



THE ENFORCER

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TENANCY BY THE ENTIRETY IN THE WAKE OF CRAFT: CONSEQUENCES FOR DIVORCE JUDGMENTS

What happens when a federal tax lien has been placed on entireties property as a result of the tax delinquency of a spouse? In the wake of the U.S. Supreme Court's decision in *Craft*, innocent spouses are paying the price for the tax obligations of their partner.¹ *Craft* holds that the IRS may attach a lien to property held in tenancy by the entirety and levy that lien to the extent of the debtor's interest in the property. What each spouse's interest is in the property is open for debate.

The Decision in *Craft v. US*

Under Michigan property law neither spouse in a tenancy by the entirety is considered to have any individual property right or interest. Thus, creditors of just one spouse are precluded from levying liens against entireties property. In *Craft*, the U.S. Supreme Court held that property held in tenancy by the entirety could no longer be insulated from a levy arising out of a federal tax obligation of one spouse. The Court held that a tenancy by the entirety provided each spouse, "some of the most essential property rights"² and thus an individual interest which could be subject to a federal tax lien. Where in the past the marital home would have been protected from the creditors of a delinquent spouse, the IRS was now permitted to place a lien on the debtor's interest and sell the property in some instances.

Valuing Each Spouse's Interest in Entireties Property

Craft made clear that the broad language of the federal tax lien statute indicated Congress' intent to reach every interest that the taxpayer had in the property.³ However, *Craft* intentionally left unresolved the issue of what each spouse's interest in the property was when the IRS sought to collect on the lien.⁴ Since the decision was handed down in 2002, the federal courts have been reluctant to assume *Craft*'s invitation and have in large part avoided the issue.

The circuits that have addressed the issue have done so primarily in the context of bankruptcy, however those

decisions deal with similar issues as are present in federal tax lien cases. Three approaches have emerged. Courts have (1) evaluated each spouse's interest either by use of actuarial tables to determine the life expectancy of each spouse; (2) have deemed that each spouse has a 50% interest; or (3) in the case of the 6th Circuit, that each spouse is considered to possess a 100% interest.⁵

The Sixth Circuit in a 2005 bankruptcy case arrived at a disturbing conclusion as to how each spouse's interest in a tenancy by the entirety should be valued.⁶ In *Brinley*, the court emphasized that a tenancy by the entirety vests in each spouse ownership of the entire estate from the moment that it is created. Since each spouse had an undivided whole interest in the property, the court believed that a debtor had a 100% interest in the property. Thus, encumbered property held in tenancy by the entirety could be sold with *all* of the proceeds going to the IRS, and nothing to the innocent spouse.

It remains unclear whether the Sixth Circuit's startling conclusion in *Brinley* would be applicable where the tenancy has been severed by a divorce, and what if any affect valuation of interests in a divorce judgment would have. However, if the tenancy is intact an innocent spouse should beware of the IRS's ability sell the marital home and take all of the proceeds.

The Third Circuit has arrived at a more reasonable conclusion in valuing each spouse's interest in a tenancy by the entirety.⁷ In *Popky v. United States*, the court reasoned that in a tenancy by the entirety each spouse has both an entire interest and a half interest in the property. The court was persuaded to value each spouse's interest at 50%, as if the tenancy was severed and the property sold, each spouse would be entitled to an equal share in the proceeds. Therefore, under this approach, the innocent spouse would be entitled to half of the proceeds and the IRS to the other half.

Still other courts have chosen to employ the use of actuarial tables to determine each spouse's interest in the tenancy based upon their life expectancy.⁸ Reliance on actuarial tables is rationalized by courts employing this approach as necessary because of the survivorship interest that each spouse has in a tenancy by the entirety. Thus, the calculated life expectancy of each spouse will dictate the interest in the



property that the debtor spouse has and permit the IRS to collect only on that portion of the property.

An Approach to be Advocated

While there are no cases directly dealing with the impact of a divorce judgment and the assignment of varying interests to each spouse, there has been support for the proposition that these determinations should be taken into account when valuing each spouse's interest.⁹ Most courts, with the exception of the 6th Circuit, have adopted the approach of assigning each spouse a half interest in the property. Indeed this is the position advocated by the IRS. However, when there is a divorce judgment involved, each spouse's interest should be adjusted based upon the interest assigned to each as *adjudicated* by a family court. It is unlikely that the parties could enter into a consent judgment awarding all interests to an innocent spouse in avoidance of the tax lien. Until the courts address this issue, in the interim innocent spouses (and their counsel) should be mindful of their vulnerability to federal tax liens being levied against their home.

ENDNOTES

1. *Craft v. United States*, 535 U.S. 274 (2002).
2. *Id.* at 283.
3. *Id.*, see 26 U.S.C. § 6321.
4. See *Id.* at 245 ("We express no view as to the proper valuation of respondent's husband's interest in the entirety property").
5. See *Brinley v. LLP Mortgage, Inc.*, 403 F.3d 415 (6th Cir. 2005); *Popky v. United States*, 419 F.3d 242 (3rd Cir. 2005); *In re Levinson*, 372 B.R. 582 (Bkrtcy. E.D.N.Y. 2007); *In re Murray*, 318 B.R. 211, 214 (Bankr. M.D. Fla. 2004); *Peltz v. United States*, 221 F.3d 1114 (9th Cir. 2000).
6. *Brinley*, 403 F.3d 415.
7. *Popky*, 419 F.3d 242.
8. See *In re Murray*, 318 B.R. 211; *Peltz*, 221 F.3d 1114.
9. *Kimberly A. Butlak, When is a Tenancy by the Entirety Interest in Common Law Jurisdictions an Asset of One Spouse?*, 34 U. Balt. L. Rev. 287 (2005).

