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Bankruptcy A Practice Focus

In the Wake of *Craft*

Months after the Supreme Court ruled, key questions linger for tenants by the entirety.

By Lisa Bittle Tancredi

"Tenancy by the entirety" is a long-standing common law doctrine that, where recognized, protects marital property from the creditors of an individual spouse. As the doctrine has traditionally been applied, creditors of only one spouse cannot attach or liquidate property owned by both spouses as tenants by the entirety. However, in *United States v. Craft,* 535 U.S. 274 (2002), the Supreme Court last April concluded that a federal tax lien, arising from taxes owed by the husband alone, could attach to the husband's interest in property held in a tenancy by the entirety.

In making their decision, the justices took a fresh look at the tenancy-by-the-entirety doctrine. The Court's analysis has generated widespread discussion among practitioners about how it affects entireties rights, what such rights are worth, and whether the decision has applications beyond federal tax liens. In the nine months since *Craft* was decided, a handful of courts have actually taken a look at these questions.

The Lien of the IRS

The *Craft* dispute began when the Internal Revenue Service filed a notice of tax lien after Don Craft failed to pay his income taxes. The IRS filed its notice under Section 6321 of the Internal Revenue Code, which provides that a tax lien attaches to "all property and rights to property, whether real or personal," belonging to the taxpayer. At the time, Don and his wife, Sandra, owned a piece of real property in Michigan as tenants by the entirety.

After the IRS filed the notice of lien, the Crafts jointly executed a quitclaim deed purporting to transfer the husband's entireties interest in the property to the wife alone. When the wife later tried to sell the property, the IRS contended that it had a lien on the property. The IRS agreed to release its asserted lien to permit the sale so long as half the net proceeds of the sale were held in escrow pending a determination of the government's interests.

The wife brought the action to "quiet" title to those sale proceeds. The IRS argued that it was entitled to the escrowed proceeds because its lien had attached to the husband's interest in the property, even though his interest was as a tenant by the entirety. The U.S. District Court agreed with the IRS, but the U.S. Court of Appeals for the 6th Circuit reversed. The 6th Circuit held that no lien had attached to the property because the husband had no separate interest in the property under Michigan law.

Granting certiorari, the Supreme Court examined some of the rights that the husband held as a tenant by the entirety under Michigan law. In doing so, the Court used Justice Benjamin Cardozo's analogy that property is "a 'bundle of sticks'—a collection of individual rights which, in certain combinations, constitute property." The husband had various "sticks," or rights. He had the right to use the property, the right to exclude others from the property, the right to a portion of income from the property, the right of survivorship, the right to become a tenant-in-common upon divorce, the right to sell the property with the wife's consent, the right to encumber the property with the wife's consent, and the right to keep the wife from unilaterally selling or encumbering the property.

The Supreme Court observed that "[s]tate law determines only which sticks are in a person's bundle. Whether those sticks qualify as 'property' for purposes of the federal tax lien statute is a question of federal law." The Court further noted that the federal tax lien statute is very broad and that Congress intended it to cover "every interest in property that a taxpayer might have." Accordingly, the Court concluded that the husband's entireties interest was "property" or "rights to property" to which a lien could attach under the statute.

The two dissents, written among three justices, highlight how far-reaching this conclusion may be. Justice Antonin Scalia observed that *Craft* "nullifies (insofar as federal taxes are concerned, at least) a form of property ownership that [is] of particular benefit" to the stay-at-home wife and mother, who is unlikely to be the actual debtor and likely, eventually, to be the surviving tenant by the entirety. Justice Clarence Thomas, joined by Justices Scalia and John Paul Stevens,

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pointed out that the rights to which the Court was permitting the tax lien to attach bear "no resemblance to those to which a federal tax lien has ever attached" before.

After *Craft*

Almost as notable as what the Court did decide is what the Court did not decide. The Court expressly declined to determine the value of the husband's rights in the entireties property. The Court did not decide whether the right of survivorship alone was "property" or a "right to property." And, of course, the Court did not decide whether *Craft* would have applications beyond federal tax liens.

One of the questions that immediately came to the minds of bankruptcy practitioners following *Craft* was whether tenancy-by-the-entirety rights would be property of a bankruptcy estate that may be sold by a bankruptcy trustee.

Under the U.S. Bankruptcy Code, "property of the bankruptcy estate" is a broad concept that includes "all legal or equitable interests of the debtor in property as of the commencement of the case." Assuming that a tenancy-by-the-entirety right is property of the bankruptcy estate and that there is a willing buyer, perhaps a Chapter 7 trustee may sell the right for the benefit of the debtor's creditors. It was not long after *Craft* that a Chapter 7 trustee did just that.

In the case of *In re Ryan,* 282 B.R. 742 (D.R.I. 2002), one of the largest creditors of the debtor offered to purchase, for $5,000, the debtor's survivorship interest in property owned by the debtor and his wife as tenants by the entirety. The Bankruptcy Court approved the sale of the right of survivorship over the debtor's objection.

On appeal, the District Court affirmed. But in its opinion, the court did not appear to rely on *Craft,* citing instead to Rhode Island law that allows creditors to attach property owned as tenants by the entirety, and permits creditors to sell a contingent future expectancy interest such as a right of survivorship.

The value of the survivorship interest—which issue the Supreme Court had left untouched—was raised in the *Ryan* case. The question was not whether the $5,000 purchase price was fair, but whether the debtor could protect his entireties interest from the proposed sale by using his homestead exemption under bankruptcy law.

At the time of the *Ryan* case, Rhode Island's homestead exemption stood at $100,000. The unencumbered value of the property was $155,000. The debtor argued that his entireties interest was 50 percent of the unencumbered value, or $77,500, which amount would fit within, and thus be protected by, the homestead exemption. The court, however, held that the debtor's interest in the property was 100 percent—the full $155,000. Thus, the debtor could not protect his entire survivorship interest from the sale.

Survivorship Value

The value of the survivorship interest was again at issue in the case of *In re Basher,* 2002 Bankr. LEXIS 1467 (Bankr. E.D. Pa. Dec. 3, 2002). Before the court was the question of the extent of the IRS's tax lien (on account of a debt that was the debtor's alone) on property owned by the debtor and his wife as tenants by the entirety. The debtor argued and presented testimony that the right of survivorship was worthless. However, the court was not persuaded, making the intriguing statement that such a valuation "assumes that the only measure of value of such interest is what the Debtor could realize in a private sale" and that "[t]here may be other legal avenues for realizing value from this asset."

The court also rejected the IRS's contention that the entireties interest should be valued at 50 percent of the assessed value. Unlike a joint tenancy or a tenancy in common (for which the court thought a 50 percent measure might be appropriate), a tenancy by the entirety requires the consent of the other spouse before the property may be sold or encumbered. The court ultimately required further briefing on the extent of the IRS's lien.

Outside the Estate

The question of whether *Craft* may be used by a bankruptcy trustee to tap into tenancy-by-the-entirety assets was directly addressed in the case of *In re Knapp,* 285 B.R. 176 (Bankr. M.D.N.C. 2002). In *Knapp,* a debtor claimed as exempt the property that he held with his wife as tenants by the entirety, and in which there was equity of $67,000. The Chapter 7 trustee objected to that exemption, arguing under *Craft* that the debtor's interest in the property was an asset of the bankruptcy estate that should be liquidated to pay creditors.

However, the *Knapp* court refused to apply *Craft* beyond federal tax liens, reasoning that the federal tax collector has, by statute, unique collection powers not enjoyed by private creditors or bankruptcy trustees. This decision may make it more difficult for Chapter 7 trustees to use *Craft* to increase the bottom line of bankruptcy estates.

On the other hand, it has only been nine months since the Supreme Court decided *Craft.* As Justice Cardozo, the father of the bundle-of-sticks analogy, prophetically observed (in his 1928 book *The Paradoxes of Legal Science*), "The bundle of power and privileges to which we give the name of ownership is not constant through the ages. The [bundle] must be put together and rebound from time to time." While the Supreme Court reassembled and rebound the bundle, the effect of its decision on tenancy-by-the-entirety ownership will need to be the subject of more cases in the coming months and years before the full impact of *Craft* can be known.

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