TAX COLLECTIONS AND THE TEXAS HOMESTEAD

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I. INTRODUCTION. When the question of whether the IRS can seize a homestead in Texas for a federal tax debt is asked, most tax practitioners would say, "Yes, the IRS can levy, foreclose, seize all of the delinquent taxpayer's assets." A non-tax practitioner would likely say no, the taxpayer's homestead is sacred in Texas and cannot be lost to satisfy a federal tax liability. Neither answer, of course, is entirely accurate. The correct answer in typical tax non-answer jargon is, "It depends."

II. THE TYPICAL FACT PATTERNS. There are four distinct fact patterns that control the outcome of an attempt by the IRS to levy upon and seize a residence[1] for unpaid federal taxes. Obviously, there are variations that can occur within the basic fact patterns but, such variations normally have only minor impact to the result. The following ownership patterns produce different, and in at least one case, quite surprising results:

(i) The residence is Texas community property and both spouses are liable for the tax;

(ii) The residence is Texas community property and only one of the spouses is liable for the tax;

(iii) Only one spouse is liable for the tax and the residence is the separate property of the liable spouse; and

(iv) Only one spouse is liable for the tax and the residence is the separate property of the non-liable spouse.

III. THE APPLICABLE STATUTORY LAW. The following outlines the basic law from which controls the case law applying to homestead seizure for tax.

A. <u>U.S. Constitution</u>.

Article VI [2] This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

[1] The tax term "residence" is used throughout this outline and each time it is used in an example it is assumed that the residence qualifies as a homestead under Texas law.

B. Texas Constitution.

Article 16

Section 50(a). The homestead of a family, or of a single adult person shall be, and is hereby protected from a forced sale, for the payment of all debts except for: *** (2) The taxes due thereon;...

Section 52. DESCENT AND DISTRIBUTION OF HOMESTEAD; RESTRICTIONS ON PARTITION. On the death of the husband or wife, or both, the homestead shall descend and vest in like manner as other real property of the deceased, and shall be governed by the same laws of descent and distribution, but it shall not be partitioned among the heirs of the deceased during the lifetime of the surviving husband or wife, or so long as the survivor may elect to use or occupy the same as a homestead, or so long as the guardian of the minor children of the deceased may be permitted, under the order of the proper court having the jurisdiction, to use and occupy the same.

C. Texas Law Applicable to Property Exposure for Debts.

1. Texas Family Code §3.202 RULES OF MARITAL PROPERTY LIABILITY

(a) A spouse's separate property is not subject to liabilities of the other spouse unless both spouses are liable by other rules of law.

(b) Unless both spouses are personally liable as provided by this subchapter, the community property subject to a spouse's sole management, control, and disposition is not subject to:

(1) any liabilities that the other spouse incurred before marriage; or
(2) any nontortious liabilities that the other spouse incurs during marriage.

(c) The community property subject to a spouse's sole or joint management, control, and disposition is subject to the liabilities incurred by the spouse before or during marriage.

(d) All community property is subject to tortious liability of either spouse incurred during marriage.

2. Texas Property Code §41.001. INTERESTS IN LAND EXEMPT FROM SEIZURE

(a) A homestead and one or more lots used for a place of burial of the dead are exempt from seizure for the claims of creditors except for encumbrances properly fixed on homestead property.

(b) Encumbrances may be properly fixed on homestead property for:

(1) purchase money;
(2) taxes on property….

D. Internal Revenue Code.

1. SECTION 6321. **LIEN FOR TAXES**. If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States *upon all property and rights to property*, whether real or personal, belonging to such person.

2. SECTION 6331. LEVY AND DISTRAINT. (a) AUTHORITY OF SECRETARY. – If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy *upon all property and rights to property*….

3. SECTION 7403. ACTION TO ENFORCE LIEN OR TO SUBJECT PROPERTY TO PAYMENT OF TAX (a) FILING. – In any case where there has been a refusal or neglect to pay any tax, or to discharge any liability in respect thereof, whether or not levy has been made, the Attorney General or his delegate, at the request of the Secretary, may direct a civil action to be filed in a district court of the United States to enforce the lien of the United States under this title with respect to such tax or liability or to subject any property, of whatever nature, of the delinquent, or in which he has any right, title, or interest, to the payment of such tax or liability. For the purposes of the preceding sentence, any acceleration of payment under section 6166(g) shall be treated as a neglect to pay tax.

4. SECTION 7520(a). GENERAL RULE. For purposes of this title, the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest shall be determined –

(1) under tables prescribed by the Secretary, and
(2) by using an interest rate (rounded to the nearest 2/10ths of 1 percent) equal to 120 percent of the Federal midterm rate in effect under section 1274(d)(1) for the month in which the valuation date falls.

IV. THE FACT PATTERNS AND THE EVOLVEMENT OF THE LAW.

A. <u>Community Property; Both Spouses Liable</u>. The initial fact pattern is simple: The residence is community property and both spouses are liable for the tax because they filed a joint return. While the Texas Constitution and Texas Property Code prohibit the collection of tax that is not *tax on the property* by foreclosure of a homestead, the federal law (IRC Sections 6321 and 7403) override the Texas Constitution and Texas Property Code pursuant to the U.S. Constitution Supremacy Clause. Because this fact pattern is the most frequently encountered fact pattern, it causes most people to believe the IRS can always foreclose on the homestead but, as will be seen, variations of the facts produces a different result.

B. Community Property; One Spouse Liable. The second most frequently encountered fact pattern is the same as presented in IV.A, but with a significant variation. The residence is community property but only one spouse is liable for the tax. The liable spouse may have filed a separate return or, as shows up with remarkable frequency in the case law, the liable spouse has been assessed a payroll tax liability, either a direct liability for the tax or an assessed Section 6672 penalty. The 5th Circuit Court of Appeals decision in *Harris*, hereafter discussed, is the guidance presently followed by the IRS but before one can understand *Harris*, the U.S. Supreme Court decision in *Rodgers v. United States*, 461 U.S. 677 (1983) must be considered.

1. *Rodgers v. United States.* While homestead survivorship rights may have been a target of IRS collection activity prior to *Rodgers*[2], it was the *Rodgers* decision that caused the IRS to focus on homestead survivorship rights as a property right.

(a) Lucille Boscoe Rodgers lived in Texas in a home that was the community property of Phillip Boscoe and Lucille during their marriage. Phillip died in 1974 at a time when he owed assessed taxes to the IRS. Lucille was not liable for any part of the tax. The IRS filed liens on the residence prior to Phillip's death and, subsequent to his death, the IRS attempted to foreclose the lien. Lucille's position was that under the Texas Constitution she had a right to live in the residence until her death because it was a homestead and the IRS has to wait until she died to foreclose. The IRS position was that not only could the IRS foreclose immediately, Lucille's survivorship right of occupancy could be ignored.

(b) The U. S. Supreme Court disagreed with both parties and held that the IRS could foreclose on the residence, and a sale of the residence could be ordered by the district court, but Lucille had to be compensated for her lifetime right to occupy the residence as provided by the Texas Constitution. The Court held that the government's lien under Section 6321 could not extend beyond the property interests held by the delinquent taxpayer and that the government could not collect more than the value of the taxpayer's property interests subject to Lucille's survivorship right to occupy the homestead for her life.

[2] *See e.g.*, United States v. St. Clair, 45 AFTR 2d 80-1528 (N.D. Tex. 1980) a pre *Rodgers* decision. There the court allowed the foreclosure of a community property homestead for husband's separate tax liability and the wife received none of the proceeds representing her survivorship right.

Apparently, the IRS believes that the Supreme Court determined the privilege of lifetime occupancy pursuant to the Texas Constitution to be a right to property and not merely a statutory entitlement or inchoate personal privilege. But, is it?

(c) The question then became how would the value of such a right be calculated. The Court laid down a practical solution which was to simply apply a life estate calculation to determine the value of Lucille's survivorship right. The Court did not mandate the form of the life estate calculation, indeed, as an illustration of how a life estate would be calculated the Court discussed the use of a "standard statutory or commercial" table.

(d) In reaching its decision, the IRS also held that under certain facts and circumstances, the IRS could not sell the residency immediately but would have to wait on the death of the surviving spouse. See V.A hereafter.

2. *Harris v. United States,* 764 F. 2d 1126 (5th Cir. 1985). Two years after the *Rodgers* decision, the Fifth Circuit Court of Appeals was faced with a fact pattern similar to *Rodgers* but with one major distinction: both spouses were still alive.

(a) Sarah Harris (the appellant) and John Harris were married in 1973. In 1977 they purchased a home. In 1978, John incurred a payroll tax liability. On May 17, 1979, the IRS and John Harris stipulated to the amount of debt in bankruptcy proceedings. On June 22, 1979, the IRS filed a lien and on July 13, 1979 Sarah was awarded the home by a judgment in a divorce proceeding. Sarah sold her home (which had been community property) and by agreement with the IRS a portion of the sales proceeds were escrowed. The fight was over the split of the proceeds. Sarah argued that she should be entitled to a life estate equivalent based on the single life tables and alternatively one-half of the proceeds of her one-half community property.

(b) The court rejected Sarah's arguments and determined that under Texas law debts incurred during marriage are presumed to be debts of the community and all the community property is eligible to satisfy the debts of *either* husband or wife; therefore, the only interest she was entitled to retain was her homestead survivorship interest determined on the two life table, not the single life table as in *Rodgers* where only one party to the marriage was alive at the time of the foreclosure.

(c) In reaching its conclusion, the Court in *Harris* made a statement that has proven to be somewhat misleading to the IRS and thus, problematic for taxpayers. The Court was trying to show that Sarah's one life table position had to be erroneous because at the time of the lien John also had a survivor's homestead right and, if they were both valued on a one life table, the two combined values would exceed 100%. In making its point, the Court made the following simple observation:

> "In this case, the following interests existed in the Harrises' residence. First, at the time of assessment notice and attachment of the lien, Sarah and John owned a joint homestead interest in the residence, which is the economic equivalent of a joint life estate. Second, Sarah and John each owned a contingent homestead interest or life estate, which would become a possessory interest in favor of the surviving spouse. Finally, Sarah and John jointly owned the remainder interest in the property."
>
> 764 F.2d 1126, 1131.

(d) The Fifth Circuit Court of Appeals mandated very specific tables for the calculation of the life estate there in issue. The government asserted in *Harris* that the appropriate tables to apply in determining the life estate was found in Treasury Publication 723A, Actuarial Values II: *Factors at 6 Percent Involving One and Two Lives* (1971). The taxpayer in *Harris* argued that a question of fact existed as to which actuarial table measured her life expectancy. The Court adopted the use of the treasury tables for the purpose of determining the life estate and, while acknowledging that the regulatory tables had not attained the force of law by applying them, the Court in essence bestowed the force of law on the tables.

(e) Subsequent to *Harris*, pursuant to the short statement in *Harris* quoted above, the IRS developed the following formula (hereafter the "*Harris* Formula").

REQUIRED FACTORS FROM PUBLICATION 1457
A. Taxpayer Remainder Factor
B. Taxpayer Life Estate Factor
C. Spouse Remainder Factor
D. Spouse Life Estate Factor
E. Two Life Remainder Interest
COMPUTATION OF FIRST TO DIE
F. First to Die Remainder Factor (A + C – E)
G. First to Die Income Factor (1.0 – F)

TAXPAYERS SHARE
H. One Half of Joint Life Estate (G ÷ 2)
I. Deferred Contingent Life Estate (B – G)
J. Remainder (E)
K. Total (H + I + J)
SPOUSES SHARE
L. One-Half of Joint Income Interest (G ÷ 2)
M. Deferred Contingent Life Estate (D – G)
N. Total (L + M)
CHECK
Total of Taxpayer and Spouse's Interests (K + N)

(f) Applying the *Harris* Formula calculation for the respective interests in the community property residence where the liable spouse (H) is 56 and the non-liable spouse (W) is 55 and the Section 7520 rate at the particular time of sale is 2.4%.

REQUIRED FACTORS FROM PUBLICATION 1457	
A. Taxpayer (Liable Spouse) Remainder Factor	.57383
B. Taxpayer Life Estate Factor	.42617
C. Non-Liable Spouse Remainder Factor	.56322
D. Non Liable Spouse Life Estate Factor	.43678
E. Two Life Remainder Interest	.48605
COMPUTATION OF FIRST TO DIE	
F. First to Die Remainder Factor (A + C – E)	.65100
G. First to Die Income Factor (1.0 – F)	.34900
TAXPAYERS SHARE	
H. One Half of Joint Life Estate (G ÷ 2)	.17450
I. Deferred Contingent Life Estate (B – G)	.07717
J. Two Life Remainder (E)	.48605
K. Total (H + I + J)	.73772
SPOUSES SHARE	
L. One-Half of Joint Income Interest (G ÷ 2)	.17450
M. Deferred Contingent Life Estate (D – G)	.08778
N. Total (L + M)	.26288
CHECK	
Total of Taxpayer and Spouse's Interests (K + N)	.10000

C. <u>Separate Property Owned by the Liable Spouse</u>. In the event the liable spouse owns the home but is married at the time of the seizure, the non-liable spouse must be compensated for his or her Texas homestead survivorship right pursuant to the *Rodgers* decision. Unlike the *Harris* decision where the home was community property, the non-liable spouse has no potential for a remainder interest, just a life possessory right if the non-liable spouse survives the liable spouse. The computation therefore is a different formula then that in *Harris*, and not exactly like that in *Rodgers* (where the liable spouse was dead) because the only value the non-liable spouse has is a lifetime possessory right *if* the non-liable spouse survives the liable spouse. Accordingly, a two life formula without the remainder interest factors must be used.

Accordingly, applying the same facts as set out in the example at IV.B.2(f) except the residence is the separate property of the liable spouse, then the non-liable spouse's only interest is a contingent life estate calculated as if both the non-liable spouse and the liable spouse live lives according to the assumptions in the tables, the non-liable spouse's interest is tiny (.08778).

D. Separate Property Owned by the Non-Liable Spouse. In this ownership pattern when applying a typical IRS collection process, the result is not only surprising but patently inequitable.

1. The Fact Pattern. Consider the following example: As in the prior example, husband (H) is 56 and wife (W) is 55 and they live in Texas. The home they live in is W's separate property that she acquired prior to their marriage by inheritance. Unknown to both W and H at the time of their marriage, H had potential exposure for penalties for failure to pay payroll taxes. H and W signed a premarital agreement, which among other things, acknowledged that the home was W's separate property but the agreement did not provide for a waiver or abandonment of H's survivorship rights. After the IRS assessed a Section 6672 penalty against H, the IRS filed a nominee lien on the home that, in essence, says W is holding title to property rights (the survivorship right) owned by H. Unless W pays the IRS for a release of the lien, the IRS will attempt to foreclose, sell the home and extract from the proceeds an amount equal to H's survivorship rights and apply it to his liability with the balance going to W. Does the IRS have the authority to force a sale of W's home under the existing case law? If so, what value may the IRS take from the sale proceeds? The answers, if favorable to the IRS, present significantly negative results to the uninformed non-liable spouse. Unfortunately, the IRS has not published guidance to the public and perhaps not even to the various local revenue officers who are filing nominee liens in such circumstances and pursuing levies.

2. The IRS' Position. It was not difficult to predict the IRS' reaction to *Rodgers*. If a homestead survivorship right is a right that must be respected and immune from IRS collection of tax debt when owned by a non-liable owner, then it is a *property right* that can be seized when it is owned by a taxpayer who owes delinquent taxes. Apparently, the IRS views *Rodgers* as direct authority for the right to seize a survivorship right no matter what surrounding facts exist. Stated differently, if the Supreme Court determined that a homestead survivorship right is a property right that has to be protected for the non-liable spouse, then it is a property right that may be extracted when it is owned by the liable spouse. But, it must be recognized that in doing so, the IRS will be evicting the non-liable owner from the home in order to satisfy or partially satisfy the tax delinquency with the non owner's survivorship right — *a property right created by the marriage rather than an asset bought and paid for with the taxpayer's money*.

3. The Calculation. The *Harris* formula cannot be applied where H (the liable spouse) has only a contingent survivor's life estate and no other rights. The correct calculation should be item I. (.07717) set out in IV.B.2(f), less than 8% of the value of the house. This result occurs because of 3 factors:

(i) the liable spouse owns no present interest in the residence;

(ii) the liable spouse owns no remainder interest; and

(iii) the 7520 rate is very low working against the value of the life estate.

The result would be dramatically different in favor of the IRS if H and W were half their age and the 7520 rate was doubled. Is it conceivable that the IRS should be allowed to dislodge the non-liable spouse for an 8% interest in the value? See V.A hereafter.

4. Valuation Confusion. In *Rodgers*, the valuation of the survivorship right was made easy by the court. The taxpayer was deceased and Lucille Rodgers' survivorship rights had vested, that is, she was married to Phillip Boscoe and was living in the home at the time of his death. Other fact patterns present much more complicated issues. Indeed, the Court in *Rodgers* seemed to be aware that it may have been setting up a rule of law that could be unintentionally extended beyond the facts of *Rodgers* when the Court stated:

> "Thus, *although analogy is somewhat hazardous in this area*, it may be said that the homestead laws [referring to the survivorship rights] have the effect of reducing the underlying ownership rights in a property to something akin to remainder interests and vesting in each spouse an interest akin to an undivided life estate in the property." [emphasis added].
>
> 461 U.S. 677, 685, 686.

This statement and the interpretation and application of it in *Harris* appears to create a rule that, standing by itself, could apply to facts beyond those that existed in *Rodgers*.

5. The Challenge. As indicated in IV.D.3 above, the IRS believes it has the authority (presumably from *Rodgers*) to proceed to file liens on and seize a residence owned by a non-liable spouse in a situation where the liable spouse has not waived the homestead rights. The IRS believes it can force a sale of the residence and extract the liable spouse's share of the residence. In

Rodgers, the Supreme Court protected Mrs. Rodger's survivorship right but it did not directly hold that it was a property or property right which is required under Section 6331 for the IRS to seize. The position of the IRS is based solely on the assumption that if a non-liable spouse's survivorship right must be extracted from the liable spouse bundle of property rights held by the liable spouse in the home, it (the bare survivorship right) must also be a property right. A bare spousal survivorship right, however, is not clothed with any of the rights normally associated with property: (i) it cannot be transferred; (ii) the possessory right is contingent in the sense that it can be lost by divorce or death; and (iii) it can be lost if the survivor moves out of the home. These are very realistic contingencies that not only call into question whether a bare survivor's life right is a property right but they also point to the impossibility of valuation of a bare survivorship right.

6. The *Kim* Decision. In *Kim v. Dome Entertainment Center, Inc.*, 748 F.3d 647 (5th Cir. 2014), the Fifth Circuit Court of Appeals cast a big shadow on the IRS position. *Kim* is an appeal from a District Court's affirmation of a Bankruptcy Court decision when the non-debtor spouse had to be compensated for her Texas rights although they were limited to the value of the homestead survivor's rights based on the dollar amount of the homestead exemption set out in 11 U.S.C. §522(p), not based on fair market value of the residence. In coming to its decision, the 5th Circuit made notable observations about Texas law:

> The Kims rely upon the United States Supreme Court's hypothetical calculations of the value of Texas homestead rights in the *Rodgers* decision. But the Court *assumed "only for the sake of illustration*, that a homestead estate is the exact economic equivalent of a life estate." The Kims have provided no authority that Texas law would value homestead rights as "the exact economic equivalent of a life estate," and the Supreme Court of Texas has said that "the homestead estate is not identical to a life estate because one's homestead rights can be lost through abandonment." *Laster v. First Huntsville Properties, Co.*, 826 S.W.2d 125 (Tex. 1992).
>
> From our examination of Texas law, it is not entirely clear that Texas courts would place exactly the same economic value on homestead rights as it would on a life estate. One significant difference between the economic value of a life estate and homestead rights is that the former can be alienated while the latter cannot. When a spouse no longer possesses the real property that was impressed with homestead rights, the homestead rights in that property cease to exist. A spouse cannot transfer her homestead rights and receive value in exchange. This is not true of a life estate. The assumptions used only for illustrative purposes in

Rodgers would seem to overvalue homestead rights under Texas law.

7. The Closing Argument. If a survivor's right to remain in the residence is simply a legal right of possession which has value to the owner but is not a vested economic right, can it be characterized as a property right allowing the IRS to extract a value from the true owner of the real property? It would seem that it is not a property right. When the IRS forecloses on a liable spouse's bare homestead survivor's right, it is not foreclosing on an asset that it can sell. Indeed, it is foreclosing on a property (the residence) that is not owned by the taxpayer but in which the taxpayer, the liable spouse, has a personal, non assignable right. It does not follow that a mere flipping *Rodgers* on its head is enough to make the bare survivor's personal right of possession a property right under Sections 6321 and 6331 of the Code. [3]

V. PROTECTION FOR THE NON – LIABLE SPOUSE.

A. *Rodgers* Court's Exceptions To A Forced Sale. The Supreme Court made the following statement:

> "[W]e are convinced that recognizing that district courts may exercise a degree of equitable discretion in §7403 proceedings is consistent with the policies of the statute: unlike an absolute exception … the exercise of limited equitable discretion in individual cases can take into account both the Government's interest in prompt and certain collection of delinquent taxes and the possibility that innocent third parties will be unduly harmed by that effort."

The following are the circumstances the Supreme Court stated that a court should consider when applying equity.

1. A Factor Favoring the Government. A court should consider the extent to which the Government's interests are prejudiced if it were relegated to a forced sale of the partial interest actually liable for the delinquent taxes

[3] Since the *Rodgers* decision, there have been many federal district court decisions determining whether the *Rodgers* equity factors applied to the specific facts in each case to produce a denial of the government's proposed foreclosure. Each case is a facts and circumstance decision and for the most part the federal district courts have been rather stingy with equitable relief to the taxpayers. Not many of the district court opinions result in Court of Appeal reviews, but the Sixth Circuit (applying the *Craft* decision, not *Rodgers*) has been particularly active. *See e.g.*, United States v. Winsper, 680 F.3d 482 (6th Cir. 2012) (remanding the taxpayer favorable decision back to the district court based on the lower courts mischaracterization of the *Rodgers* four factor test); United States v. Barczyk, 434 Fed.Appx. 488 (108 AFTR 2d 2011-5862 (6th Cir. 2011) (following United States v. Barr holding non-liable spouse was entitled to 50% of the house proceeds not a greater share based on her longer life expectancy); United States v. Barr, 617 F.3d 370 (6th Cir. 2010). Although *Barczyk* and *Barr* were Michigan cases applying the state law legal principles arising under Michigan's tenancies by the entireties the results cannot be reconciled with the more complex formula adopted by the Fifth Circuit in *Harris*.

meaning could the government sell a home subject to the non-liable party's homestead rights and receive as much as government would get if it sold the entire property interests and reimbursed the non-liable spouse for his or her interests. It would be rare that anyone would buy under those circumstances.

2. Non-Liable Spouse's Expectation. A court should consider whether the third party with a non-liable separate interest in the property would, in the normal course of events (leaving aside Section 7403 and eminent domain proceedings, of course), have a legally recognized expectation that that separate property would not be subject to forced sale by the delinquent taxpayer or his or her creditors. If there is no expectation (meaning a creditor other than the government could foreclose), there is no reason to preclude the sale. In most situations there would be an expectation that the homestead could not be taken.

3. Equitable Factors Relating to the Non-Liable Spouse. A court should consider the likely prejudice to the non-liable spouse, both in personal dislocation costs and in the sort of practical undercompensation that most likely occur here. The court made no point of it but if there were minor children living in the home, it should be a critical factor.

4. Relative Valuations. A court should consider the relative character and value of the non-liable and liable interests held in the property. If the innocent spouse has no present possessory interest or fee interest in the property, there may be little reason not to allow the sale. If, on the other hand, the third party not only has a possessory interest or fee interest, but that interest is worth 99% of the value of the property, for example, then there might well be virtually no reason to allow the sale to proceed.

B. Waivers. Note the facts in IV.D.1. H and W signed a premarital agreement but H did not waive his Texas homestead rights. If he had, there would be no right that would set up the issue of whether his bare survival right can be a property right under Section 6321 and Section 6331. Even if a party is coming into the marriage with a known tax liability or potential tax liability, a premarital agreement including a waiver will be respected. Whether post-marital agreements will be respected falls into the gray zone and the facts and circumstances that exist have to be examined. On one extreme, if H and W execute a post marital agreement with a waiver of Texas Homestead right before they have knowledge of the tax liability, there is no reason for the IRS to reject the agreement. At the other extreme, if the post marital agreement is executed upon the threat of a tax lien but before the filing of the lien, maybe not[4].

[4] *See* Calmes v. United States, 926 F. Supp. 582 (N.D. Tex. 1996) where the IRS challenged the efficacy of a premarital agreement (earned income was separate property in a community property state) on the basis of the agreement being a fraudulent conveyance (inadequate consideration). The Court held that the non-liable spouse was not a related party at the time of the agreement and even if she was she paid adequate consideration to the liable taxpayer by giving up equal claims to his future earned income.

VI. COMPARABLE TREATMENT IN NON-COMMUNITY PROPERTY STATES.

A. *United States V. Craft,* 535 U.S. 274 (2002). In *United States v. Craft*, the Supreme Court dealt with the question of whether a tenancy by the entirety created under Michigan law was a property right to which an IRS lien could attach, followed by a forced sale then a division of the proceeds from a sale of the underlying property between the IRS and the non-liable spouse. The taxpayer (husband of the respondent in the Supreme Court proceedings) failed to pay federal income tax liabilities assessed against him, and pursuant to Section 6321 a federal tax lien attached to "all [of his] property and rights to property." After the notice of the lien was filed, respondent and her husband jointly executed a quitclaim deed purporting to transfer to her his interest in a piece of real property in Michigan that they owned as tenants by the entirety and, subsequently, the IRS agreed to release the lien and allow respondent to sell the property with half the net proceeds to be held in escrow pending determination of the IRS' interest in the property. Respondent brought the action to quiet title to the escrowed proceeds. The IRS claimed, among other things, that its lien had attached to the husband's interest in the tenancy by the entirety. The district court had no problem finding that the quitclaim deed would be a fraudulent conveyance if the IRS could seize that which was conveyed, the husband's interest in the tenancy by the entireties property. The district court granted the government motion for summary judgment, but the Sixth Circuit held that no lien attached because the husband had no separate interest in the entireties property under Michigan law, and remanded the case for consideration of an alternative claim not at issue at the Supreme Court. The Supreme Court held that the husband's interests in the entireties property constituted property or rights to property to which a federal tax lien could attach.

B. Whether A Property Right? In *Craft*, the Court noted that it looks initially to state law to determine what rights the taxpayer has in the property the government seeks to reach and then to federal law to determine whether such state-delineated rights qualify as property or rights to property under Section 6321. At the time *Rodgers* was decided, the rule of property or property right determination was primarily a state court function. *United States v. Bess*, 357 U.S. 51 (1958). The Court observed: "…section 3670 [1939 Internal Revenue Code] creates no property rights but merely attaches consequences, federally defined, to rights created under state law…." But post *Rodgers*, the concept was narrowed somewhat by *United States v. National Bank of Commerce,* 472 U.S. 713 (1985). The Court said "…state law defines nature of the taxpayer's interest in the property, but the state law consequences of that definition are of no concern to the operation of the federal tax law." It was then further narrowed in *Drye v. United States,* 528 U.S. 49 (1999). In *Drye,* the Supreme Court further extended the federal law control by explaining that state law is only initially examined to find the rights the taxpayer has in the subject property then federal law determines whether the taxpayer's rights constitute property or property rights.

C. The Three Legal Structures For Concurrent Ownership Property. In *Craft*, the Court further noted that "English common law provided three legal structures for the concurrent ownership of property that have survived into modern times: tenancy in common, joint tenancy, and tenancy by the entirety." Citing 7 R. Powell & P. Rohan, Real Property §51.01[3] (M. Wolf ed. 2001), the Court described tenants in common as each owning a separate fractional share in undivided property and each tenant may unilaterally alienate their shares through sale or gift or place encumbrances upon these shares and transfer such shares at death. They also have many other rights in the property, including the right to use the property, to exclude third parties from it, and to receive a portion of any income produced from it. *Id* at §§50.03 – 50.06.

D. The Survivorship Component. Joint tenancies, the *Craft* Court noted, also have a survivorship component, meaning that upon the first to die of the joint tenants, the survivor owns all of the underlying property. Tenancy by the entirety is yet distinguishable from both tenancies in common and joint tenancies in that tenancy by the entirety is available only to married couples and, like joint tenancies, there is a right of survivorship. The Court noted that a unilateral disposition of one spouse's interest in a tenancy by the entireties is typically not possible without severance and severance requires the consent of both spouses. Under Michigan law, a spouse could not unilaterally convey an interest in a property held as tenancy by the entireties, and each spouse had a survivorship right. In coming to its conclusion that one spouse's "bundle of sticks" in a tenancy by the entireties was enough to call it a "property right", the court relied heavily on *Rodgers* and rejected the respondent's argument that a property right that could not be alienated could not be seized by the IRS. Note the similarity of this analysis to the Fifth Circuit's analysis in *Harris.* The *Craft* Court said:

> "Excluding property from a federal tax lien simply because the taxpayer does not have the power to unilaterally alienate it would, moreover, exempt a rather large amount of what is commonly thought of as property. It would exempt not only the type of property discussed in *Rodgers*, but also some community property. Community property states often provide that real community property cannot be alienated without the consent of both spouses. See, *e.g.,* Ariz. Rev. Stat. Ann. §25-214(C) (2000); Ca. Fam. Code. Ann. §1102 (West 1994); Idaho Code §32-912 (1996); La. Civ. Code Ann/. Art. 2347 (West Supp. 2002); Nev. Rev. Stat. Ann. §123.230(3) (Supp. 2001); N.M. Stat. Ann. §40-3-13 (1999); Wash. Rev. Code §26.16.030(3) (1994). Accordingly, the fact that respondent's husband could not unilaterally alienate the property does not preclude him from possessing 'property and rights to property' for the purposes of §6321."
>
> 535 U.S. 274, 285.

E. Strong Dissents. The *Craft* Court's majority opinion was delivered by Justice O'Connor. Justices Thomas, Scalia and Stevens dissented strongly taking issue primarily with the notion that a property right that cannot be alienated and may be lost on termination of the marriage should not be a property right eligible to be lost to the

IRS (535 U.S. 274, 292-301 (2002)). The dissenting opinion makes an analogy of a marriage to that of a partnership or a corporation, that is, a fiction of law with the point being that if the IRS files a lien that attaches to a partnership interest the IRS does not have the ability to dissolve the partnership and take its share. It is possible that in future litigation dealing with the question posed here, that is, whether a nonowner's contingent homestead survivor's right is a property right subject to levy, the *Craft* decision will play a larger role than the *Rodgers* decision. In *Rodgers*, the court acknowledged the age old rule that state law determined when property rights existed and federal law controlled with respect to the government's right to take it. Even though the issue was whether a single element of the homestead bundle of rights (the right to remain in the home after the death of the first spouse to die) was a property right that the government could not take from Mrs. Rodgers, the Court did not break it down and analyze that single piece of the bundle as the Court did in *Craft*. In *Craft*, significant debate over the elements of a property ensued between the majority opinion and the dissenting opinion, principally over the absence of a unilateral right to convey the economic benefit of a tenancy by the entireties. The focus here is on the right of survivorship as a separate property right and whether the government can force the sale of a non-liable spouse's home to extract solely the value of that right. The right of survivorship under homestead law does not include all those elements of a property right that were debated in *Craft*. It is non assignable and the owner of it can do nothing with it except possess it. More importantly, it is contingent and may never be of any value since it can be lost by divorce.

F. <u>Speculation Regarding Today's Court</u>. Similarly, a property right that is created by a marriage and subject to being lost by dissolution of the marriage should not be eligible for foreclosure even if the other spouse, the non taxpayer, is compensated. Query whether the Supreme Court today would reach the same conclusion since the Court now has four different Justices. Would this decision be the same if reviewed today or would the forceful voice of the dissent get additional votes? It is interesting that in *United States v. Parcel of Real Property Known as 1500 Linda Avenue*, 949 F.2d 73 (3rd Cir. 1991), Justice Alito (who was not on the Supreme Court at the time of the *Craft* decision) writing for the three judge panel in a Third Circuit Court of Appeals in a civil forfeiture case involving real property used in the illegal diversion of pharmaceutical drugs, refused to allow a forced sale of the property but required the government to wait until the death of the innocent co-owner. The property was owned by the convicted party and the innocent party as a tenancy by the entireties. The result of this decision was exactly the result requested by the non-liable spouse in *Rodgers*, but rejected by the Supreme Court and subsequently rejected by *Craft*, where a forced sale and proceeds splitting was ordered.

G. <u>The Bundle Of Sticks</u>. The Court in *Craft* broke down the bundle of sticks and analyzed the individual elements of ownership by the entireties, that is, the separate rights that comprise the bundle of rights. In contrast, *Rodgers* applied the then simplistic rule that state law defines property and federal law determines what the IRS can do with it. *Rodgers* did not dissect homestead rights and it must be remembered that the single right at issue in *Rodgers* was the right of survivorship and not any of the other homestead rights such as the right of creditor protection and the right precluding unilateral alienation by a single spouse during the marriage. And, to add further complexity, that single right of survivorship must be applied to different sets of fact patterns since the survivorship at issue in *Rodgers* was the unconditional right to possess the homestead for life, but such right in other cases are distinguishable because the right is conditional. What "sticks" then exist for owners of a bare survivorship right? In *Rodgers* it was simply one, the right of possession, no right of sale or even transfer by gift. If, however, the two spouses still occupy the homestead at the time of an attempted seizure and sale by the IRS, there is no vested right of occupancy since that right is subject to staying married and subject to one spouse surviving the other spouse and there is no right of assignment. That is not a large bundle of sticks and one can only speculate what the *Craft* court in 2003 and, more importantly, the Supreme Court today, would do with the question presented here. A tenancy by the entireties is a consensual contractual arrangement that two spouses enter into presumably with full knowledge of their respective rights. A homestead survivorship right is a property right created by marriage with the couple usually having very little knowledge of the risks the non-liable spouse is taking.

H. <u>IRS Notice 2003-60</u>. Subsequent to *Craft*, the IRS published guidance in Notice 2003-60, 2003-39 I.R.B. 643, on collection from property held in a tenancy by the entirety, where only one spouse is liable for the tax deficiency. Though the IRS' position is that *Craft* is not new law, the IRS has offered some comfort to non-liable spouses. As a matter of policy, the IRS will not apply *Craft* for certain interests created before *Craft* to the detriment of third parties who may have reasonably relied on the belief that state law prevents the attachment of the federal tax lien. The sale of entireties property subject to the federal tax lien presents practical problems and, because of the potential adverse consequences to the non-liable spouse, the IRS will use lien foreclosure for entireties property on a case by case basis. Notice 2003-60 further provides that the value of the taxpayer's interest in entireties property generally is deemed to be one-half and whether there has been a sale or other transfer of entireties property subject to the lien that does not provide for the lien's discharge, the lien thereafter encumbers a one-half interest in the property held by the non-liable spouse or third party transferee.