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After Craft: Implementation Issues

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SPECIAL REPORT

TAX ANALYSTS

AFTER *CRAFT*: IMPLEMENTATION ISSUES

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This April, the Supreme Court decided *United States v. Craft*. It held that the federal tax lien attaches to tenancy-by-the-entireties interests even when state law prevents creditors from proceeding against these interests. This decision overthrows a contrary rule that had been followed in numerous lower court decisions over many decades.

Attachment of the tax lien is important, but it is at the beginning of the collection process, not the end. Thus, *Craft* raises many follow-up or implementational issues. How well the IRS and the courts address these issues will determine whether *Craft*'s incorporation into the tax system is accomplished relatively smoothly or only with friction and disruption.

Professor Johnson identifies the principal implementation issues and suggests answers to them. In general, he recommends a "go slowly" approach, with exceptions and applications to particular circumstances.

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Scientists often observe that answering one question about the world or universe causes many new questions to arise. Chess players understand that to win material in the opening or middle game is empty without playing the end game properly. Military commanders and their civilian superiors know that winning a battle is not an end in itself. They must then address what do with their victory, how to turn it to useful result. Having to confront these second-generation or follow-up problems clearly beats the alternatives (remaining ignorant or losing the game or battle), but initial success ushers in not immediate repose but the need for further work. Indeed, often it is as hard (sometimes harder) to properly exploit the success as it was to achieve it initially.

The establishment of a legal rule will resolve or obviate some disputes but will force decisionmakers to address a variety of definitional or implementational issues attending the new rule.

So it is in law as well. The establishment of a legal rule will resolve or obviate some disputes but will force decisionmakers to address a variety of definitional or implementational issues attending the new rule. The IRS now finds itself in this desirable but demanding position as a result of its recent win in the *Craft* case.[1] In *Craft*, the Supreme Court held that the federal tax lien attaches to a tax-debtor spouse's interest in tenancy-by-the-entireties property even when the other spouse is not jointly liable for the unpaid taxes and state law provides that entireties property is beyond the reach of separate creditors of one spouse. Attachment of the tax lien — although important — only begins the collection process. If the taxes remain unpaid, the IRS may have to proceed against the property. Legally how might it proceed, and prudentially how should it proceed?

This article addresses the "follow-up" or "second-stage" questions. The IRS is currently engaged in for-

[1]*United States v. Craft*, 122 S. Ct. 1414, *Doc 2002-9398 (32 original pages), 2002 TNT 75-9* (Apr. 17, 2002).

mulating its positions on these questions, in light of *Craft*. No matter what perspicacity and sensitivity it brings to bear in this process, however, subsequent disputes and litigation are likely. The difficulty of the questions virtually assures this controversy.

This article has three parts. Part I describes the Court's decision in *Craft* and the background to it. Part II sounds a general chord, urging the IRS to proceed cautiously with the implementation of *Craft*. Part III strikes individual notes. It takes up four issues: (1) post-lien-attachment options available to the IRS, (2) protection of the nondebtor spouse, (3) retroactivity, and (4) valuation.

I. Background and Decision

The general federal tax lien under section 6321 attaches to "all property and rights to property" of the delinquent taxpayer. The Supreme Court has repeatedly emphasized that this statutory language "is broad and reveals on its face that Congress meant to reach every interest in property a taxpayer might have."[2] In the main, the lower federal courts have followed the Court's lead in this regard.[3]

> ***The opinion for the Court rests on no narrow ground. Craft overthrows the traditional position of the lower courts, freeing the federal tax lien from control by state law immunities as to entireties property.***

An exception was the former treatment of entireties property and interests by the lower courts. Tenancy by the entireties is a form of concurrent ownership available only to wife and husband. It originated in England in the Middle Ages to reflect or serve male supremacy, scriptural literalism, and feudal military organization. Nonetheless, it was imported into the United States and survived in many jurisdictions despite its abolition by England in 1925 and its abandonment by a number of American states.[4]

Although some attributes of entireties estates are common among the states recognizing this form of ownership, differences exist as well. An important difference involves the extent to which creditors can proceed against entireties property to collect separate debts of one of the spouses.[5] Some states (about 10, hereafter the "partial bar" states) provide that the liens of separate creditors can attach to entireties property but subject to the rights of the nondebtor spouse. That is, the underlying property held by the entireties estate cannot be levied on until the nondebtor spouse's rights cease to be absolute, such as on the termination of the entireties estate by death or divorce.[6] In contrast, in a somewhat larger number of jurisdictions (about 16, hereafter called the "full bar" states), the liens of separate creditors cannot attach at all to entireties property or interests.[7]

Before *Craft*, the Supreme Court had not had occasion to pass directly on tax liens as to entireties interests.[8] Lower courts had, though, often over several score years. Virtually without exception, these courts held the attachment of the tax lien to depend on the debtor-creditor rule prevailing in the state. Thus, in the partial bar jurisdictions the tax lien was held to attach, in effect, to the debtor spouse's survivorship interest,[9] and, in the full bar jurisdictions, it was held to attach not at all.[10]

The decision of the trial court in *Craft* broke with this traditional view. The Crafts owned real property in Michigan, a full bar state. Don Craft — an attorney — failed to file income tax returns for 1979 through 1986. The IRS made assessments exceeding $480,000 against Don (but not his wife, Sandra) for those years, which remained uncollected. Originally, the Crafts owned the property as tenants by the entireties. When the IRS filed notices of tax lien against Don, the Crafts quitclaimed the property to Mrs. Craft solely. Later, she sold the property. The IRS asserted that the conveyance to Mrs. Craft was fraudulent and that its lien attached to Mr. Craft's interest in the property. On this basis, the IRS sought some of the sale proceeds.[11]

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[2]*United States v. National Bank of Commerce*, 472 U.S. 713, 719-20 (1985); *see also Glass City Bank v. United States*, 326 U.S. 265, 267 (1945) ("Stronger language could hardly have been selected to reveal a purpose to assure the collection of taxes.").

[3]*See generally* William D. Elliot, *Federal Tax Collection, Liens & Levies* para. 9.09 (2d ed. 1995) (describing cases as to attachment of the tax lien to various classes of property).

[4]For fuller description, see Steve R. Johnson, "Fog, Fairness, and the Federal Fisc: Tenancy-by-the-Entireties Interests and the Federal Tax Lien," 60 *Mo. L. Rev.* 839, 842-43 (1995) (hereafter Johnson I), and Steve R. Johnson, "After *Drye*: The Likely Attachment of the Federal Tax Lien to Tenancy-by-the-Entireties Interests," 75 *Ind. L.J.* 1163, 1169-70 (2000) (hereafter Johnson II). The Supreme Court cited Johnson II in *Craft*. 122 S. Ct. at 1424.

[5]Entireties property is answerable for joint debts of the spouses. *E.g.*, *Tony Thornton Auction Service, Inc. v. United States*, 791 F.2d 635, 637-38 (8th Cir. 1986).

[6]*See* part II.B.1 *infra* for ways to terminate entireties estates.

[7]*See* Johnson I, *supra* note 4, at 843-44, for discussion of the partial bar and full bar regimes.

[8]*United States v. Rodgers*, 461 U.S. 677 (1983), taught that the tax lien attaches to interests in homestead property, even when only one spouse owes tax and even though state law protects homestead property from creditors no less than entireties property is protected from creditors in the full bar states. The majority, in *dicta*, and the dissent skirmished over entireties cases. *See id.* at 703 n.31 (majority) and 719 (dissent).

[9]*E.g.*, *Geiselman v. United States*, 961 F.2d 1, 6-7 (1st Cir. 1992) (Massachusetts); *United States v. Gibson*, 817 F.2d 1406, 1407 (9th Cir. 1987) (Oregon); *Pilip v. United States*, 186 F. Supp. 397 (D. Alaska 1960).

[10]*E.g.*, *United States v. American National Bank*, 255 F.2d 504 (5th Cir. 1958) (Florida), *cert. denied as to another issue* 358 U.S. 835 (1959); *Raffaele v. Granger*, 196 F.2d 620 (3d Cir. 1952) (Pennsylvania); *United States v. Hutcherson*, 188 F.2d 326 (8th Cir. 1951) (Missouri).

[11]*Craft*, 122 S. Ct. at 1419.

The district court held for the IRS, and it valued Don's interest at one-half of the value of the whole property.[12] With one judge doubting the old rule, a three-judge panel of the Sixth Circuit reversed and remanded, taking the traditional full bar position.[13] Several further opinions ensued, including a similar opinion by another Sixth Circuit panel,[14] one of whose members concurred on law-of-the-case grounds but stated his view that the traditional position no longer was good law.[15]

It was this decision that the Supreme Court reversed in *Craft*. Justice Sandra Day O'Connor wrote for the six-person majority; three justices dissented. The opinion for the Court rests on no narrow ground. *Craft* overthrows the traditional position of the lower courts, freeing the federal tax lien from control by state law immunities as to entireties property.

The principal basis of the Court's decision is the inconsistency of the traditional view with the Court's teaching as to the limited role of state law in federal tax lien analysis. In December 1999, the Court unanimously decided *Drye v. United States*.[16] *Drye* is a landmark in federal tax lien analysis that ended (we hope) decades of confusion caused by loose language in previous Supreme Court opinions.[17]

> ***As a result of Drye, it now is clear that analysis of federal tax collection cases involves three levels.***

As a result of *Drye*, it now is clear that analysis of federal tax collection cases involves three levels. First, one looks to state law to identify what strings, powers, or controls the tax debtor has as to particular property. Second, one decides whether those identified strings, powers, or controls rise to the level of being "property [or] rights to property" as those terms are understood under section 6321. If they do, the federal tax lien attaches to the property on completion of certain procedural steps.[18] Third, on continued nonpayment, one reaches the level of post-lien-attachment consequences, that is, what further actions the IRS may take against the property to enforce collection and what defenses or protections the taxpayer and third parties have against such actions.[19]

I call these three, respectively, the "identification," "characterization," and "consequences" levels. The key teaching of *Drye* was as to the respective roles of state law and federal law in these levels of analysis. Under *Drye*, state law is consulted only at level one (identification). Once one has identified, by reference to state law, the strings or powers the tax debtor has, recourse to state law ends and all further questions are purely and exclusively the province of federal law.[20] Thus, how particular strings or powers are labelled or classified by state law is irrelevant, for characterization is a matter of solely federal law. And, any immunities or exemptions for debtors and any limitations on creditors which state law may provide are irrelevant, for consequences too are a matter of solely federal law.

In *Craft*, the Court adhered to its teaching in *Drye*[21] and applied it to entireties property. At level one, the Court identified numerous strings, powers, or controls which each spouse has over entireties property. These included affirmative (as well as negative) powers, powers each spouse could exercise independently of the other spouse (as well as powers exercisable only jointly), and powers currently and immediately exercisable (as well as future or contingent powers).[22]

At level two, the Court concluded that those powers did constitute property or property rights for section 6321 purposes. The powers gave Don Craft "a substantial degree of control over the entireties property,"[23] and, under *Drye*, the breadth of the taxpayer's control

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[12]*Craft v. United States*, 94-2 U.S. Tax Cas. (CCH) para. 50,493, *Doc 94-11103, 94 TNT 247-61, supplemental opinion*, 1995 WL 549317, *Doc 95-10471 (3 pages), 95 TNT 226-25* (W.D. Mich. 1995).

[13]*Craft v. United States*, 140 F.3d 638, *Doc 98-11403 (12 pages), 98 TNT 64-7* (6th Cir. 1998). One judge concurred only on the ground that because material issues of fact existed, summary judgment for the government was inappropriate. He expressed his belief that the old rule was no longer good law. *Id.* at 645-49 (Ryan, J. concurring).

[14]*Craft v. United States*, 233 F.3d 358, *Doc 2000-20459 (20 original pages), 2000 TNT 228-55* (6th Cir. 2000), *rev'd*, 122 S. Ct. 1414 (2000). For criticism of the Sixth Circuit's decision, see Steve R. Johnson, "The Good, the Bad and the Ugly in Post-*Drye* Tax Lien Analysis," 5 *Fla. Tax Rev.* 415, 445-52 (2002) (hereafter Johnson III).

[15]233 F.3d at 376-77 (Gilman, J., concurring).

[16]528 U.S. 49 (1999).

[17]For discussion of those previous cases and the effect of *Drye* on them, see Johnson III, *supra* note 14, at 419-32.

[18]The IRS must assess the tax and make notice and demand for payment on the taxpayer. On the taxpayer's failure to pay, the tax lien comes into existence and relates back to the date of the assessment. Sections 6201(a), 6303(a), and 6322. The IRS may later choose to file notice of the tax lien, but doing so is principally to improve the IRS's position versus competing creditors. *See* section 6323. The lien exists whether or not notice of it is filed.

[19]*See Drye*, 528 U.S. at 52.

[20]*Id.*

[21]At least the six-member majority did. The dissent by Justice Clarence Thomas, joined by Justices John Paul Stevens and Antonin Scalia, inexplicably and clearly erroneously suggested that, under *Drye*, the level-two characterization is a matter of state law. *See* 122 S. Ct. at 1428 & 1432.

[22]For example, under Michigan law, Don Craft had, among others, these rights as to the entireties 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 [Sandra's] consent and to receive half the proceeds from such a sale, the right to place an encumbrance on the property with [Sandra's] consent and the right to block [Sandra] from selling or encumbering the property unilaterally." *Id.* at 1422.

[23]*Id.* at 1423.

over the property is an important consideration in the characterization decision.[24] The Court noted that entireties spouses lack the right to unilaterally alienate the property, but it remarked: "There is no reason to believe . . . that this one stick . . . is essential to the category of 'property.'"[25] Indeed, the Court noted that other kinds of property — including homesteads, community property, and spendthrift trust interests — have been held amenable to the federal tax lien even when the taxpayer could not unilaterally alienate them.[26]

At level three, the Court recognized that Michigan law provides that entireties property cannot be reached by separate creditors but also recognized that — since consequences turn on federal law exclusively — the IRS cannot be bound by such a state provision. "The interpretation of section 6321 is a federal question, and in answering that question we are in no way bound by state courts' answers to similar questions involving state law."[27] The *Craft* Court invoked *Drye* for the proposition that "exempt status under state law does not bind the federal collector"[28] and *Rodgers* for its clarification that the Supremacy Clause of the Constitution "provides the underpinning for the Federal Government's right to sweep aside state-created exemptions."[29]

The incompatibility of the old rule with the three levels of tax collection analysis, as clarified by *Drye*, was the core of the Court's opinion in *Craft*. A secondary strand also existed, the recognition that the old rule created a ready pathway for tax abuse.[30] The abuse takes several forms, all leading to a common outcome. For instance, both spouses could fail to file income tax returns (even if both owed tax), or both could file separate returns (both significantly understating tax due), or one spouse (the one with the higher income) could file a highly inaccurate return while the other filed an accurate return. In none of these scenarios would the IRS be able to make joint assessments against the spouses.[31] Under the old rule, this inability would completely prevent the attachment of the tax lien in full bar jurisdictions and limit its attachment in partial bar jurisdictions. The couple would take advantage of that by holding all or most of their property in entireties form.[32] Thus, by conjoining separate returns with entireties ownership, a couple could significantly underpay tax since the IRS would be powerless to collect on its separate assessments against them. The *Craft* court acknowledged this as a problem of the old rule.[33]

For these reasons, *Craft* overthrew the old lower court cases, a result compelled by fidelity to *Drye* and other Supreme Court decisions. The federal tax lien now attaches to a debtor spouse's interest in entireties property, regardless of any immunities created by state law. In the remaining parts of this article, we address the implementational issues that arise from this.

II. General Approach

For the moment, it seems a bit detached from reality to be talking about enforced collection options for the IRS. The Internal Revenue Service Restructuring and Reform Act of 1998[34] contained some useful provisions but, taken as a whole, must be accounted a disaster for effective tax administration.[35] The distractions, diversions, and demoralization caused by the 1998 legislation caused precipitous declines in both examination and collection activity by the IRS.[36] Despite some recent improvements, such activity has yet to recover from the results of the unwise and politically opportunistic 1998 legislation.[37]

But collection does still go on, albeit at reduced levels. And today is not forever. Already legislation has been introduced to moderate some of the excesses of the 1998 act, and the administration supports at least some correction.[38] Sooner or later, the pendulum will swing back toward more robust collection activity. Both for collections in progress now and for the more numerous collections that will occur in the future, it is appropriate to consider the implementation issues raised by *Craft*.

My gratuitous advice to the IRS in this area is "proceed cautiously." There are career IRS revenue officers and attorneys who have lived under the frustration of the old rule for years or decades. It might be

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[24]*Id.* (quoting *Drye*, 528 U.S. at 61). Although "control" was sufficient to resolve the characterization question in *Craft*, it would be too narrow to make control the level two touchstone in all cases. *See United States v. Murray*, 217 F.3d 59, 63 (1st Cir. 2000); Johnson III, *supra* note 14, at 462-63.

[25]122 S. Ct. at 1423.

[26]*Id.* at 1423-24.

[27]*Id.* at 1425.

[28]*Id.* at 1426 (quoting *Drye*, 528 U.S. at 51) (internal quotation marks omitted).

[29]122 S. Ct. at 1426 (quoting *Rodgers*, 461 U.S. at 701).

[30]*See* Johnson I, *supra* note 4, at 848-49; Johnson II, *supra* note 4, at 1171.

[31]*See* section 6013(d)(3) (income tax liability is joint and several only if the spouses file a joint return).

[32]In a few states, only realty can be held by the entireties. In many states, though, all kinds of property can be so held. *E.g.*, *Tyler v. United States*, 281 U.S. 497, 500 (1930) (Maryland); *Winters v. Park*, 91 So. 2d 649, 651 (Fla. 1956).

[33]122 S. Ct. at 1424.

[34]P.L. 105-206, 112 Stat. 685.

[35]For discussion of the process leading to enactment of the 1998 legislation and the unfortunate effects of some of its provisions, see Steve R. Johnson, "The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden-of-Proof Rules," 84 *Iowa L. Rev.* 413 (1999), and Steve R. Johnson, "The Tax Advisor-Client Privilege: An Idea Whose Time Should Never Come," *Tax Notes*, Feb. 23, 1998, p. 1041.

[36]*See, e.g.*, Joint Comm. on Taxation, "Report Relating to the Internal Revenue Service as Required by the IRS Reform and Restructuring Act of 1998," *Doc 2000-12222 (62 original pages), 2000 TNT 84-67*, section 134 (May 1, 2000).

[37]*See, e.g.*, George Guttman, "Rossotti's Report Card," *Tax Notes*, Mar. 25, 2002, p. 1584 at 1585.

[38]*See* Amy Hamilton, "Bush Wants to Modify IRS Reform Act," *Tax Notes*, Feb. 11, 2002, p. 665.

understandable for them — out of relief or exuberance — to move to use *Craft* aggressively. But these feelings should be restrained. Below, I explain both the "why" and the "how" of this restraint.

A. Why to Exercise Restraint

Restraint is desirable principally to allow parties to adjust to the new rule. The old view was misconceived from the start, but it was around for a long time. The principal cases anchoring the old view were decided in the 1950s,[39] but similar decisions had been made long before even them.[40]

Moreover, the government's hands are not entirely clean. The IRS and the Department of Justice sent mixed signals about this issue for years.[41] On one hand, scores of times, the government did assert in litigation that the tax lien attaches to entireties interests — that was how the cases supporting the old rule came to be. On the other hand, the government stated or implied its acceptance of the old rule in a variety of rulings and manuals over the years.[42]

I have always seen "maybe it's wrong, but it's settled" as the strongest argument in favor of the old rule, but ultimately that argument is insufficient.[43] *Stare decisis*, although not absolute,[44] is an important policy, and it is "at [its] acme in cases involving property rights and contract rights, where reliance interests are involved."[45] However, the old rule was not so settled as to give rise to reasonable reliance by taxpayers. I say that for the following reasons:

(1) The old rule was inconsistent with the language of the controlling statute. Section 6321 provides that the general tax lien attaches to "all" property and property rights not to "all [such rights] except entireties interests."[46]

(2) All the cases supporting the old rule were lower court decisions. The Supreme Court had never endorsed it. Indeed, even before *Drye*, the old rule seemed decidedly difficult to reconcile with Supreme Court decisions in 1983 and 1985.[47]

(3) Even at the lower court level, by the 1990s, some cracks began to appear in the once solid wall of support for the old rule.[48]

(4) Cases in analogous areas — including income tax liability (as opposed to tax collection), bankruptcy, and forfeiture cases — appeared inconsistent with the old rule.[49]

(5) A number of commentators suggested the inconsistency of the old rule with the statute and Supreme Court precedents.[50]

(6) As noted above, the government challenged the old rule in litigation over decades.

So, in my view, here's how the matter stands. The support for the old rule was not so massive and authoritative as to give rise, before *Craft*, to settled, reasonable expectations that entireties interests were exempt from the federal tax lien. Yet, though not rising to that level, such expectations as may have formed are hard to dismiss entirely. The near unanimous pre-*Craft* lower court case law and, especially, the government's schizophrenia on the issue merit some regard. In fairness, the government would do well to proceed slowly with *Craft*, to give entireties spouses, their professionals, and the real estate industry time to adjust to the new order. Some couples used entireties estates under the old rule as a vehicle for tax abuse.[51] But certainly not all did. There are many who kept property in entireties form for benign, nonabusive purposes. Minimizing harm to them is a worthy goal in the new environment.

The above consideration of fairness is principal, but it is reinforced by a second consideration. Ham-handed implementation of *Craft* could give rise to a movement to reverse the decision legislatively. I doubt that such a movement would succeed: Congress rarely reverses Supreme Court tax decisions; the steam has largely gone out of the taxpayer rights movement;[52] Congress has more pressing matters — tax and nontax — to

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[39]*See* cases cited in note 10 *supra*.

[40]*E.g.*, *United States v. Nathanson*, 60 F. Supp. 193 (E.D. Mich. 1945); *Shaw v. United States*, 94 F. Supp. 245 (W.D. Mich. 1939); *Smith v. Commissioner*, 24 B.T.A. 807, 811-13 (1931).

[41]The explanation for this inconsistency is disagreement within the IRS and within the Department of Justice over the issue. Different government tax personnel in different functions had sharply divergent views of the merits of the old rule and of the feasibility of challenging it.

[42]Many of these statements are cited by Justice Thomas's dissent in *Craft*. *See* 122 S. Ct. at 1431-32 n.9. Justice Thomas's recitation of the many cases and government positions supporting the old rule is the strongest part of his dissent, although it is somewhat overstated.

[43]For evaluation of the argument, see Johnson II, *supra* note 4, at 1187-89.

[44]*See, e.g.*, *Smith v. Allwright*, 321 U.S. 649, 665 (1944); *Hertz v. Woodman*, 218 U.S. 205, 212 (1910).

[45]*Payne v. Tennessee*, 501 U.S. 808, 828 (1991).

[46]*See* cases cited in note 2 *supra* for the broad reading given to the statutory language.

[47]*See* Johnson I, *supra* note 4, at 868-76 (discussing *United States v. Rodgers*, 461 U.S. 677 (1983), and *United States v. National Bank of Commerce*, 472 U.S. 713 (1985)).

[48]*See* Johnson I, *supra* note 4, at 876-81.

[49]*See id.* at 862-63, and Johnson III, *supra* note 14, at 441.

[50]In addition to my writings, see Elliott, *supra* note 3, at 9-92; John F. Hernandez, "The Federal Tax Lien: Beyond *United States v. Rodgers*," 36 *U. Fla. L. Rev.* 1081, 1098 (1984); Terrence C. Brown-Steiner, Comment, "Federal Tax Liens & State Homestead Exemptions: The Aftermath of *United States v. Rodgers*," 34 *Buff. L. Rev.* 297-323 (1985).

[51]*See* text accompanying notes 30 to 33 *supra*.

[52]*See* text accompanying note 38 *supra*. Taxpayer rights measures have been included in some recent bills. *E.g.*, Personal Responsibility, Work, and Family Promotion Act of 2002, H.R. 4737 (passed by the House of Representatives on May 16). Even if they find their way into law eventually, however, the measures would operate at the margins only. These proposals do not remotely approach the significance of the 1998 Act.

occupy it; and the critical mass of votes for reversal likely could not be formed.[53]

> ***The victory in Craft was long in the making; it should not be surrendered by over-zealousness that prompts legislative reversal.***

However, complacency in matters of tax legislation can be dangerous. Even a few examples of IRS heavy handedness (whether real or only perceived)[54] can stampede Congress into ill-advised "legislation by anecdote."[55] Insensitive application of *Craft* could generate instances that are or are perceived as antifamily or oppressive. The IRS should steer well clear of that reef. The victory in *Craft* was long in the making; it should not be surrendered by overzealousness that prompts legislative reversal.

B. How to Exercise Restraint

If the IRS accepts that *Craft* should be implemented cautiously, what specifically would that mean in practice? Each case differs, of course,[56] and there is no substitute for the sound judgment of the revenue officer and her superiors.[57] Nonetheless, it is possible to make some useful generic observations. They are made below under three headings: (1) available approaches, (2) consequences, and (3) conditions under which the approaches should be used.

1. Approaches. A continuum of approaches exists, ranging from the most aggressive to the most cautious. The most aggressive, of course, would be attempting immediately to effect collection out of the debtor spouse's interest in the entireties property. For reasons explained later,[58] that likely would take the form of attempted judicial sale of the whole property with consequent division of the proceeds under section 7403.

The polar opposite — the most cautious stance — is what I call the "wait and see" approach. This is what was permitted the IRS in partial bar jurisdictions even before *Craft*. Under it, the IRS would not seek to effect collection from entireties property while the entireties estate is intact. What happens thereafter would depend on how the entireties estate ended:

- By operation of law, divorce converts a tenancy by the entireties into a tenancy in common.[59] Since the latter is a severable form of ownership, the IRS would then be free to proceed against the debtor spouse's interest by any normal means.[60]
- On the death of one spouse, the survivor becomes the fee simple owner of the whole property.[61] Thus, under a wait-and-see approach, were the tax debtor spouse to die first, his interest in the property would be extinguished and the IRS could collect nothing from it. However, were the nondebtor spouse to die first, the IRS could move against the whole property, now the debtor's as sole owner.

Of course, this situation would be less than perfect from an administrative standpoint. The longer the wait-and-see period, the worse for the fisc — for time-value of money reasons as well as the possible extinguishment of the debtor's interest. Moreover, concern about expiration of the 10-year statute of limitations on collection[62] would rise as time passes. The limitations problem could be handled, however, by the government bringing suit to reduce the assessment to judgment[63] and perhaps by legislation.[64]

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[53]There are some populous full bar states: Florida, Pennsylvania, and Michigan. Nonetheless, the bulk of the country's population resides in states in which tenancies by the entireties are not recognized at all, are not significant, or involve the partial, not full, bar form.

[54]The 1998 legislation was propelled by sensationalistic hearings of the Senate Finance Committee. The General Accounting Office, however, was unable to substantiate allegations made by witnesses at the hearings. *See* GAO/OSI-99-9R, section 2, *Doc 2000-11630 (52 original pages), 2000 TNT 80-13* (Apr. 25, 2000); Ryan Donmoyer, "Secret GAO Report Is Latest to Discredit Roth's IRS Hearings," *Tax Notes*, Apr. 24, 2000, p. 463.

[55]*See* Michael J. Graetz, *The Decline [and Fall?] of the Income Tax* 32-33 (1997); Leandra Lederman, "Of Taxpayer Rights, Wrongs, and a Proposed Remedy," *Tax Notes*, May 22, 2000, p. 1133 at 1136; Steve R. Johnson, "A Residual Damages Right Against the IRS: A Cure Worse Than the Disease," *Tax Notes*, July 17, 2000, p. 395 at 398-99.

[56]*See, e.g.*, I.R.M. 536(14).1 ("Whether to levy benefit income must be considered case-by-case, and sound judgment must be used in determining whether there is flagrant and aggravated neglect or refusal to pay.").

[57]In *Rodgers*, the Supreme Court noted that the exercise of collection powers "is left in the first instance to the good sense and common decency of the [IRS]." 461 U.S. at 699. One can imagine a zealot or a politician in search of an applause line putting a cynical spin on that language, but I believe that in many instances, though not all, references to the good sense and common decency of IRS agents is descriptive of fact and not just aspirational.

[58]*See* part III.A. *infra*.

[59]*E.g.*, *Sebold v. Sebold*, 444 F.2d 864, 871 (D.C. Cir. 1971); *Smith v. Smith*, 107 S.E.2d 530, 534 (N.C. 1959).

[60]*E.g.*, *United States v. Estes*, 654 F. Supp. 49 (S.D. Ohio 1986).

[61]*E.g.*, *United States v. 2525 Leroy Lane*, 910 F.2d 343, 350-51 (6th Cir. 1990), *cert. denied* 499 U.S. 947 (1991).

[62]Section 6502(a)(1).

[63]If such a suit is commenced within the limitations period, it is irrelevant when judgment is obtained. The judgment may be enforced at any time during its legal life, even after expiration of the normal 10-year period for collection of assessments. *See* section 6502(a); *Hector v. United States*, 255 F.2d 84 (5th Cir. 1958).

[64]Should Congress decide to visit this area, a possible approach would be to mandate the wait-and-see approach in some situations. This would be distinctly favorable to tax debtors and their spouses, so it would be fair to condition the benefit on extension of the limitations period. For instance, the running of the period could be tolled during the tenure of the entireties estate (perhaps coupled with a requirement that the taxpayer notify the IRS when that estate ends). There is ample precedent in the code for extending

(Footnote 64 continued on next page.)

Spouses have the ability to terminate an entireties estate by agreement and to divide the underlying property between themselves.[65] Presumably, this would happen rarely in a tax lien situation. If it did, however, the IRS would be able to proceed against the portion or interest allocated to the debtor spouse. Circumspection would be required, of course, to be sure that the tax debtor spouse received a fair and reasonable allocation of the property[66] — else, this device could be used to circumvent *Craft*. In the event of inadequate allocation, the IRS could invoke familiar remedies like fraudulent conveyance suits[67] or transferee liability assessments.[68]

Between the two polar approaches — immediate seizure or sale versus wait and see — other approaches are possible. For example, the IRS could initially stay its hand but later switch to enforced collection, either after the passage of a certain period of time or on the happening of a material event. Sale of the property would likely be such an event. In many states, sale does not terminate entireties status; it just transfers it from the property sold to the proceeds of sale.[69] Nonetheless, the liquidation of an asset, its transmutation into cash may well be a reasonable "event of realization" in a collection sense. For example, interests may balance differently when the item at issue is a residence than when it is cash obtained through selling that residence.[70]

2. **Consequences.** In general, the consequences of the approaches are easy to state. Immediate seizure or sale produces revenue for the government fastest, but potentially is the most burdensome or disruptive for the couple — and minimizing harm to nondebtor spouses, especially those who did not collude with the debtor spouse to use entireties ownership as a strategy of tax avoidance, should be an important goal in implementing *Craft*.[71] Conversely, the wait-and-see approach would delay tax collection (and perhaps forgo it entirely, should the tax delinquent spouse predecease the other spouse) but would be least problematic for the couple.

But more needs to be appreciated beyond the simple relationships above. The wait-and-see alternative likely would produce more revenue, or revenue faster, than might at first be supposed. In several circumstances, the IRS could realize revenue simply because of the existence of the lien on the property, even without the IRS taking enforced collection.

First, the existence of the lien is a cloud on title. The property is virtually unsaleable while the lien exists.[72] Even before *Craft*, entireties spouses occasionally paid the assessment, to avoid the expense, delay, and uncertainty of litigating the issue. With the comfort of the old rule now removed, that behavior will become much more common. Many entireties owners will pay "voluntarily" to render the property saleable or simply to achieve peace of mind. Similar results could be reached by other routes, such as through certificates of discharge,[73] substitution of proceeds,[74] and offers in compromise.[75]

Second, the IRS could "piggyback" onto a collection action brought by another creditor, an unpaid joint creditor of the couple. For instance, assume one spouse wants to borrow money from a private lender. Lenders in entireties states, cognizant of state law limitations as to separate debts, typically require that both of the spouses become obligors in the borrowing. Further assume that the private lender is not paid and that the IRS has an unpaid assessment against one of the spouses. If the lender proceeds against the property, the IRS will be joined or will intervene since it too has a claim against the property. How much the IRS gets as a result will depend on its priority relative to the private lender,[76] the value of the property, and the amounts of the various claims. The point, though, is that in these cases, the IRS could realize revenue from entireties property as a consequence of the actions of a third party. The IRS itself need not precipitate the levy on or liquidation of the property.

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assessment or collection limitations periods as the concomitant of a taxpayer-friendly special rule. *See, e.g.*, sections 547(f), 6320(c), 6330(e), 6502(a)(2), 6503(c), (d), (e), (g), and (l), 7811(d); *United States v. Moyer*, 308 F. Supp. 754 (W.D. Pa. 1968), *aff'd per curiam* 420 F.2d 375 (3d Cir. 1970), *cert. denied* 400 U.S. 819 (1970).

[65] *E.g., Sheldon v. Waters*, 168 F.2d 483, 483-84 (5th Cir. 1948); *Runco v. Ostroski*, 65 A.2d 399, 400 (Pa. 1949).

[66] *See* part III.D *infra* for discussion of valuation issues.

[67] *See, e.g., United States v. Hickox*, 356 F.2d 969 (5th Cir. 1966); *United States v. Poio*, 1986 WL 31983 (E.D. N.Y. 1986).

[68] *Craft* confirmed that the transfer of property out of entireties estates into the sole ownership of the nondebtor spouse can be attacked as fraudulent conveyances. 122 S. Ct. at 1426.

[69] *See* Michael Allan Wolf (ed.), 7 *Powell on Real Property* para. 52.02[6] (2002) (citing cases).

[70] *See Rodgers*, 461 U.S. at 704 ("in practical terms financial compensation may not always be completely adequate substitute for a roof over one's head").

[71] *See* Johnson I, *supra* note 4, at 850-52, and Johnson II, *supra* note 4, at 1181-84 (both arguing that overthrow of the old rule can be accomplished without traducing the legitimate interests of nondebtor spouses).

[72] Once the lien attaches, it can travel with the property. After notice of the lien is filed, a purchaser or grantee takes the property subject to the tax lien, hardly an inviting prospect. *See, e.g., United States v. Hughel*, 20 F. Supp. 2d 1154, 1157 (S.D. Ohio 1997).

[73] *See* section 6325(b)(2)(A).

[74] *See* section 6325(b)(3). The IRS agreed to allow the sale of the Crafts' parcel of real estate free of the tax lien. In substitution, the IRS asserted its claim against the proceeds of sale of the parcel.

[75] *See* section 7122. Since it now is clear that entireties interests are reachable by the IRS regardless of state law provisions, any offer in compromise submitted by the tax debtor spouse, to be acceptable, will have to include an amount reflecting that spouse's interest in entireties property.

[76] The general rule of priority of IRS versus other claims is "first in time, first in right." *E.g., United States v. Pioneer American Insurance*, 374 U.S. 84, 87 (1963). For special priority rules, see section 6323.

3. **Conditions.** There are two conditions that if present, could reinforce the general caution desirable as to *Craft* implementation. If both (1) the property in question is of a sensitive type and (2) the nondebtor spouse cannot be shown to have colluded or participated with the tax debtor spouse in a scheme to use entireties ownership to defeat tax collection, then the imperative of protecting the nondebtor spouse is particularly strong, and a wait-and-see approach is particularly warranted.

The two conditions require some definition. Sensitive property consists of assets of special importance to the nondebtor's spouse, the loss of which would subject him or her to privation. The marital residence will often fit the description. So may a business or a financial account if it is the sole source of needed current or future income. Such assets, if held by the entireties, could be particularly important to the nondebtor spouse.

Suggesting restraint in these cases is hardly radical. It imports into the entireties area solicitude already shown elsewhere. For instance, the 1998 legislation limited seizures of residences and businesses and required heightened administrative or judicial scrutiny of them.[77] And, by policy, the IRS typically will effect collection out of retirement benefits[78] or Medicare payments[79] only in flagrant cases, or when hardship would not ensue.

Sensitivity to the assets, however, would have its limits. Assets of very high value should be reachable at least in part. The excess over amounts needed for reasonable support and welfare should not be viewed as sacrosanct.

Collusion or participation clearly bears on the equities (and perceived equities) of the situation. Little special solicitude is due a spouse who, though not owing taxes him or herself, helped the other spouse in a plan to defeat collection. That policy explains a number of sections dealing with tax administration,[80] and it should find expression in this area as well. Proof of such complicity would not always be easy,[81] but principles of proof developed in analogous areas[82] could be brought to bear here as well.

[77]*See* section 6334(a)(13) and (e).

[78]*See* I.R.M. section 536(14).1.

[79]I.R.M. section 536(14).3.

[80]*E.g.*, sections 6015(b)(1)(D) and (c)(4) (limiting spousal relief), 6901(a) (providing for transferee liability).

[81]An interesting question is whether Sandra Craft participated or colluded with Don. The facts recounted in the various *Craft* opinions are insufficient to support a firm conclusion either way. There are, however, enough facts to at least raise a suspicion. For instance, Don failed to file returns for eight consecutive years, underpaying tax by nearly $500,000, which would have been unlikely to escape his wife's notice. And, on the filing of the notice of tax lien against Don, Don and Sandra jointly executed a quitclaim deed, transferring (for $1) the parcel to Sandra's sole ownership. 122 S. Ct. at 1419. Sandra's knowledge of the events from an early date and perhaps her participation in them are more than remotely possible.

[82]*See, e.g.*, *In re Kaiser*, 722 F.2d 1574, 1582-83 (2d Cir. 1983) (elaborating "badges of fraud" from which a court may infer that a transfer was a fraudulent conveyance).

So, "wait and see" is especially prudent in cases in which the property held by the entireties estate is of a sensitive type and the nondebtor spouse cannot be shown to have collaborated with the debtor spouse to hamper tax collection through a strategy of separate returns and entireties ownership of property. Cases free of these factors are better candidates for immediate enforcement or for hybrid approaches.

III. Particular Issues

The general spirit of *Craft* implementation will find expression in particular decisions and issues. In this part, we discuss four issues: (1) In those cases in which the IRS is not content with waiting and seeing, what enforced collection actions can it and should it take? (2) How can the legitimate interests of nondebtor spouses be protected? (3) To what extent can and should *Craft* be applied retroactively to collection cases already commenced? (4) How should entireties interests be valued?

A. Enforced Collection Options

The most frequent method of enforced collection used by the IRS is levy, followed in the case of noncash property by administrative sale.[83] But use of that method in entireties situations with assessments against only one of the spouses would raise difficult theoretical and practical problems.

There would be no satisfactory conceptualization of the state of ownership existing after levy and (especially) sale by the IRS of the debtor spouse's interest. An entireties estate can exist only between wife and husband.[84] Mere levy by the IRS on the husband's interest probably would not disturb this since levy is understood to be only a provisional, not a final, remedy.[85] But sale to a third party following levy would produce, if respected, an ownership structure fundamentally incompatible with the entireties form.

How would the courts handle the conundrum? There are three possibilities, none satisfactory. First, the courts could say that the administrative sale broke one of the essential unities, terminating the entireties estate. One would feel uncomfortable with this outcome. Under our system, states are entitled to establish whatever property rules they wish for their own purposes, although those rules do not bind the federal government in pursuit of its proper purposes, including revenue raising.[86] The national government should be free within its proper sphere from state limitation, and the states should be free within their proper spheres from federal limitation. *Craft* itself comports

[83]*See* sections 6331 and 6335.

[84]*See, e.g.*, John V. Orth, "Tenancy by the Entirety: The Strange Career of the Common-Law Marital Estate," 1997 *B.Y.U.L. Rev.* 35 (describing the early authorities). Entireties estates must involve a number of unities, including the so-called "unity of person" that comes from marriage.

[85]*E.g.*, *United States v. National Bank of Commerce*, 472 U.S. 713, 721 (1985).

[86]*See Craft*, 122 S. Ct. at 1425-26; Johnson II, *supra* note 4, at 1186-87.

with these principles, but tension would arise if, in implementing *Craft* through IRS levy and sale, the result is destruction of entireties estates for all purposes. The IRS, naturally, will want to achieve collection of taxes due with as little collateral disruption as possible.

Second, the courts, to prevent destruction of the entireties estate, could declare that the IRS could not sell the levied interest at all or could only sell it back to the debtor spouse from whom it was taken. The reasoning would be: (1) the IRS can sell only what it got from the debtor spouse;[87] (2) what the IRS got from the debtor spouse was an entireties interest; (3) sale of an entireties interest outside the couple would destroy the estate, so the entireties interest wouldn't be an entireties interest any longer; therefore (4) the interest isn't saleable at all or is saleable only back to the debtor spouse. Of course, such an outcome would be worthless to the IRS. Collection out of entireties property presumably would be a last resort — after the IRS had proceeded against the debtor's other assets — so the debtor would have little or no money with which to effect repurchase.[88] More, when there are no other potential buyers, the debtor spouse would have limited incentive to make a substantial offer.

Third, the courts could "craft" a hybrid arrangement, neither fish nor fowl. They could allow the sale to the third party but permit the entireties estate to continue (under some fiction to preserve the marital unity of person). Under this approach, the nondebtor spouse would retain all of her rights in the property, both present and future, and the purchaser's rights would be subject to them. Thus, the nondebtor spouse would still have an absolute right to occupy or use the property, to prevent sale or other transfer of the property, etc. Again, this outcome would be unsatisfactory to the IRS. Who would want to buy the interest from the IRS under these circumstances? The IRS would receive no bids or only very low bids.

The uncertainty as to which of the above approaches courts would take, coupled with the undesirable aspects of the possible outcomes, would make the IRS reluctant to sell and third parties reluctant to buy the debtor spouse's interest.[89] The typical levy-and-sale approach would be impracticable as a way to enforce collection.[90]

Thus, were it intent on acting beyond mere imposition of its lien, the IRS would need an alternative device. It exists. Code section 7403 was designed for divided ownership situations. It permits the IRS to petition a federal district court to sell the entire property in which the tax delinquent has an interest, then to divide the net proceeds of sale among the various interest holders, the IRS receiving the delinquent's share up to the total of his or her outstanding liabilities.[91] Presumably, section 7403 sale-and-division will be the IRS's method of choice when it decides to forgo or terminate a wait-and-see approach.[92]

B. Protection of Nondebtor Spouses

Reasonably protecting the rights and legitimate interests of the nondebtor spouse is fundamental. It would be unfair to collect the debtor spouse's taxes out of the nondebtor spouse's property. Indeed, to do so without adequate compensation could violate Due Process.[93]

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[87]It is often said that the IRS, in exercising its collection function, "steps into the taxpayer's shoes," Boris Bittker and Martin McMahon, *Federal Income Taxation of Individuals* para. 44.5[4][a] (2d ed. 1995 and 2000 Cum. Supp.), and "has the same rights as the taxpayer in property or rights to property subject to the lien," *Craft*, 122 S. Ct. at 1427 (Thomas, J., dissenting). This has a sound-bite quality and serves well as a generalization. However, section 7403 gives the IRS power to achieve outcomes as to the property that the taxpayer could not have achieved.

[88]The same reason also would bar the efficacy of another collection option. The government can sue a tax delinquent for the unpaid amount, then exercise the usual rights of a judgment creditor. *Rodgers*, 461 U.S. at 682-93. The debtor spouse's lack of other collectible assets would render this option as unavailing as administrative levy and sale.

[89]Potential buyers may be inhibited by the outcome of *Elfelt v. Cooper*, 485 N.W.2d 56 (Wisc. 1992). There, Mr. and Mrs. Cooper held a homestead in joint tenancy. The IRS made an assessment against only Mr. Cooper for unpaid income tax. Under section 6331, the IRS administratively seized Mr. Cooper's undivided one-half interest in the homestead (by sending him notice of seizure although he continued to live on the property) and sold that interest to the Elfelts. Several rounds of litigation ensued between the Elfelts and the Coopers as to title to the property. Reversing lower courts, the Wisconsin Supreme Court agreed with the Coopers' contention that section 6331 did not give the IRS authority to sell Mr. Cooper's interest in the homestead without Mrs. Cooper's consent (although the Court acknowledged that a different result might have ensued had the IRS proceeded under section 7403). *Id.* at 62. The validity, especially now, of the court's reasoning is dubious, but the lessons of the case are fairly clear. One who buys from the IRS an undivided interest in protected property, after its administrative seizure, does so at her own peril. She likely is buying costly litigation with uncertain outcome.

[90]For cases stating that undivided interests in homesteads and similar property are, as a practical matter, unsaleable, see *United States v. Bierbrauer*, 936 F.2d 373, 376 (8th Cir. 1991); *United States v. Hughel*, 20 F. Supp. 2d 1154, 1159 (S.D. Ohio 1997); *United States v. Anderson*, 1991 WL 236849, at *3 (D. S.D. 1991); *United States v. Bachman*, 584 F. Supp. 1002, 1005 (S.D. Iowa 1984).

For an example of a hybrid approach, see *United States v. Jones*, 877 F. Supp. 907 (D. N.J. 1995), *aff'd without opinion* 74 F.3d 1228 (3d Cir. 1995) (denying section 7403 sale but directing nondebtor spouse to pay IRS monthly half the imputed value of the entireties property).

[91]*See, e.g., United States v. Bachman*, 1981 WL 1934, at *4 (S.D. Iowa 1981) (noting the superiority of section 7403 over administrative levy and sale in multiple owner situations), *remanded on other grounds* 710 F.2d 484 (8th Cir. 1983) (*per curiam*).

[92]This is similar to how entireties interests may be treated in bankruptcy cases. *See* note 103 *infra*.

[93]*See Rodgers*, 461 U.S. at 697.

Fortunately, there is ample room to avoid substantial unfairness to nondebtor spouses in the implementation of *Craft*. If the IRS maintains a wait-and-see strategy, particularly as to sensitive types of property,[94] the nondebtor's right to use and enjoy the property — as well as his or her right of survivorship — will remain secure. There would be some loss of flexibility, to be sure. For example, the couple could not sell or give away the property free of the tax lien. But the nondebtor did not have a right of unilateral alienation in any event. The loss of joint flexibility is the result of the other spouse's failure to pay his taxes and reflects the strong national interest in collecting those taxes.[95]

> ***Fortunately, there is ample room to avoid substantial unfairness to nondebtor spouses in the implementation of Craft.***

Nondebtor spouses can be adequately protected even if the IRS proceeds to enforced collection. As described above,[96] the IRS likely would proceed via judicial sale and division of proceeds under section 7403. There are considerable safeguards in the section 7403 procedure. First, the district court is not absolutely required to grant the government's petition to sell and divide. The statute is phrased permissively.[97] Thus, the Supreme Court has held that the district court has a degree of equitable discretion to deny sale.[98] This discretion is limited, and its exercise must be guided by several factors.[99] Nonetheless, district courts often have exercised this discretion.[100] Indeed, they sometimes have pushed to or beyond the limits of their discretion, in their desire to protect third parties.[101] One would expect district courts to feel considerable sympathy for nondebtor spouses who did not participate in a plan of tax reduction with their debtor spouses.

Second, if the district court does order sale of the property, the nondebtor spouse will receive a share of the proceeds that reflects her proportionate interest in the property.[102] This is consistent with the approach taken as to entireties interests in bankruptcy cases,[103] and it obviates any due process objections.[104]

An interesting question would arise if the nondebtor spouse had separate creditors too, creditors other than the IRS. On division of the proceeds of a section 7403 sale, could those separate creditors seek to attach or levy on the nondebtor spouse's share of the proceeds? To permit that arguably would make the nondebtor spouse worse off[105] since her creditors couldn't have gotten paid had the original entireties estate continued but now could receive payment after the section 7403 sale and division of proceeds.

This is not a matter of direct concern to the tax system since it involves only the nondebtor spouse and his or her separate creditors. It implicates instead the policies behind the state's choice to make entireties property immune from separate creditors. To preserve those policies, the courts could hold that the portion of the sale proceeds not going to the IRS remains entireties property, thus still immune.[106]

A corollary also would be necessary. If the entireties estate later were broken (say by divorce), the remaining proceeds should not be divided evenly between the spouses, as usual. If they were, then — taking the section 7403 event and the subsequent event together — the debtor spouse would have received (directly, or

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[94]*See* part II.B.3. *supra.*

[95]*See, e.g., Bull v. United States,* 295 U.S. 247, 259 (1935) ("taxes are the life-blood of government, and their prompt and certain availability an imperious need").

[96]*See* part II.B.1. *supra.*

[97]Section 7403(a) (the district court "may" order sale).

[98]*Rodgers,* 461 U.S. at 703-09.

[99]*See id.* at 709-11. The main factors are (1) the extent to which the IRS's ability to collect revenue would be prejudiced were the whole property not sold; (2) whether the third party with an interest in the property has a legally recognized expectation that his or her separate property will not be subject to forced sale by the tax delinquent's creditors; (3) the extent to which the third party would be prejudiced "both in personal dislocation [and] practical undercompensation"; and (4) the relative characters and values of the interests held in the property.

The factors must be discussed when the district court exercises its limited discretion to deny sale. They need not be discussed when the court grants sale. *United States v. Davenport,* 106 F.3d 1333, 1337-38 (7th Cir. 1997).

[100]*E.g., United States v. Reid,* 127 F. Supp. 2d 1361, 1381-83 (S.D. Ga. 2000); *United States v. DiGuilio,* 1997 WL 834820, at *14-18 (W.D. N.Y. 1997); *United States v. Johnson,* 943 F. Supp. 1331 (D. Kan. 1996).

[101]*See, e.g., United States v. Bierbrauer,* 936 F.2d 373, 375-77 (8th Cir. 1991); *United States v. Gibson,* 817 F.2d 1406, 1407-08 (9th Cir. 1987) (both holding that the district court abused its discretion in refusing sale of the property and remanding for detailed analysis of the *Rodgers* factors).

[102]This is one reason why the interests of the spouses must be valued correctly. For valuation options, see part III.D. *infra.*

[103]The bankruptcy estate formed on the filing of a bankruptcy petition consists of "all legal or equitable interests of the debtor in property." 11 U.S.C. section 541(a)(1). This includes a spouse's interest in entireties property, even when only that one spouse filed a petition. *E.g., In re Grosslight,* 757 F.2d 773, 775-76 (6th Cir. 1985). The bankruptcy trustee may, under stated conditions, sell the whole property, paying over to the nondebtor spouse the value of her interest in the property and retaining the rest. 11 U.S.C. section 363(f), (h). This approach has been viewed as adequately protecting the nondebtor spouse. *See, e.g., In re Koehler,* 6 B.R. 203, 204-05 (Bankr. M.D. Fla. 1980); H.R. Rep. No. 595, 95th Cong., 2d Sess. 177 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6137-38.

[104]*E.g., Rodgers,* 461 U.S. at 697-99; *United States v. Overman,* 424 F.2d 1142, 1146 (9th Cir. 1970).

[105]If one can be considered to be worse off as a result of having to pay one's legitimate obligations.

[106]Often, under current practice, the proceeds of sale of entireties property are themselves treated as within an entireties estate. *See* note 69 *supra.*

indirectly through payment to the IRS for his account) more than half of the original property's value, while the nondebtor spouse would have received less than half. An answer would be to treat the payment to the IRS on behalf of the debtor spouse as a "draw" by the debtor, an advance payment or loan to him out of the entireties property. That draw would then be repaid by its being subtracted from the amount going to him on the subsequent split of the entireties estate.[107] Thus, there is room for courts to fashion a rule adequately protecting nondebtor spouses from their separate creditors after section 7403 sale and division of proceeds.

Although the protections provided by the section 7403 procedures are of principal significance, other protections may also come into play in particular situations.[108] All considered, there is ample opportunity to avoid undue harm to nondebtor spouses in the implementation of *Craft*, both by prudence and good judgment on the part of the IRS and by formal legal protections if the IRS acts overly zealously.

C. Application to Matters Already Commenced

Under settled principles, *Craft* applies retroactively. When the Supreme Court declares or interprets a federal rule, "that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events predate or postdate [the Court's] announcement of the rule."[109] Thus, the rule announced by *Craft* applies to tax liens and entireties interests generally, not just those created after April 17, 2002, the date the Court handed down its decision.

There are both legal and prudential limits on this principle, however. That is, there will be situations in which other rules of law prohibit the IRS from changing course to reflect *Craft* as well as situations in which the IRS should choose to forgo such change even absent legal compulsion. There will be myriad scenarios. By way of illustration, consider the following:

(1) Under the doctrine of *res judicata*, any case decided by a court adversely to the IRS based on the old rule would be beyond correction if final judgment had been entered.[110] Absent final judgment, the IRS or the Department of Justice should be able to assert *Craft*, amending its pleadings or, in a bankruptcy case, its proofs of claim, if necessary.

(2) Pursuing entireties property would be time barred if the statute of limitations on collection already has expired.[111]

(3) There likely are a number of administrative agreements that the IRS has entered into giving the taxpayer favorable terms based on acceptance of the old rule and the failure to anticipate its overthrow. These could include accepted offers in compromise,[112] installment agreements,[113] release of lien,[114] or discharge of entireties property from the lien.[115]

On grounds of contract or estoppel by agreement, the IRS typically would be barred from abrogating the agreements, if duly approved and executed.[116] A plea of changed circumstances probably would be unavailing to the IRS, absent egregious deception or concealment of the entireties asset by the taxpayer. The IRS's own error of law (accepting the validity of the old rule) or of strategy (concluding the agreement before resolution of *Craft*) would not be grounds for ignoring the agreement.[117]

On the other hand, the IRS would not be barred were the agreement unexecuted or improperly executed.[118] Even clearer are situations in which there is no agreement at all but the IRS has "53'd" the account, treating it as "currently not collectible." Such a classification is a unilateral and provisional act by the IRS. If the taxpayer without other assets has interests in entireties property, the IRS now can, as a result of *Craft*, remove the account from "CNC" status — and it should, unless some reason for forbearance exists in the facts of the particular case.

(4) Now, a scenario in which the IRS could legally proceed but probably, prudentially, should not. Assume that assessment had been made and notice of tax lien had been filed against one spouse only. Thereafter, the two spouses sold property they held by the entireties to a third party, a bona fide purchaser for value. The purchaser either did not know about the notice of tax lien (because of an inadequate title search) or went through with the purchase anyway (emboldened by the old rule). In general,[119] a purchaser takes the property subject to the federal

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[107] Such an approach is compatible with present entireties practice. Now, if one spouse takes more than her share from entireties property or income, the other spouse can sue for an accounting. *E.g., Lacker v. Zuern*, 109 So. 2d 180, 182-83 (Fla. Dist. Ct. App. 1959). The draw/repayment mechanism suggested here is comparable to the accounting remedy.

[108] For example, the collection due process rules created in 1998. *See* sections 6320 and 6330; Johnson II, *supra* note 4, at 1182-83.

[109] *Harper v. Virginia Dep't of Taxation*, 509 U.S. 86, 97 (1993).

[110] *See, e.g., Rubel Corp. v. Rasquin*, 132 F.2d 640, 643 (2d Cir. 1943).

[111] *See* sections 6502 and 6503.

[112] Section 7122.

[113] Section 6159.

[114] Section 6325(a).

[115] Section 6325(b).

[116] *See, e.g., Guggenheim v. United States*, 77 F. Supp. 186, 196-97 (Ct. Cl. 1948).

[117] *Cf. In re Motter*, 1997 WL 685297 (Bankr. M.D. Fla. 1997) (IRS not allowed to set aside accepted offer in compromise).

[118] *See, e.g., Botany Worsted Mills v. United States*, 278 U.S. 282, 288-89 (1929); *Country Gas Service, Inc., v. United States*, 405 F.2d 147 (1st Cir. 1969).

[119] Exceptions exist, such as section 6323(b)(4) (filed lien invalid against some purchasers of personal property at retail).

tax lien once notice of the lien has been filed.[120] In light of *Craft*, the tax lien did attach to the property bought by our purchaser, so (had notice of the lien been filed before the purchase) the IRS could act against it in the purchaser's hands.

Could, but probably shouldn't. That the lien attached to the property did not become clear until after the bona fide sale. Indeed, numerous courts over generations said the lien didn't attach. The reasons for restraint described in part II above apply, if anything, more forcefully with respect to our purchaser than with respect to the spouses. The IRS can and should proceed against the debtor spouse's interest in the proceeds of the sale. But it would do well to confine itself to that recourse.

D. Valuation

The valuation of entireties interests was left open by *Craft*.[121] It will be an important matter for at least three reasons. First, to properly divide the proceeds of a section 7403 sale, one must know how much each spouse's interest is worth.

Second, the IRS will receive requests for administrative relief with respect to entireties property or from taxpayer having entireties interests. For instance, it may receive requests to issue certificates discharging property from the lien, to allow it to be sold or otherwise, in return for a payment.[122] Valuation of the interest will be needed to determine whether the suggested payment is sufficient. Or the IRS may receive an offer in compromise from a taxpayer having an entireties interest.[123] Valuation will be needed to ascertain whether an adequate amount has been included in the offer on account of that asset.

Third, what if the debtor spouse transfers his interest to the other spouse — as Don Craft did to Sandra — to try to defeat collection? The government might bring a fraudulent conveyance action. This would not require valuation since the result of such an action, if successful, is to reconvey the property into its prior ownership. Alternatively, though, the IRS might pursue a transferee liability assessment against the recipient spouse. This would entail valuation since the amount of the assessment would depend on the value of the transferred interest.[124]

So, valuation matters. How should it be conducted? Presumably, it would be a two-stage process: valuing the underlying property held by the entireties estate, then multiplying that value by a percentage reflective of the interest of the debtor spouse. The first stage presents no unique challenges. The second stage will be new and, likely, controversial.[125]

There are three main candidates for the method by which to derive the percentage: (1) open-ended "facts and circumstances" inquiry and proof, (2) a fixed percentage (presumably 50 percent) to be applied universally, and (3) actuarial valuation. These candidates are evaluated below. I prefer the second approach, but the third seems most likely to emerge as the accepted method.

1. Facts and circumstances. Untold thousands of tax controversies have involved the valuation of property and property interests. Sometimes, situationally specific rules apply, but the general rule is: "All relevant facts and elements of value as of the applicable valuation date shall be considered in every case."[126] Typically, expert testimony is required in a case involving large monetary stakes.

In entireties cases too, we could allow the parties to argue for whatever percentage they think they can sustain under all the facts and circumstances of the case and to put on whatever proof — expert or otherwise — they can adduce in support of their positions. We could, but I hope we don't.

Even now, facts-and-circumstances valuation is a blight on the system. Other than the paid experts, nobody is happy with valuation cases — not lawyers, not their clients, and certainly not judges.

First, even now, facts-and-circumstances valuation is a blight on the system. Other than the paid experts, nobody is happy with valuation cases — not lawyers, not their clients, and certainly not judges. Valuation cases expend precious judicial resources, multiply costs for the parties, and delay ultimate resolution of the controversy. Moreover, one is rarely confident that an accurate result was reached. Valuation is notoriously inexact,[127] and courts possess no particular expertise in deciding valuation disputes.[128] Subjecting a new class of cases to these ills is not an inviting prospect.

Second, valuing entireties interests would present unique difficulties. Valuation often is based on comparable sales, the prices at which similar assets are

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[120] *See* section 6323(a); *United States v. Snyder*, 149 U.S. 210 (1893); *United States v. Phillips*, 715 F. Supp. 81, 83-85 (S.D. N.Y. 1989).

[121] 122 S. Ct. at 1426 ("We express no view as to the proper valuation of [Don's] interest in the entireties property, leaving this for the Sixth Circuit to determine on remand.").

[122] *See* section 6325(b).

[123] *See* section 7122(c)(1); I.R.M. section 5.8(4)4.2 (determination of adequacy of offer).

[124] *E.g.*, *Yagoda v. Commissioner*, 39 T.C. 170, 185 (1962), *aff'd* 331 F.2d 485 (2d Cir. 1964).

[125] *Cf. LeFrak v. Commissioner*, T.C. Memo. 1993-526, 66 T.C.M. (CCH) 1297, 1307, *Doc 93-11799 (51 pages)*, *93 TNT 235-49* (1993) (for gift tax purposes, because of discounts, "[t]he fair market value of a fractional interest in real property cannot as a general rule be derived by simply applying the percentage of the interest in the whole to the value of the entire property").

[126] Treas. reg. section 20.2031-1(b) (estate tax).

[127] *E.g.*, *Commissioner v. Marshall*, 125 F.2d 943, 946 (2d Cir. 1942); *Messing v. Commissioner*, 48 T.C. 502, 512 (1967) ("inherently imprecise").

[128] *E.g.*, *Buffalo Tool & Die Mfg. Co., Inc. v. Commissioner*, 74 T.C. 441, 452 (1980).

bought and sold in their customary market.[129] There is no customary market for entireties interests — state law proscription of unilateral alienation precludes such a market.

Third, since valuing entireties interests would be a new field, many fundamental questions would have to be addressed. Precisely what facts and circumstances are relevant in the entireties context? Some — like the ages of the spouses and what state law allows and prohibits to entireties tenants — are obvious. But many questions would remain. The following are illustrative:

- Would the degree of harmony/disharmony or agreement/disagreement existing within the marriage (either generally or specifically as to the use of the entireties property) be relevant? To admit such evidence would involve intrusive inquiry, but arguably it would be a germane circumstance.[130] Parties fought these battles to exhaustion when considering the family attribution doctrine in estate and gift tax valuation.[131] Would we have to refight them in entireties interests valuation?
- Estate and gift taxation has become mired in expensive and unpredictable litigation[132] about ever more creative (or bizarre) asserted valuation premiums and discounts.[133] Discount theory has developed differently for business interests than for undivided fractional shares of property ownership.[134] Facts-and-circumstances valuation inevitably would involve years of litigation as to which, if any, discounts are appropriate for entireties interests and, in particular cases, the amounts of these discounts.
- There is a potential "whole versus sum of the parts" problem. Courts have remarked in a number of contexts that the sum of the values of all the ownership interests in particular assets may, after adjustment for associated discounts and premiums, be less than the value of the property itself.[135] It is not hard to foresee such an argument being made as to entireties interests. The restrictions on unilateral action by either spouse could be asserted to leave each's interest as having a value of under half of the value of the underlying property held by the entireties estate.

  Acceptance of such an argument, however, would produce mischievous results. For instance, assume unpaid taxes of $5,000, no creditor other than the IRS, and entireties property worth $10,000. Assume further that the property is sold under section 7403 yielding $10,000, and that because of discounts attached to each, both the debtor's interest and the nondebtor's interest are valued at 40 percent of the whole property's value. Then, the nondebtor spouse would receive $4,000 of the sale proceeds, as would the IRS standing in the debtor's shoes. What would happen to the remaining $2,000 of proceeds? The common-sense answer would be to split it between the nondebtor spouse and the IRS. But that would be inconsistent with the valuation made — leaving each with 50 percent rather than 40 percent.

  The difficulty in the preceding paragraph is only conceptual. More seriously, there could be practical problems as well. For instance, the more sharply the debtor spouse's interest is discounted, the more tempting it would be for her to transfer it to the other spouse, rather than allow the IRS to proceed against it. The IRS could pursue a tranferee liability assessment against the recipient,[136] but the amount recoverable thereby would be limited to the value of the transferred interest.[137] The result is that the transfer would have enriched the nondebtor spouse by more than half the value of the property (she or he now is the fee simple owner, freed of any restrictions on alienation), but the IRS would be able to collect from the nondebtor spouse as a transferee less than half of the value of the property (only the discounted value of the tranferor spouse's interest).

Further examples could be given. In short, facts-and-circumstances valuation inevitably will give rise to claims that the sum of the values of the two spouses' entireties interests is less than the value of the property owned by them by the entireties. Acceptance of these claims by the courts would lead to anomalous results in a number of contexts.

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[129]*E.g.*, Treas reg. section 20.2031-1(b).

[130]The greater the likelihood of agreement, the less it matters that agreement has to be obtained for certain actions. On the other hand, the willing buyer/willing seller test is fundamental to valuation. *See, e.g., United States v. Cartwright*, 411 U.S. 546, 551 (1973); Treas. reg. sections 20.2031-1(b) and 25.2512-1. That test assumes *hypothetical* buyers and sellers and is not personalized to a particular buyer or seller. *E.g., Kolom v. Commissioner*, 71 T.C. 235, 244 (1978), *aff'd* 644 F.2d 1282 (9th Cir. 1981). Thus, considering the degree of family accord could be inconsistent with the test. *See Estate of Bonner v. United States*, 84 F.3d 196, 198, *Doc 96-16744 (4 pages), 96 TNT 111-13* (5th Cir. 1996).

[131]*See, e.g., Estate of Bright v. United States*, 658 F.2d 999 (5th Cir. 1981); Rev. Rul. 93-12, 1993-1 C.B. 202.

[132]A commentator recently titled an article "Is There Rhyme or Reason to Business Valuation Cases in the Tax Court?" Steven A. Horowitz, *Taxes*, June 2002, p. 11. He noted that "taxpayer planning has been increasingly more aggressive in the area of valuation discounts" for business interests and concluded that "the Tax Court has cast doubt on its credibility" in deciding such cases. *Id.* at 11. Whether one agrees or disagrees, it is hard to be happy about the state of valuation doctrine.

[133]The numerous cases defy ready cataloguing, much less comprehension. For a start, see Regis W. Campfield, Martin B. Dickinson, and Willaim J. Turnier, *Taxation of Estates, Gifts and Trusts* ch. 11 (22d ed. 2002).

[134]*See, e.g.*, James John Jurinski, "Death Tax Reduction Using Family-Owned Fractional Interests," 29 *Real Estate Tax'n* 137, 138 (2002).

[135]*E.g., Estate of Bonner v. United States*, 84 F.3d 196, 197 (5th Cir. 1996); *Estate of Chenoweth v. Commissioner*, 88 T.C. 1577, 1589-90 (1987) (*dictum*).

[136]*See* section 6901.

[137]*See* note 124 *supra*. The IRS also might be entitled to interest but that is a complex area under transferee liability. *See* Elliott, *supra* note 3, para. 18.06[3].

Finally, a fairness concern. Horizontal equity, the notion that similarly situated taxpayers should be treated similarly, is one important aspect of a fair tax system.[138] One of the problems with the old rule was that it treated taxpayers differently based on factors that should not be relevant to the tax system, thus traducing horizontal equity.[139] The principle can be fractured as surely in the implementation of a rule as in the formal statement of that rule. The fact-finding and adjudication infirmities associated with facts-and-circumstances valuation essentially guarantee that were that approach chosen, there would be valuation discrimination among taxpayers. We should not trade a formally unfair rule for an implementationally unfair rule.

2. Fixed percentage. Instead of trying to unravel the Gordian Knot, Alexander cleaved it with one stroke of an axe. Similarly, the variability and uncertainty of facts-and-circumstances valuation can be dispatched by one stroke of the legislative pen. That is, Congress could provide a statutory valuation binding in all cases. Were it to do so, the most likely candidate would be a 50 percent-50 percent allocation: The husband's entireties interest and the wife's entireties interest each would be set at half of the value of the underlying property held by the entireties estate.

> ***The '50 percent solution' has common-sense appeal and is consistent with a number of rules, both state and federal, as to entireties interests and property.***

In *Craft*, the IRS agreed to discharge the parcel from the tax lien and to permit Sandra to sell it with the stipulation that half of the net proceeds of the sale be held in escrow pending litigation of the IRS's claim.[140] The original decision of the district court in the case awarded the IRS half of the proceeds.[141]

The "50 percent solution" has common-sense appeal and is consistent with a number of rules, both state and federal, as to entireties interests and property. For instance:

- Each spouse is entitled to a share of rents and profits derived from the entireties property. In many states, that right is fixed at one-half for each.[142]
- The spouses are allowed to end their entireties estate by agreement and to divide the property between them in the proportions they choose. Fifty-fifty is the default rule for this purpose. If the agreement fails to state the proportions, the courts will make a 50-50 division.[143]
- Property that has been used illegally may be subject to forfeiture. A 50-50 rule is used for at least some state forfeiture purposes.[144]
- The starting point in measuring the amount of any federal estate tax owed by a decedent's estate is calculating his or her gross estate. The code directs that one-half of property owned by the decedent and his or her spouse as tenants by the entireties be included in the gross estate.[145]
- For federal income tax purposes, any rents, interest, or other income produced by entireties property is taxed one-half to each spouse if the spouses file separate returns.[146] A similar rule applies as to deductions with respect to entireties property.[147]

The objection to a fixed percentage would be its possible imprecision in some cases.[148] Yes, some inexactitude could exist, but that condition is far from unique. Often times in taxation — or indeed in legal rules generally — we choose a bright line, concluding that the benefit of clarity outweighs possible imprecision in some cases. Some of the 50-50 rules cited above are examples, and numerous examples from other areas also could be adduced.[149]

It is worth remembering that not just a fixed percentage but all valuation approaches involve some imprecision since valuation inherently entails "a conjecture, a guess, a prediction, a prophecy."[150] Actuarial valuation is prey to the fact that individuals often live longer or shorter than what is predicted by group

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[138]*E.g., Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 544 (1979); *Commissioner v. Sunnen*, 333 U.S. 591, 599 (1948).

[139]*See* Johnson I, *supra* note 4, at 852-55.

[140]*Craft*, 122 S. Ct. at 1419.

[141]*Craft v. United States*, 1994 WL 669680, at *3 (W.D. Mich. 1994).

[142]*E.g., Craft*, 122 S. Ct. at 1422; *In re Odegaard*, 31 B.R. 718, 721 (Bankr. D. Or. 1983); *Brown v. Hanger*, 368 So. 2d 63, 64 (Fla. Dist. Ct. App. 1979).

[143]*E.g., Sheldon v. Waters*, 168 F.2d 483, 486 (5th Cir. 1948).

[144]*E.g.*, N.C. Gen. Stat. section 75D-8 (1990); *see* Eric G. Zajac, "Tenancies by the Entirety & Federal Civil Forfeiture Under the Crime Abuse Prevention & Control Act: A Clash of Titans," 54 *U. Pitt. L. Rev.* 553 (1993) (urging use of the North Carolina approach for federal forfeiture purposes).

[145]Section 2040(b)(1), (2)(A).

[146]*E.g., Morgan v. Finnegan*, 87 F. Supp. 274, 278 (E.D. Mo. 1949), *aff'd* 182 F.2d 649 (8th Cir. 1950).

[147]*E.g., Cox v. Commissioner*, T.C. Memo. 1993-326, 66 T.C.M. (CCH) 192, *Doc 93-8004, 93 TNT 154-15*.

[148]For example, if one spouse is much older than the other or has a mortal illness, that spouse likely would have much less use of the property than the other.

[149]For instance, section 2701 was enacted in 1990 as part of the government's long effort to curb estate freeze techniques. Central to the section are two special valuation rules: the minimum value rule of section 2701(a)(4)(A) (issued common stock must be assigned a value of not less than 10 percent of the total enterprise value of the company) and the zero value rule of section 2701(a)(3)(A) (the interest retained by the transferor is assigned a value of zero under some conditions). A 50-50 rule for entireties interests valuation is likely to entail less artificiality and inaccuracy than these section 2701 rules.

[150]*Commissioner v. Marshall*, 125 F.2d 943, 946 (2d Cir. 1942).

averages.[151] Facts-and-circumstances valuation is no better than the experience, integrity, available time, and communicative abilities of the expert witnesses and the insightfulness of the judges hearing them permit — and these human and institutional limitations can be great indeed.[152]

My suspicion is that Congress will choose not to visit this area. If it does, however, the 50 percent solution would be a reasonable way to resolve entireties valuation. It would be far better, in my estimation, than open-ended facts-and-circumstances valuation.

An interesting question would arise were the fixed percentage provided not by Congress through statute but by the Treasury and the IRS through a regulation. Would the regulation be valid? I think not. Section 7520 provides, for purposes of the code, that "the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest shall be determined . . . under tables prescribed by the [Treasury] and [using a prescribed interest rate]."[153] Entireties interests do not fit comfortably into the enumeration, and a fixed percentage would not be a "table" within the contemplation of the section.[154]

So, section 7520 is not an express delegation to Treasury of authority to provide a fixed percentage by regulation, nor can I find any other section that is. Accordingly, such a regulation would be pursuant only to the general authority of Treasury to issue regulations.[155] As such, it would be only an interpretive regulation not a legislative regulation, so (at least in theory) would be entitled to a lesser degree of deference if challenged in court.[156]

Prescribing a fixed valuation percentage is so inherently a legislative act that I doubt a merely interpretive regulation prescribing a fixed percentage could be sustained. Congress decreed via statute the 50-50 rule as to inclusions of entireties interests in the gross estate.[157] A similar rule for collection purposes would seem to deserve equal dignity. A fixed percentage regulation likely would be invalid. It goes without saying that I believe an attempt to fix a percentage by some administrative pronouncement inferior to a regulation — like a revenue ruling or procedure — would be beyond the authority of the IRS.[158]

3. Actuarial valuation. Two of the key aspects of entireties tenancies are the right to use the property and the right of survivorship. The spouse who lives the longer will have greater personal use of the property and will be able to bequeath the whole property to whomever he or she wishes, if it is not consumed or alienated during life. Lacking clairvoyance, we do not know how long each spouse will live. We could make do, though, with actuarial valuation.

Actuarial tables have been developed and are used widely in tax valuations, especially for transfer tax purposes.[159] Moreover, in *United States v. Rodgers*,[160] the Supreme Court held that the government could seek section 7403 judicial sale (with division of proceeds) of homestead property. In *dicta*, the Court illustrated how the division between the IRS (taking the place of the debtor spouse) and the nondebtor spouse could be effected:

> The exact method for the distribution required by section 7403 is not before us at this time. But we can get a rough idea of the practical consequences of the principles we have just set out. For example, if we assume, *only for the sake of illustration*, that a homestead estate is the exact economic equivalent of a life estate, and that the use of a standard statutory or commercial table and an 8 percent discount rate is appropriate in calculating the value of that estate, then three nondelinquent surviving or remaining spouses, aged 30, 50, and 70 years, each holding a homestead estate, would be entitled to approximately 97 percent, 89 percent, and 64 percent, respectively, of the proceeds of the sale of their homes as compensation for that estate. In addition, if we assume that each of these hypothetical nondelinquent spouses also has a protected half-interest in the underlying property being sold, then their total compensation would be 99 percent, 95 percent, and 82 percent, respectively, of the proceeds from such sale.[161]

This approach has been applied by lower courts valuing homestead interests, but with the modification arising from the *Harris* line of cases. In *Harris*,[162] the district court valued the nondebtor spouse's one-half interest in a homestead at an amount equal to one-half of the proceeds from the sale of the property. On appeal, that spouse argued for a higher valuation, urging a strict application of the *Rodgers* illustration. The Fifth

[151]The problems with valuation via standardized tables have been recognized but not fully satisfactorily resolved. *See, e.g., Bank of California v. United States*, 672 F.2d 758, 759-60 (9th Cir. 1982); Rev. Rul. 80-80, 1980-1 C.B. 194.

[152]*See* part III.D.1. *supra*.

[153]Section 7520(a).

[154]*See* section 7520(c).

[155]*See* section 7805(a) (generally authorizing Treasury to "prescribe all needful rules and regulations for the enforcement of [the code]"). For discussion of nonlegislative administrative rules generally, see Robert A. Anthony, "Three Settings in Which Nonlegislative Rules Should Not Bind," 53 *Admin. L. Rev.* 1313 (2001), and William Funk, "A Primer on Nonlegislative Rules," 53 *Admin. L. Rev.* 1321 (2001).

[156]*See, e.g., United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 24-25 (1982); *Rowan Cos., Inc. v. United States*, 452 U.S. 247, 252-53 (1981).

[157]*See* section 2040(b).

[158]For discussion of the respective weights of administrative tax authorities, see Gail Levin Richmond, *Federal Tax Research: Guide to Materials and Techniques* 76-119 (1997 ed.).

[159]*See, e.g.*, Treas. reg. section 20.2031-7.

[160]461 U.S. 677 (1983).

[161]*Id.* at 698-99 (emphasis in original) (footnotes omitted). The calculations were based on a table in a state statute, but the Court also noted federal estate tax tables and commercial tables. *See id.* at 699 n.26.

[162]*Harris v. United States*, 588 F. Supp. 835 (N.D. Tex. 1984), *aff'd* 764 F.2d 1126 (5th Cir. 1985).

Circuit disagreed, because of a factual difference. In *Rodgers*, the debtor spouse had died before the litigation.[163] Accordingly, the Court used a single-life table in calculating the examples in its hypothetical. In *Harris*, though, both spouses were alive. Thus, the Fifth Circuit held for the use of joint-life, rather than single-life, tables and affirmed the district court's valuation.[164]

A number of courts have followed *Harris*, both as to homesteads[165] and entireties interests, notably in *Pletz*.[166] *Pletz* involved entireties interests in a partial bar state, and its facts more closely resembled *Harris* than *Rodgers*.[167] The courts therefore used joint-life actuarial tables, corrected for the difference in anticipated lifespan between the spouses, and held, based thereon, that the wife had a 53.2 percent interest in the property and the husband had a 46.8 percent interest.[168]

I suspect that actuarial valuation along these lines will emerge as the norm, particularly in the absence of legislation. Even *dicta* from the Supreme Court is accorded great respect. Moreover, a number of decisions have explored this avenue, and the tried-and-familiar holds great attraction for judges.

This approach clearly would be superior to open-ended facts-and-circumstances valuation. For one thing, it would avoid the "whole versus sum of the parts" problems described earlier[169] because joint tables are constructed to sum to 100 percent.[170]

Also, litigation costs, uncertainties, and inconsistencies would be considerably reduced. There would be some areas of controversy, to be sure, but they would be fewer in number and standardized in nature. One class of disputes would involve which of the several sets of actuarial tables to use in a given case. The Treasury tables are an obvious candidate,[171] but commercial and other tables exist as well. Which discount rate is appropriate also may be disputed. And, there will be cases in which the actual facts diverge starkly from the averages on which the tables are predicated, making resort to the tables inappropriate.[172] Skirmishing about these and related questions can be anticipated but should be managable.

IV. Conclusion

In its *Craft* decision, the Supreme Court brought treatment of entireties interests in line with federal tax lien analysis generally. That was a salutary step. How the new regime is received will depend on how implementation issues are handled by the IRS and the courts.

To allow property owners and the private sector to adjust, the IRS would do well to proceed cautiously in implementing *Craft*. This is especially so when concern for the nondebtor spouse is at its highest, that is, when that spouse did not participate or collude with the delinquent spouse in a scheme to avoid tax and when the property held by the entireties occupies a place of great significance in the personal or economic life of the nondebtor spouse. This cautious approach should inform both retroactive and prospective applications of *Craft*.

When the IRS does feel compelled to proceed with enforced collection, it will best do so pursuant to section 7403 sale and division of proceeds. Reasonable valuation methods already exist (and could be refined) to effect such divisions, and the procedures under section 7403 can appropriately protect the legitimate interests of the nondebtor spouse.

The old view overthrown by *Craft* produced controversy and error for generations. Inevitably, there will be controversy as to the implementation of *Craft*. However, reasonable sensitivity and enlightened awareness of self-interest on the part of the IRS could go far toward minimizing this controversy.

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[163] 461 U.S. at 685.

[164] 764 F.2d at 1130-32.

[165] *E.g., United States v. Molina*, 764 F.2d 1132 (5th Cir. 1985); *United States v. Anderson*, 1991 WL 236849, at *3-4 (D. S.D. 1991).

[166] *In re Peltz*, 225 B.R. 206 (Bankr. D. Or. 1997), *aff'd* 234 B.R. 800 (D. Or. 1998), *aff'd* 221 F.3d 1114 (9th Cir. 2000).

[167] "*Rodgers* involved the valuation of only a single life estate interest in property *after the debtor had predeceased his nondebtor spouse*. . . . Here the Debtor is still alive and has both an undivided right to the Property for his life and a right of survivorship. In fact, he still occupies the Property." 221 F.3d at 1117 (emphasis in original) (citations omitted).

[168] *Id.* at 1116.

[169] *See* text accompanying notes 135 to 137 *supra.*

[170] *See Harris*, 764 F.2d at 1131.

[171] *See, e.g., United States v. Baran*, 996 F.2d 25, 28, *Doc 93-7591, 93 TNT 144-13* (2d Cir. 1993) (applying Treasury tables in preference to opinion of spouse's appraiser); *In re Hansen*, 95 B.R. 586, 588 (Bankr. C.D. Ill. 1989) (Treasury tables not accorded force of law status in bankruptcy case but "their use in valuing life estates is well-accepted").

[172] *See, e.g., O'Reilly v. Commissioner*, 973 F.2d 1403, 1407-08 (8th Cir. 1992); *Weller v. Commissioner*, 38 T.C. 790, 803 (1962); Treas. reg. sections 20.7520-3 and 25.7520-3.