 1005/1c.
- 17 Ind. Code §32-17-3-1.
- 18 Ky. Rev. Stat. Ann. §381.050.
- 19 Md. Code Ann. Real Prop. §4-108.
- 20 Mass. Gen. Laws Ann. ch. 184, §7.
- 21 Mich. Comp. Laws Ann. §§557.71, 700.2901(2)(g).
- 22 *Matter of E.L. Childress Est.*, 588 So2d 192 (Miss. 1991); *Ayers v. Petro*, 417 So2d 912 (Miss. 1982).
- 23 Mo. Ann. Sta. §442.025.
- 24 N.J. Stat. Ann. §37:2-18.
- 25 N.Y. Real Prop. Law §240-b.
- 26 N.C. Gen. Stat. §§39-13.3 to 39-13.6.
- 27 Ohio Rev. Code Ann. §5302.21.
- 28 Or. Rev. Stat. §§91.020, 108.090.
- 29 Pa. Stat. Ann. tit. 69, §541.
- 30 R.I. Gen. Laws §33-1.1-5.
- 31 Tenn. Code Ann. §§66-1-109 to -110.
- 32 See *Lowell v. Lowell*, 138 Vt. 514, 419 A2d 321 (1980).
- 33 See *Rogers v. Rogers*, 257 Va. 323, 512 SE2d 821 (1999).
- 34 Wyo. Stat. Ann. §34-1-140.
- 35 THOMPSON, *supra* note 4, at §33.05; MOYNIHAN & KURTZ, *supra* note 3, at ch. 9, §6.
- 36 POWELL, *supra* note 6, at §52.03[4].
- 37 *Id.*, at §52.03[1], but see MOYNIHAN & KURTZ, *supra* note 3, at 277-78 (noting that seven jurisdictions allow, in some form, unilateral conveyance or encumbrance by one spouse, subject to the other spouse's survivorship rights).
- 38 POWELL, *supra* note 6, at §52.03[3].
- 39 See *id.*, *supra* note 6, at §§52.01[3], 52.03[4]. The following are full-bar jurisdictions: Delaware, District of Columbia, Florida, Hawaii, Illinois, Indiana, Maryland, Michigan, Mississippi, Missouri, North Carolina, Ohio, Pennsylvania, Vermont, Virginia and Wyoming.
- 40 See *id.* The following jurisdictions allow creditors of the liable spouse to reach the T by E property, subject to the nonliable spouse's right of survivorship: Alaska, Arkansas, New Jersey, New York and Oregon. Kentucky, Massachusetts, Rhode Island and Tennessee allow creditors of either spouse to reach the debtor spouse's contingent right of survivorship, but not the life estate.
- 41 Code Sec. 6321 (emphasis supplied).
- 42 Code Sec. 6322.
- 43 *Id.*
- 44 Code Sec. 6331(a).
- 45 Code Sec. 7403.
- 46 L.M. Rodgers, SCt, 83-1 USTC ¶ 9374, 461 US 677, 103 SCt 2132.
- 47 *Wilson v. Wilson*, DC Mich., 2003-1 USTC ¶ 50,153.
- 48 R. Aquilino, SCt, 60-2 USTC ¶ 9538, 363 US 509, 80 SCt 1277.
- 49 *Id.*, 363 US, at 514.
- 50 *Id.*
- 51 *Id.*, 363 US, at 513, note 3; see also M.G. Bess, SCt, 58-2 USTC ¶ 9595, 357 US 51, 55, 78 SCt 1054 (federal lien statute does not create property rights but attaches consequences to "rights created under state law.")
- 52 William H. Baker, *Drye and Craft—How Two Wrongs Can Make a Property Right*, 64 U. Pitt. L. Rev. 745, 750 (Summer 2003) (hereinafter referred to as "Baker, Drye and Craft") (citing *Bess, id.*, 357 US, at 57); see also D. Gaster, CA-3, 94-2 USTC ¶ 50,622, 42 F3d 787, 791 (citing *National Bank of Commerce*, SCt, 85-2 USTC ¶ 9482, 472 US 713, 722-23, 105 SCt 2919 ("state law controls in determining the nature of the legal interest which the taxpayer had in the property").
- 53 See *supra* notes 3, 10-34, 41 and 42.
- 54 L.G. Hutcherson, CA-8, 51-1 USTC ¶ 9249, 188 F2d 326.
- 55 *Id.*, 188 F2d, at 330. For a thorough review of the history of the federal tax lien, see Baker, Drye and Craft, *supra* note 52, at 769, note 190.
- 56 S.L. Craft, CA-6, 98-1 USTC ¶ 50,305, 140 F3d 638, 639.
- 57 *Id.*; see also Code Sec. 6020(b).
- 58 Craft, *supra* note 56, 140 F3d, at 639; see also Code Sec. 6321.
- 59 Craft, *supra* note 56, 140 F3d, at 639.
- 60 *Id.*
- 61 *Id.*, at 640.
- 62 S.L. Craft, DC Mich., 99-2 USTC ¶ 50,618, 65 FSupp2d 651, 654.
- 63 *Id.*
- 64 *Id.*
- 65 *Id.*
- 66 Craft, *supra* note 1, 535 US, at 277.
- 67 Craft, *supra* note 56, 140 F3d, at 638, 643.
- 68 *Id.*, at 644-45.
- 69 Craft, *supra* note 62, 65 FSupp2d, at 657-58.
- 70 Craft, *supra* note 56, 140 F3d, at 659.
- 71 *Id.*, at 658 (citations omitted).
- 72 *Id.*, at 659. The District Court awarded the government \$6,693. See Craft, *supra* note 62, 65 FSupp2d, at 662.
- 73 S.L. Craft, CA-6, 2000-2 USTC ¶ 50,860, 233 F3d 358, *reh'g denied*, Mar. 16, 2001.
- 74 *Id.*, 233 F3d, at 363.
- 75 *Id.*, at 363-69.
- 76 *Id.*, at 369-75.
- 77 *Cert. granted*, S.L. Craft, SCt, 533 US 976 (2001).
- 78 Craft, *supra* note 1, 535 US, at 288-89.
- 79 *Id.*, at 278.
- 80 *Id.*, at 279.
- 81 *Id.*, at 282.
- 82 *Id.*, at 283.
- 83 R.F. Drye, Jr., SCt, 99-2 USTC ¶ 51,006, 99-2 USTC ¶ 60,363, 528 US 49, 120 SCt 474.
- 84 *Id.* In *Drye*, for purposes of the application of a federal tax lien, the Court rejected the state fiction that allows an heir, who is subject to the lien, to disclaim his interest in the estate and, as a result, remove his inheritance from the reach of the IRS. *Id.*, 528 US, at 59-61.
- 85 Craft, *supra* note 1, 535 US, at 283-85. The Court emphasized that to hold otherwise would exempt a large amount of property, namely homesteads and community property, from the reach of Code Sec. 6321.
- 86 Craft, *supra* note 1, 535 US, at 286.
- 87 *Id.*, at 288 (quoting *Drye, supra* note 84, 528 US, at 59).
- 88 *Id.*, at 283 ("The statutory language authorizing the tax lien 'is broad and reveals on its face that Congress meant to reach every interest in property that a taxpayer might have.'") (citing *National Bank of Commerce, supra* note 52, 472 US, at 719-20).
- 89 *Id.*, at 291-92. Justice Thomas stated that it is "uncontested" that a federal tax lien cannot create property rights. Instead, the tax lien "merely attaches" federally defined consequences to state-created property rights.
- 90 *Id.*, at 291 (emphasis added).
- 91 *Id.*, at 292.
- 92 *Id.*
- 93 *Id.*, at 293.
- 94 *Id.*, at 293-94. Justice Thomas stated that the majority's reliance on *Drye, supra* note 84, J.O. Irvine, SCt, 94-1 USTC ¶ 60,163, 511

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