

Part III - Administrative, Procedural, and Miscellaneous

Notice 2003-60

PURPOSE

This notice provides guidance on collection from property held in a tenancy by the entirety, where only one spouse (referred to here as the taxpayer) is liable for the outstanding taxes, in light of the Supreme Court decision in United States v. Craft, 535 U.S. 274 (2002).

BACKGROUND

On April 17, 2002, the Supreme Court issued its decision in United States v. Craft, 535 U.S. 274 (2002), and held that the federal tax lien that arises under section 6321 of the Internal Revenue Code on "all property and rights to property" of a delinquent taxpayer attaches to the rights of the taxpayer in property held as a tenancy by the entirety (entireties property), even though local Michigan law insulates entireties property from the claims of creditors of only one spouse. The Court stated that while state law determines what rights a taxpayer has in property, federal law determines whether the state-defined rights are "property" or "rights to property" for purposes of section 6321. The Court's decision in Craft has consequences in the approximately twenty-six jurisdictions that recognize tenancy by the entirety as a form of property ownership.

While state law governing property ownership varies by jurisdiction, there are a number of principles generally applicable to a tenancy by the entirety. Tenancy by the entirety is a form of property ownership, including personal property in some jurisdictions, available only to a husband and wife as a marital unit. A key feature of the tenancy is the right of survivorship—the surviving spouse becomes the fee simple owner of the property upon the death of the other spouse. The tenancy also is terminated by the transfer of the property or upon the spouses' divorce.

Entireties property is subject to the claims of the joint creditors of the spouses. However, the majority of jurisdictions that recognize tenancy by the entirety, so-called full bar jurisdictions, completely prohibit creditors from attaching entireties property to satisfy the debts of only one spouse. The state law rationale is that a spouse individually has no interest in the property; rather, the property is held by the marital unit. The other jurisdictions that recognize tenancy by the entirety, so-called modified or partial bar jurisdictions, permit creditors to attach one spouse's interest in entireties property for the debts of only that spouse, subject to the rights of the non-liable spouse.

Issues related to entireties property can arise in a number of areas, including enforcing collection through administrative and judicial means, evaluating offers in compromise and proposed installment agreements, valuing the Service's secured claim in bankruptcy, applications for discharge and subordination, and determining the nature of the Service's rights vis-a-vis a transferee in a transfer in which the federal tax lien has not been discharged.

OVERVIEW

The Service will rely on a number of general principles in addressing issues raised as a result of the Court's decision in Craft:

(1) Under section 6321, the federal tax lien attaches to all the property and rights to property of the taxpayer. The Court's decision confirms that, for purposes of section 6321, a taxpayer's property and rights to property have always included any rights that taxpayer may have in entireties property under state law. The Court's decision, therefore, does not represent new law and does not affect other law applicable to federal tax liens and federal tax collection. For example, the Craft decision does not change any limitation on the ability of the Service to rescind an accepted offer in compromise or terminate an

accepted installment agreement.

(2) As a matter of administrative policy, the Service will, under certain circumstances, not apply Craft, with respect to 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.

(3) The administrative sale of entireties property subject to the federal tax lien presents practical problems that limit the usefulness of the Service's seizure and sale procedures. Levying on cash and cash equivalents held as entireties property is considerably less problematic and will be used by the Service in appropriate cases.

(4) Because of the potential adverse consequences to the non-liable spouse of the taxpayer, the use of lien foreclosure for entireties property subject to the federal tax lien will be determined on a case-by-case basis.

(5) As a general rule, the value of the taxpayer's interest in entireties property will be deemed to be one-half.

(6) Where there has been a sale or other transfer of entireties property subject to the federal tax lien that does not provide for the discharge of the lien, whether the transfer is to the non-liable spouse or a third party, the lien thereafter encumbers a one-half interest in the property held by the transferee.

QUESTIONS AND ANSWERS

The following questions and answers illustrate how the Service will apply Craft. The first two Q&As address the application of Craft with respect to interests in entireties property acquired before the date of the decision, while the remaining questions and answers address its application with respect to interests acquired after the date of the decision.

Q1. If the Service has filed a notice of federal tax lien with respect to the taxpayer before Craft and an interest in entireties property was later acquired by a purchaser, holder of a security interest, a mechanic's lienor, or a judgment lien creditor within the meaning of section 6323, then will the Service assert lien priority over the subsequently acquired interest? What if the entireties property was transferred, before Craft, to the non-taxpayer spouse in a divorce? Does the result differ if, before Craft, the transfer was to a donee, such as a family trust? Do the results differ depending on whether the jurisdiction at issue is one that recognizes tenancy by the entirety and completely prohibits the attachment of entireties property for separate debts of one spouse (*i.e.*, a full bar jurisdiction) or one that permits attachment to entireties property in connection with the separate debts of one spouse (*i.e.*, a modified or partial bar jurisdiction)?

A1. Application of Section 6323. Section 6323 provides that "[t]he lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary." Section 6323(a). The rule of Craft, with respect to entireties property, applies to federal tax liens regardless of when they arose. A federal tax lien, therefore, has priority over any interest of a purchaser, a holder of a security interest, a mechanic's lienor, or a judgment lien creditor (*i.e.*, the class of persons protected by section 6323(a)) if notice of the federal tax lien was filed before such other interest arose.

As a matter of administrative policy, the Service will not assert its federal tax lien rights where doing so may disturb the settled expectations of certain classes of persons who may have been under the belief that a federal tax lien arising from the liability of only one spouse does not attach to entireties property. Accordingly, with respect to entireties property located in full bar jurisdictions, the Service will not assert its federal tax lien priority over the interests of the class of persons protected under section 6323(a), if the section 6323(a) interests were created before Craft was decided. For example, if a purchaser acquired entireties property before Craft was decided and meets the definition of a purchaser

under section 6323(h)(6), the Service will not assert lien priority even though a notice of federal tax lien had been filed prior to the purchase.

In contrast to full bar jurisdictions, there are no settled expectations in modified or partial bar jurisdictions, where a creditor is permitted to attach some or all of a debtor-spouse's interest in entireties property. For example, while Oklahoma law recognizes tenancy by the entireties as a form of property ownership, creditors collecting the debt of one spouse can force the sale of entireties property, severing the tenancy. In modified or partial bar jurisdictions, the Service will assert its lien priority against the class of persons protected under section 6323(a) regardless of when those persons may have acquired interests in entireties property, so long as those interests were acquired after a notice of federal tax lien had been filed.

Divorce. A spouse of the taxpayer who obtained entireties property in a divorce acquires the property subject to the federal tax lien. In the context of a divorce, a spouse is not in the class of persons protected by section 6323(a). Consequently, if the assessment giving rise to the federal tax lien under section 6321 had occurred prior to the divorce, then the lien also attached to the taxpayer's rights in the entireties property. As a general rule, if the transfer occurred before Craft, then the Service will treat the transfer as one for value and will not assert its lien against the property in the hands of the ex-spouse of the taxpayer. This will not apply if the Service determines that, notwithstanding the divorce, the transfer was fraudulent.

Donation. A donee who obtains entireties property acquires the property subject to the federal tax lien. As in the case of a transfer pursuant to a divorce, the donee is not in the class of persons protected by section 6323(a). Transfers to donees that occurred before Craft will be evaluated on a case-by-case basis to determine whether the equities favor or disfavor the Service asserting the federal tax lien against property held by a donee. There may be circumstances where, although the donee gave nothing of value in exchange for the property, it would be inequitable for the Service to assert the federal tax lien because of the donee's reliance on the mistaken view that the property was unencumbered. For example, if the transfer was of real property to which the donee has made substantial improvements, the equities may favor not asserting the federal tax lien (or agreeing to limit its reach by carving out the value of the improvements). On the other hand, the absence of such reliance may warrant assertion of the federal tax lien.

The identity of the donee is also a factor that will be considered by the Service. The federal tax lien is more appropriately not asserted where the donee is a disinterested person, having no relation to the taxpayer, than where the donee and taxpayer are closely related. For example, the Service may decide to assert the federal tax lien where the taxpayer transferred entireties property to a family trust, but may decide not to assert the lien where the taxpayer transferred entireties property to a charitable organization.

Q2. Does the Craft decision provide a basis for the Service to rescind offers in compromise, terminate installment agreements, or revoke certificates of discharge and subordination? Will the Service amend bankruptcy proofs of claim? Can the Service revisit a determination that an account is currently not collectible?

A2. The decision in Craft does not provide legal authority to rescind any accepted offer in compromise, terminate an installment agreement, or revoke any certificate of subordination or discharge.

With respect to bankruptcy proofs of claims, the Service has made an administrative decision not to routinely amend such proofs of claim to adjust the amount of the Government's secured claim to reflect the federal tax lien on the taxpayer's interest in entireties property. There may be circumstances, however, where the Service elects to amend the claim to assert the federal tax lien on entireties property, depending on the value of the property and the status of the bankruptcy case. The existence of entireties property will be considered in filing new proofs of claim and in future investigations related to determining whether there is any property subject to post-bankruptcy collection.

Finally, based on an evaluation of a taxpayer's interest in entireties property, the Service may revisit a prior determination that an account is currently not collectible.

Q3. If entireties property subject to the federal tax lien is sold or transferred after Craft and the Service does not discharge the lien, is the property subject to the federal tax lien in the hands of the transferee?

A3. A conveyance of entireties property terminates the entireties estate with respect to that property. Accordingly, after Craft, unless the Service discharges the property from the federal tax lien, the lien will encumber a one-half interest in the hands of the transferee, regardless of whether the transferee is a donee or gives value. As explained below, the Service generally will deem the value of the taxpayer's interest in entireties property to be one-half of the total value of the property.

Q4. Does the federal tax lien on entireties property survive the death of the taxpayer? What effect does the death of the non-taxpayer have on the federal tax lien?

A4. As is the case with joint tenancy with the right of survivorship, if a taxpayer's interest in entireties property is extinguished by operation of law at the death of the taxpayer, then there is no longer an interest of the taxpayer to which the federal tax lien attaches. When a taxpayer dies, the surviving non-liable spouse takes the property unencumbered by the federal tax lien.

When a non-liable spouse predeceases the taxpayer, the property ceases to be held in a tenancy by the entirety, the taxpayer takes the entire property in fee simple, and the federal tax lien attaches to the entire property.

The rule that the federal tax lien does not survive the death of the taxpayer does not apply if the entireties estate previously has been terminated. For example, if the property has been conveyed to a third party, the federal tax lien will be deemed to encumber a one-half interest in the hands of the transferee and will not be affected by the subsequent death of either spouse.

Q5. Does the federal tax lien remain on entireties property awarded to a non-liable spouse in a divorce decree?

A5. Entireties property subject to the federal tax lien and then transferred after Craft to a non-liable spouse pursuant to a divorce remains encumbered in the hands of the ex-spouse.

Q6. After a notice of federal tax lien is filed, the taxpayer and spouse jointly mortgage entireties property to a bank. What effect would the death of either spouse have on the respective rights of the Government and the bank? Where the property is transferred either to a third party or as a result of a divorce, does the federal tax lien have priority over the bank?

A6. Under section 6323, the federal tax lien has priority over the bank's interest with respect to the taxpayer's interest in the entireties property.

If the taxpayer survives the spouse, the federal tax lien will be a senior lien against the whole property. The taxpayer's interest in the entireties property to which the federal tax lien attaches includes the taxpayer's right of survivorship. With the death of the taxpayer's spouse, the taxpayer becomes the fee simple owner of the property, and the federal tax lien attaches to that interest in the property, which is senior to the bank's interest.

As discussed in Q&A 4, if the taxpayer predeceases the spouse and his or her interest is extinguished by operation of law, the federal tax lien will be extinguished. The mortgage lien becomes the first lien on the property.

Since a divorce or transfer to a third party terminates the entireties estate (and, with it, the spouses' rights of survivorship), if the property is transferred to a third-party or to either spouse as a result

of a divorce, then the federal tax lien generally will have priority with respect to a one-half interest in the property over the bank's subsequent security interest.

Q7. Will the Service administratively seize and sell the taxpayer's interest in entireties property?

A7. The Service can administratively seize and sell a taxpayer's interest in real and personal property held in a tenancy by the entirety. Because of the nature of entireties property, it would be very difficult to gauge what market there would be for the taxpayer's interest in the property. The amount of any bid would in all likelihood be depressed to the extent that the prospective purchaser, given the rights of survivorship, would take the risk that the taxpayer may not outlive his or her spouse. In addition, a prospective purchaser would not know with any certainty if, how, and the extent to which the rights acquired in an administrative sale could be enforced. For example, rights acquired would include the right to use the property and the right to exclude others from the property. It is not clear how the rights of a prospective purchaser ultimately would be balanced with the co-existing rights of the spouse of the taxpayer. Therefore, the Service has determined that an administrative sale is not a preferable method of collection with respect to entireties property.

Levying on cash and cash equivalents held as entireties property does not present the same impediments as seizing and selling entireties property. For example, where the Service levies on a bank account that a taxpayer holds as entireties property and has the right to withdraw the funds in the account, the bank is obligated to turn over the funds in response to the levy. While the taxpayer's spouse, as the other account holder, may have an administrative or judicial claim under sections 6343(b) or 7426, respectively, *see United States v. National Bank of Commerce*, 472 U.S. 713 (1985), the amount realizable by the Service is not, at the outset, depressed as it is in the case of administrative sales.

Q8. Will the Service foreclose the federal tax lien against entireties property?

A8. The Service will foreclose the federal tax lien against entireties property in appropriate cases. While in an administrative sale the Service can sell only the taxpayer's interest in entireties property (*i.e.*, not the entire property itself), in a foreclosure action, pursuant to section 7403, the district court has discretion to order the sale of the entire property, even where a non-liable spouse has a protected interest in the property. *See United States v. Rodgers*, 461 U.S. 677 (1983) (principle applied with respect to the sale of homestead property). If the court orders the sale of the property, then the non-liable spouse must be compensated for his or her interest: section 7403 requires "a distribution of the proceeds of such sale according to the findings of the court in respect to the interests of the parties and the United States." Section 7403(c).

Q9. How is the Government's federal tax lien interest in entireties property valued for the purposes of discharge and subordination under section 6325? After private foreclosure on entireties property, what is the value of the Government's interest in proceeds left after the satisfaction of senior liens? How is entireties property valued for bankruptcy purposes? How is entireties property valued in offers in compromise?

A9. Discharge and Subordination. Under section 6325(b)(2)(A), the Service may issue a certificate of discharge of property subject to a federal tax lien upon payment of an amount not less than the value of the Government's interest in that property to be discharged. If a taxpayer applies for a certificate of discharge when entireties property is to be sold by the taxpayer and the taxpayer's spouse, then the taxpayer generally must pay the Service one-half the proceeds of the sale in partial satisfaction of the liability secured by the federal tax lien.

Foreclosing mortgagees with interests that are senior to the federal tax lien often seek a certificate of discharge, rather than joining the United States in a judicial proceeding. By obtaining a discharge of the mortgaged property, the mortgagee eliminates the Service's right under section 2410(c) of Title 28 to redeem the property from the purchaser after the foreclosure sale. As in the case of a taxpayer who seeks a certificate of discharge of the entireties property, the Service generally will determine the value of the Government's interest to be one-half the value of the property, which is

determined for this purpose by first taking into account the amount of senior liens.

Under 6325(b)(4), an owner of property subject to a tax lien (for example, a subsequent purchaser), other than the taxpayer whose liability gave rise to the lien, may seek a certificate of discharge by making a deposit or posting a bond equal to the value of the interest of the Government in the property. In connection with an application for discharge of former entireties property under section 6325(b)(4), the Service generally will determine the value of the Government's interest to be one-half the value of the property.

In light of the Craft decision, taxpayers and taxpayers' spouses will seek subordination of the federal tax lien in connection with refinancing mortgages on entireties property. If the requested subordination is for the purpose of securing a loan to refinance a senior lien, the Service will apply section 6325(d)(2). The Service will generally issue a certificate of subordination if the terms of the refinance loan, as compared to the terms of the loan secured by the senior lien, ultimately will enhance the taxpayer's equity or facilitate the collection of the tax from other property or income of the taxpayer.

If a taxpayer and a taxpayer's spouse seek a certificate of subordination for the purpose of obtaining cash or paying other debts not secured by a senior lien on the property (for example, in the case of a home equity loan), the Service will apply section 6325(d)(1). The Service generally will treat the value of the taxpayer's interest as one-half of the value of the entireties property. The Service would issue a certificate of subordination upon payment of one-half the amount of the lien or interest to which the federal tax lien will be subordinated.

Private Foreclosure. Where a senior creditor is foreclosing a mortgage or other lien on the property, the Service generally will determine the value of the taxpayer's interest to be one-half of the excess of the value of the property over the amount of the senior lien.

Bankruptcy. In bankruptcy cases, the Service, in determining the value of its secured claim, generally will value the debtor's interest in entireties property to be one-half of the total value of the property.

Offers in Compromise. Procedures for valuing entireties property for offer in compromise purposes are set forth in the Offer in Compromise Handbook, IRM 5.8.5.3.11.

The principal author of this notice is Deborah Grogan of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, contact Ms. Grogan at (202) 622-3610 (not a toll-free call).