



# CHICAGO BULL

## VOLUME 1, EDITION 21

### FEDERAL TAX LIENS AND TENANCY BY THE ENTIRETY

***ALERT: Effective immediately, in any situation involving a federal tax lien against one or both spouses where property is or will be held in a tenancy by the entirety, Chicago Title Insurance Company and its affiliate companies will require the satisfaction and release of such liens, or discharge of the property from the liens, duly filed in the office of the Clerk of Superior Court in the applicable miscellaneous file(s), notwithstanding the fact that the title to the property is held in the names of both spouses as tenants by the entirety.***

On April 17, 2002, the United States Supreme Court decided the case of **United States v. Crafts**, 535 U.S. \_\_\_\_ (2002), U.S. Lexis 2790, for which the slip opinion is online at [www.supremecourtus.gov/opinions/01pdf/00-1831.pdf](http://www.supremecourtus.gov/opinions/01pdf/00-1831.pdf). This decision provides that a federal tax lien against one spouse attaches to real property held by both spouses as tenants by the entirety.

**Facts** The case originated in Michigan. Husband and wife owned title to real estate as tenants by the entirety. The Internal Revenue Service filed a Notice of Federal Tax Lien against the husband. Thereafter, husband and wife transferred the title to the wife in her individual name. The wife attempted to sell the property a few years later and a title search revealed the lien. For reasons not explained in the opinion, the IRS was contacted about the lien and took the position that it would release the lien and allow the sale on the condition that half of the net proceeds be held in escrow pending determination of the government's interest in the property. The sale closed. The wife then brought an action to quiet title to the escrowed funds in District Court.

**Court Analysis and Decision:** After numerous appeals too lengthy to set forth in this Bulletin, the United States Supreme Court agreed to hear the case. In a 6 to 3 decision, the Supreme Court held that the husband's interests in the entirety property constitute "property" or "rights of property" under 26 U.S.C. §6321 to which a federal tax lien may attach. The court used state law to determine which "property" or "rights of property" are included in the husband's entirety interest. The Court then turned to federal law to determine whether or not those rights constitute attachable property under the federal tax lien statute. Justice O'Connor's majority opinion used a metaphor to explain the analysis:

A common idiom describes property as a "bundle of sticks" – a collection of individual rights which, in certain combinations, constitute property.... State 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 reviewed Michigan tenancy by the entirety law, which is substantially similar to North Carolina's laws. The Court held that each spouse owned sufficient "sticks" in the bundle of rights for the court to recognize that the spouse's interest in the entirety property may be subjected to a lien under the federal tax law. The "sticks" referenced include most of the basic attributes of tenancy by the entirety interests: the right to use the property, the right to exclude third parties, the right to share income produced by the property, the right of survivorship, the right to become a tenant in common upon divorce, the right to sell or encumber the property with the nondebtor spouse's consent, and the right to block the nondebtor spouse from unilaterally selling or encumbering the property. The case was remanded to the trial court to "value" this "property right" for federal tax lien purposes.

The case has engendered much discussion. How will the IRS value the property right? How does this change in lien rules affect the priority vis-à-vis other judgments, deeds of trust or liens? Is it retroactive and, if so, under what circumstances? What effect does this have on states that had previously adopted the Uniform Federal Tax Lien Registration Act? These issues (and others) will be left for future analysis and decisions.

But for now, as stated above, all current commitments outstanding and any future coverage requested will require that any federal tax liens be released or the particular property discharged, notwithstanding title being held as a tenancy by the entirety. This change applies only to federal tax liens and we are not changing our practices with respect to other non-consensual liens.

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