2005

When Is a Tenancy by the Entirety Interest in Common Law Jurisdictions an Asset of One Spouse?: Craft-Ing a Solution for the Tax Code's § 108 Insolvency Exclusion

Kimberly A. Butlak
University of Baltimore School of Law

Follow this and additional works at: http://scholarworks.law.ubalt.edu/ublr

Part of the Law Commons

Recommended Citation
Available at: http://scholarworks.law.ubalt.edu/ublr/vol34/iss3/2

This Article is brought to you for free and open access by ScholarWorks@University of Baltimore School of Law. It has been accepted for inclusion in University of Baltimore Law Review by an authorized administrator of ScholarWorks@University of Baltimore School of Law. For more information, please contact snolan@ubalt.edu.
WHEN IS A TENANCY BY THE ENTIRETY INTEREST IN COMMON LAW JURISDICTIONS AN ASSET OF ONE SPOUSE?: CRAFT-ING A SOLUTION FOR THE TAX CODE'S § 108 INSOLVENCY EXCLUSION

Kimberly A. Butlak†

I. INTRODUCTION

Gross income for purposes of federal income tax consists of income from all sources derived, including income from discharge of indebtedness.1 Discharge of indebtedness is considered income because a debt does not have to be repaid once it is discharged, even though the debtor received the beneficial use of the funds.2 Over time courts have held that a debtor has no taxable income from the discharged debt.3 This practice—recognizing that an insolvent debtor whose debt is discharged receives nothing of exchangeable value—became known as the judicial insolvency exception.4 When determining insolvency under this exception, courts disregarded property that was protected under state law from creditors' claims because the creditor discharging the debt could not seize it; therefore, this property was not considered an asset of the debtor.5

In the Bankruptcy Tax Act of 1980 ("BTA 1980"), Congress codified the judicial insolvency exception in § 108 of the Internal Revenue Code ("Code").6 Section 108, now the exclusive insolvency excep-

† Associate, Morgan, Lewis & Bockius, LLP; LL.M. (Taxation), Georgetown University Law Center (2002); J.D., University of Baltimore School of Law (2001).


2. United States v. Kirby Lumber Co., 284 U.S. 1, 3 (1931). The rule of Kirby Lumber, in which the Supreme Court held that a debtor realized "an accession to income" where "assets previously offset by the obligation . . . now extinct" became available, is codified in I.R.C. § 61(a)(12). See id.; see also infra Part II.A (discussing the inclusion of discharged debt in taxable income).

3. See, e.g., Dallas Transfer & Terminal Warehouse Co. v. Comm'r, 70 F.2d 95, 96 (5th Cir. 1934).

4. See infra Part II.B (discussing the judicial insolvency exception).


tion,⁷ allows a debtor to exclude a discharged debt from income if his or her liabilities exceed the fair market value of his or her assets.⁸ It was not until a few years ago, however, that a court considered whether property protected by state law from creditors’ claims is considered an asset under § 108, or whether it is disregarded—as it had been under the judicial insolvency exception.

In 2001, the United States Tax Court considered this issue in Carlson v. Commissioner.⁹ The court concluded that unlike the judicial insolvency exception, property protected under state law from creditors’ claims was not disregarded when determining insolvency under § 108.¹⁰ In light of Carlson, a question remains as to what type of property—which, until then, had been disregarded—is considered an asset under § 108. In particular, a question arises as to whether property titled as tenants by the entirety is considered an asset when determining a debtor-spouse’s insolvency.

In 2002, the Supreme Court took a step toward answering this question in United States v. Craft.¹¹ Although Craft did not involve a debtor’s insolvency, the opinion is instructive because the Court exhaustively analyzed the indicia of ownership of a tenancy by the entirety interest.¹² The issue in Craft was whether a federal tax lien could attach to one spouse’s tenancy by the entirety interest.¹³ In considering the issue, the Court looked at the actual rights (and not merely state law labels) the debtor-spouse had in his tenancy by the entirety interest, and determined that he had property or rights to property.¹⁴ More specifically, the Court held that, despite the protections afforded under state law, a debtor-spouse’s tenancy by the entirety interest constituted property or a right to property upon which a federal tax lien could attach, although the tax was owed by only one spouse.¹⁵

---

⁸. I.R.C. § 108(a)(1)(B), (d)(3). This article focuses on the issues of which property is considered an asset of a taxpayer and what the asset's associated value is for purposes of the § 108 insolvency calculation. The issue of what is a liability under § 108 was addressed by the United States Tax Court in Merkel v. Comm'r, 109 T.C. 463 (1997). The court held that in order for a contingent debt obligation to be a liability under § 108, the taxpayers must prove by a preponderance of the evidence that they would be called upon to pay the obligation in an amount less than their full exposure. Id. at 475-76.
¹⁰. Id. at 105-06; see also infra Part III (discussing Carlson).
¹². See infra Part IV (discussing Craft).
¹⁴. See id. at 283-88.
¹⁵. Id. at 288.
The Court, however, remanded the issue of valuation of the debtor-spouse's tenancy by the entirety interest.\(^{16}\)

In light of the Supreme Court's holding in *Craft* and the Tax Court's holding in *Carlson,* a cogent argument can be made that a tenancy by the entirety interest is considered an asset under § 108 when a debt of only one spouse is discharged. This situation is illustrated by the following example.

Assume Paul and Mary are husband and wife who own their house as tenants by the entirety in a traditional common law jurisdiction, such as Maryland.\(^{17}\) Paul, alone, takes out a $100,000 loan for his business. The business subsequently fails and the full amount of the loan is discharged. This discharged debt is income, as it is an accession to wealth. If, immediately before Paul's debt is discharged, he has liabilities of $250,000 and assets with a fair market value of $360,000 (including the value of the house), then he is solvent to the extent of $110,000. Accordingly, the entire discharged debt is includible in Paul's income. Should the house he owns with Mary as tenants by the entirety be considered an asset, although the debt discharged was not marital debt and despite the protections afforded to tenancy by the entirety property under state law? If so, what should be the value of Paul's interest in the house?

To analyze this issue, this article first sets forth the origin and development of the judicial insolvency exception and the codification of the exception in § 108.\(^ {18}\) Second, this article reviews the Tax Court's analysis in *Carlson* of exempt property as enhancing a debtor's ability to pay.\(^ {19}\) Third, this article discusses the Supreme Court's rationale for holding that a federal tax lien can attach to a tenancy by the entirety interest although only one spouse owes the tax, and despite the state law ownership restrictions (and resulting protections) associated with tenancy by the entirety property.\(^ {20}\) Fourth, this article analyzes the rights and restrictions of a tenancy by the entirety interest in a traditional common law jurisdiction such as Maryland.\(^ {21}\) Based on the discussion of the foregoing, the article concludes that a tenancy by the entirety interest should be considered an asset under § 108.\(^ {22}\)

The focus of this article then shifts to address the conundrum of determining the fair market value of a present interest in one spouse's tenancy by the entirety interest. This article reviews how courts have valued one spouse's tenancy by the entirety interest post-*Craft* and

---

16. See *id.* at 289.
17. This example will be used *passim* to illustrate the concepts and development of the law described in this article.
18. See *infra* Part II.
19. See *infra* Part III.
20. See *infra* Part IV.
21. See *infra* Part V.A.
22. See *infra* Part V.B.
23. See *infra* Part VI.B.
how this interest is valued by the IRS in collection proceedings.\textsuperscript{24} Next, this article considers the Code's statutory formula for valuing a tenancy by the entirety interest for estate tax purposes.\textsuperscript{25} Then, because the value of one spouse's tenancy by the entirety interest may be impacted as a result of divorce, this article reviews the potential effect of marital dissolution law in an equity jurisdiction (where property is divided based on the equities of the relationship, rather than equally), such as Maryland.\textsuperscript{26} This article concludes that a debtor-spouse's tenancy by the entirety interest should be valued by assigning each spouse a value in his or her respective interest that is half of the net asset value of the underlying property.\textsuperscript{27} The value should then be adjusted, when appropriate, based on the facts and circumstances, particularly those that would affect valuation in a marital dissolution proceeding or valuation of a survivorship interest.\textsuperscript{28}

II. GENESIS AND DEVELOPMENT OF THE INSOLVENCY EXCLUSION

A. United States v. Kirby Lumber Co.: Discharged Debt Included in Income

Discharged debt was first included in gross income in United States v. Kirby Lumber Co.\textsuperscript{29} Kirby Lumber arose around the time of the first Texas oil boom.\textsuperscript{30} John Henry Kirby, a Houston pioneer, sold large tracts of pine forest to Houston Oil Company but kept the timber and organized the Kirby Lumber Company to cut it down.\textsuperscript{31} The company issued bonds at par value and later purchased some of those bonds for less than par value.\textsuperscript{32} The exchange resulted in a return of $137,521.30 to the company.\textsuperscript{33} In its one-page opinion, the Court held that this amount was an accession to wealth to the company that must be considered when calculating gross income.\textsuperscript{34} The Court reasoned that the company had "no shrinkage of assets and [it] made a clear gain. As a result of its dealings it made available $137,521.30 [in] assets previously offset by the obligation of bonds now extinct."\textsuperscript{35}
The rule of *Kirby Lumber* that discharge of indebtedness is income to the debtor was codified in § 61(a)(12).³⁶

**B. Judicial Insolvency Exception**

Shortly after *Kirby Lumber*, the United States Court of Appeals for the Fifth Circuit created a judicial insolvency exception in *Dallas Transfer & Terminal Warehouse Co. v. Commissioner*.³⁷ As in *Kirby Lumber*, the debtor in *Dallas Transfer* was a Texas company—in this case, a corporation engaged in the transfer and storage business.³⁸ The corporation owed $107,880.77 to its landlord.³⁹ Because the corporation was insolvent, the landlord accepted partial payment of $17,507.20 on the debt and canceled the rest.⁴⁰

When determining whether the discharged debt was income to the insolvent corporation, the court compared the cancellation of the debt to what occurs in an insolvency or bankruptcy proceeding, whereby a debtor is discharged from liability for its debts.³¹ In such a proceeding, the debtor does not acquire something of exchangeable value in addition to what he had before: there is a reduction or extinguishment of liabilities without any increase of assets; there is an absence of gain or profit, as required to be considered income.⁴² The court recognized that a discharged insolvent or a bankrupt individual or entity would not have taxable income in the amount that the debts exceed surrendered assets.⁴³ Similarly, a discharged debt that left a debtor insolvent was not income.⁴⁴ The debtor has no increase in assets as a result of the discharge and, therefore, received no gain or profit.⁴⁵

The court concluded: "A transaction whereby nothing of exchangeable value comes to or is received by a taxpayer does not give rise to or create taxable income."⁴⁶ As a result of *Dallas Transfer*, an exception to *Kirby Lumber* was created whereby a debtor remaining insolvent after a debt was discharged does not recognize the discharged debt as income.

The judicial insolvency exception was refined a few years later in *Lakeland Grocery Co. v. Commissioner*.⁴⁷ In *Lakeland Grocery*, the Board of Tax Appeals extended the rationales of *Kirby Lumber* and *Dallas Trans-

---

³⁷. 70 F.2d 95 (5th Cir. 1934).
³⁸. Id. at 95.
³⁹. See id. at 95-96.
⁴⁰. See id. at 96.
⁴¹. Id.
⁴². See id.
⁴³. Id.
⁴⁴. Id.
⁴⁵. See id.
⁴⁶. Id.
⁴⁷. 36 B.T.A. 289 (1937).
and held that the discharged debt was excluded from income only to the extent of the debtor's insolvency. The debtor, a Florida corporation, could not pay its debts. After the debts were discharged, it was solvent to the extent of $39,596.93. The court recognized that a debtor would not have taxable income from a discharged debt if the debtor was insolvent after the discharge. In this case, however, at the time the debt was discharged, the corporation's assets exceeded its liabilities. Because the corporation was solvent, the court held that it had taxable income to the extent that the discharged debt resulted in its solvency.

Several years after its decision in *Lakeland Grocery*, the Board of Tax Appeals added another layer of analysis to the judicial insolvency exception in *Cole v. Commissioner*. Rufus Cole, the petitioner-debtor, was a corporate executive who became heavily indebted to brokers. His employer advanced $101,830 to him, and later discharged $63,000 of that amount. When determining the extent to which Mr. Cole's liabilities exceeded his assets (and thus, the extent of his insolvency), the Board of Tax Appeals disregarded assets exempt under state law—in this case, the value of Mr. Cole's equity in ten insurance policies. Without much analysis, the board based its decision on the fact that the policies were excluded from creditors' claims under New York law. Presumably, the board did so because these assets were never released from the employer-creditor's reach, as it could never attach an interest in them. For the next forty years, assets exempt under state law from creditors' claims were disregarded.

---

48. Id. at 292.
49. Id. at 291.
50. See id.
51. Id. at 292.
52. See id.; see also Haden Co. v. Comm'r, 118 F.2d 285, 286 (5th Cir. 1941) (holding that a debtor must include discharged debts in income to the extent that the debtor became solvent as a result of the discharge because the discharge is an accession to income in that year); cf. Quinn v. Comm'r, 31 B.T.A. 142, 145 (1934) (holding that the cancellation of a mortgage where the debtor remained insolvent did not result in taxable income because assets did not become available).
53. 42 B.T.A. 1110 (1940).
54. Id. at 1110.
55. Id. at 1110-11.
56. Id. at 1113.
57. Id. at 1112-13. As authority for this holding, the Board of Tax Appeals cited an old case decided by the Minnesota Supreme Court. See id. at 1113 (citing Underleak v. Scott, 134 N.W. 731 (Minn. 1912)). In *Underleak*, the court considered whether a transfer of property by a debtor to his daughter was a fraudulent conveyance under state law, which would avoid the conveyance under the Bankruptcy Act of July 1, 1898. 134 N.W. at 731-32. The court held that whether a debtor was deemed "insolvent" under § 1 of the Bankruptcy Act should be decided according to state law, and disposed of the case on the basis that exempt property of the debtor should not be considered in determining solvency. See id. at 734.
when determining insolvency under the judicial insolvency exception.\textsuperscript{58}

The development of the judicial insolvency exception can be summarized with the following principles. A discharged debt is considered income to the debtor,\textsuperscript{59} but it is not taxed to the extent that the debtor is insolvent after the discharge.\textsuperscript{60} When determining insolvency, property protected under state law from creditors' claims is disregarded as an asset of the debtor.\textsuperscript{61}

These principles are illustrated by returning to the example in the Introduction.\textsuperscript{62} Remember that in the example, Paul has liabilities of $250,000 and assets of $360,000. Assume that his assets include his ownership interest in a house in Maryland and that the underlying fair market value of the (entire) property is $300,000. Paul owns this house with his wife, Mary, as tenants by the entirety. A $100,000 debt of Paul's (alone) is discharged. Under the judicial insolvency exception, Paul has $100,000 of income from the discharged debt. Whether and to what extent that $100,000 is taxable income to Paul depends on whether and to what extent he is insolvent, which is determined by subtracting his liabilities from the fair market value of his assets. Under the judicial insolvency exception, only $60,000 of his assets are considered because the house he owns as a tenant by the entirety is exempt under state law from claims of his creditors.\textsuperscript{63} Therefore, Paul is insolvent to the extent of $190,000—$250,000 of liabilities less $60,000 of assets. Consequently, none of the $100,000 discharged debt is includible in his income.

C. Codification of the Judicial Insolvency Exception in the Bankruptcy Tax Act of 1980

Congress largely codified the judicial insolvency exception in § 108 in the BTA 1980.\textsuperscript{64} This legislation, which was part of bankruptcy law

\textsuperscript{58} See, e.g., Davis v. Comm'r, 69 T.C. 814, 833-34 (1978) (disregarding the value of a homestead exemption, an automobile, an insurance policy, clothing, and jewelry when determining insolvency because that property was exempt from creditors' claims under state law); Hunt v. Comm'r, 57 T.C.M. (CCH) 919, 948 (1989) (disregarding the value of a homestead exemption and certain personal property); Estate of Marcus v. Comm'r, 34 T.C.M. (CCH) 39, 41 (1975) (disregarding life insurance policies); Babin v. Comm'r, 64 T.C.M. (CCH) 1357, 1366 (1992) (disregarding a checking account balance of less than $400, the cash value from a life insurance policy, the value of an automobile, and apparel and household items to the extent of $200 per item).

\textsuperscript{59} See supra notes 29-36 and accompanying text.

\textsuperscript{60} See supra notes 37-52 and accompanying text.

\textsuperscript{61} See supra notes 53-58 and accompanying text.

\textsuperscript{62} See supra note 17 and accompanying text.

\textsuperscript{63} See supra notes 53-58 and accompanying text.

\textsuperscript{64} See Pub. L. No. 96-589, § 2(a), 94 Stat. 3389 (1980). Prior to its amendment by the BTA 1980, the statutory exclusion of discharge of indebtedness was limited to debt incurred in business. See S. Rep. No. 96-1035 (1980), re-
reform, set forth tax rules applicable to debts discharged in bankruptcy, as well as to insolvent debtors who do not go through bankruptcy proceedings.\textsuperscript{65}

Specifically, the BTA 1980 provided that if a debtor is insolvent, any debt discharged is excluded from income to the extent of the debtor's insolvency.\textsuperscript{66} But in order for the debt to be excluded, the debtor must reduce his or her tax attributes in other property.\textsuperscript{67} When reducing tax attributes, a debtor may elect to reduce basis in depreciable property or in real property held as inventory; otherwise, he or she must reduce net operating losses, certain tax credits, basis in other property, and capital loss carryovers.\textsuperscript{68} The legislative history of the BTA 1980 makes clear that a primary purpose of § 108 is to ensure that the discharged debt is eventually treated as ordinary income (and therefore subject to tax).\textsuperscript{69}

\textit{printed in} 1980 U.S.C.C.A.N. 7017. Further, discharged debt was excluded only to the extent that basis was reduced. \textit{See id.} There are no similar limitations in the current discharge of indebtedness exclusion. \textit{See id.} at 7035.


\textsuperscript{68} I.R.C. § 108(b)(2). A debtor may elect to first apply any portion of the discharged debt to reduce basis in depreciable property. \textit{Id.} at § 108(b)(5). If the debtor does not so elect, § 108 requires the debtor to reduce tax attributes in the following order: (1) net operating losses, both in the year of the discharge and any carryovers to that year; (2) carryovers to or from the taxable year relating to general business credits under § 38; (3) minimum tax credits under § 53(b) as of the beginning of the year immediately following the discharge; (4) net capital losses under § 1212; (5) basis of property of the taxpayer; (6) passive activity losses and credit carryovers under § 469(b) in the year of the discharge; and (7) foreign tax credit carryovers under § 27. \textit{Id.} at § 108(b)(2). A debtor's reduction of basis in property in number (5) applies to essentially all property the debtor owns, including "[p]roperty not used in a trade or business nor held for investment." Treas. Reg. § 1.1017-1(a)(5) (2003). Presumably, the basis of property owned by the debtor and his spouse as tenants by the entirety does not fall within this category because it is considered owned by a marital unit and not by either spouse individually. Analysis of this issue is analogous to the analysis of whether a tenancy by the entirety interest is an asset of the debtor-spouse. Section 108 and the Treasury Regulation should be interpreted either to consider a debtor's tenancy by the entirety interest as an asset in determining insolvency or to reduce the basis in a debtor's tenancy by the entirety interest. The focus and conclusion of this article, however, is that a tenancy by the entirety interest should be considered an asset of the debtor-spouse. A discussion of ownership interests for basis reduction is beyond the scope of this article.

More than twenty years after codification of the judicial insolvency exception, the United States Tax Court (the successor to the Board of Tax Appeals) heard *Carlson v. Commissioner.* In *Carlson,* the court considered whether property protected under state law from creditors' claims should be disregarded when determining insolvency under § 108, as it had been under the judicial insolvency exception. After examining the plain language of § 108 and reviewing its legislative history, the court held that, unlike the judicial insolvency exception, property exempt under state law from creditors' claims was *not* disregarded when determining insolvency under § 108.

The facts of *Carlson* are relatively simple. Roderick Carlson, a commercial fisherman, and his wife Jeanette purchased a fishing vessel with funds borrowed from a bank. Later, the couple became delinquent in their loan payments and the bank foreclosed on the vessel. The bank reduced the balance of the loan with the foreclosure proceeds and discharged the remaining balance. As a result, $42,142 of the debt was discharged. After concluding that their liabilities exceeded the fair market value of their assets, the debtors excluded this amount from their taxable income pursuant to § 108.

Although the debtors had a commercial fishing permit, they excluded the permit as an asset when calculating their insolvency because it was exempt under state law from creditors' claims. As a result, the court had to determine whether assets that would have been disregarded under the judicial insolvency exception were also disregarded under § 108.

The court held that the word "assets," as used to determine insolvency under § 108, included property exempt under state law from creditors' claims. Before reaching this conclusion, the court recognized that the word "assets" was not defined in § 108 or the regulations thereunder, and that its dictionary definition supported more than one construction. Consequently, the court determined that the meaning of "assets" was ambiguous and required further delibera-
tion. After reviewing the legislative history of the insolvency exception, the court concluded:

Congress did not intend to exclude assets exempt from the claims of creditors under applicable State law from a taxpayer's assets for purposes of determining whether the taxpayer is insolvent within the meaning of section 108(d)(3). If Congress had intended to exclude such exempt assets from a taxpayer's assets in determining whether the taxpayer is insolvent for purposes of section 108, Congress would have so stated in section 108(d)(3). It did not.

The court then looked at the couple's ability to pay tax on the discharged liability, recognizing that if the couple's total assets exceed their liabilities, then the debtors have "the ability to pay an immediate tax on income from discharged indebtedness." The court concluded that the fishing permit did enhance the debtors' ability to pay, despite its protection under state law. Therefore, the court held that the fishing permit was an asset for purposes of determining insolvency under § 108. Accordingly, under § 108, property exempt under state law from creditors' claims is not disregarded as an asset.

In defining assets based on the debtors' ability to pay—rather than on what the debtors' creditor could seize—the court expanded the scope of what is considered an asset. The definition makes sense because the court was determining the couples' tax rather than their ability to repay the debt. Therefore, it is irrelevant whether the creditor could seize the property. This conclusion finds support in at least two legal principles: first, exclusions from taxable income are construed narrowly; second, the IRS is empowered with authority that gives it greater rights than a typical unsecured creditor.

The holding of Carlson left open the question of what other types of property, disregarded under the judicial insolvency exclusion, are considered assets under § 108. One type is property titled as tenants

82. See id. at 93.
83. Id. at 104.
84. Id. at 105.
85. Id. at 104-05.
86. Id. at 105. The holding in Carlson is consistent with the latest position of the IRS, which considers property exempt under state law from creditors' claims as an asset for the purpose of determining insolvency. This position is a sea-change from the Internal Revenue Service's earlier position, and is based on the rationale that excluding exempt assets would allow economically solvent taxpayers (i.e. debtors whose total assets exceed their total liabilities) to avoid tax liability despite their ability to pay. See, e.g., Tech. Adv. Mem. 1999-35-002 (Sept. 3, 1999) (revoking Tech. Adv. Mem. 91-30-005 (Mar. 29, 1991)); Priv. Ltr. Rul. 1999-32-013 (Aug. 13, 1999) (revoking Priv. Ltr. Rul. 91-25-010 (Mar. 19, 1991)); Field Service Advice 1999-32-019 (Aug. 13, 1999); Service Center Advice 1998-039 (Apr. 1, 1998).
by the entirety. A question exists as to whether a tenancy by the entirety interest enhances a taxpayer’s ability to pay.

IV. UNITED STATES V. CRAFT: A SPOUSE’S TENANCY BY THE ENTIRETY INTEREST CONSTITUTES PROPERTY OR A RIGHT TO PROPERTY

In most common law jurisdictions, creditors of one spouse cannot seize property (or that debtor-spouse’s present interest in the property) held as tenants by the entirety. In 2002, the Supreme Court recognized an exception to this rule in United States v. Craft. While Craft did not concern § 108, the Court’s rationale is instructive in determining whether a tenancy by the entirety interest enhances a debtor’s ability to pay tax because of the Court’s analysis of the various property rights inherent in a tenancy by the entirety interest.

Don Craft failed to file income tax returns for eight years, and, as a result, had $482,446 of unpaid income tax. The IRS assessed this amount and, after Mr. Craft failed to pay it, the IRS attached a lien on “all property and rights to property, whether real or personal, belonging to’ him.” When the lien attached, Mr. Craft and his wife owned a parcel of real property in Michigan—a jurisdiction recognizing the traditional common law incidents of ownership—as tenants by the entirety. After notice of the lien was filed, the Crafts executed a quitclaim deed purporting to transfer Mr. Craft’s interest in the property to his wife for one dollar. One year later, Mrs. Craft attempted to sell the property and the IRS agreed to release the lien if half of the sale proceeds were held in escrow pending resolution of the issue.

Mrs. Craft then brought an action to quiet title to the sale proceeds. This action eventually came before the Supreme Court. The Supreme Court held that, although only one spouse owed the tax, a federal tax lien could attach to that spouse’s tenancy by the entirety interest. To reach this holding, the Court examined the breadth of control either spouse had over the property and concluded that they each held “property” or a “right to property” in their interests. The Court examined the state law property rights afforded to

89. See infra Part V.A (discussing tenancy by the entirety ownership in a traditional common law jurisdiction).
91. Id. at 276.
92. Id. at 275-76 (quoting I.R.C. § 6321 (West 2000)).
93. Id.
94. Id. at 276-77.
95. Id. at 277. The IRS never asked for more than half of the proceeds of the property titled as tenancy by the entirety. Id.
96. Id. at 277-78.
97. Id.
98. Id. at 288.
99. Id. at 282-85.
each spouse, describing each spouse’s property rights using the common “bundle of sticks” idiom, whereby each “stick” represents a property right. These rights include the right to use the entire property; receive income produced by the property; and, in particular, exclude others from the property—“‘one of the most essential sticks in the bundle of rights that are commonly characterized as property.’”

Although the Court acknowledged that neither spouse alone could alienate or encumber the property, nor sever the tenancy without consent of the other spouse or dissolution of the marriage, the Court concluded that these limitations were insufficient to disregard a tenancy by the entirety interest as property or a right to property. With the tenancy by the entirety interest, the rights of the debtor-spouse “went beyond use, exclusion, and income.” The Court stated that Mr. Craft also possessed the right to alienate (or otherwise encumber) the property with the consent of . . . his wife [the non-debtor-spouse] . . . . It is true . . . that he lacked the right to unilaterally alienate the property, a right that is often in the bundle of property rights . . . . There is no reason to believe, however, that this one stick—the right of unilateral alienation—is essential to the category of “property.”

The Court looked beyond the aegis of a tenancy by the entirety ownership to determine that each spouse had rights to property that, while not unfettered, were not illusory. The Court advanced a common-sense approach that the property belonged to someone. Indeed, if rights in property titled as tenancy by the entirety held by Mr. Craft, the debtor-spouse, do not constitute “property” or “rights to property,” then the property would belong to no one—Mrs. Craft, the non-debtor-spouse, would have no more interest in the property than her husband; if neither of them had a property interest in the entireties property, who did? This result not only seems absurd, but would also allow spouses to shield their property from federal taxation by classifying it as entireties property, facilitating abuse of the federal tax system.

Finally, the Court recognized the necessity of an expansive reach to collect federal taxes because collection of federal taxes was para-

100. Id. at 278-79.
101. Id. at 282-83 (quoting Kaiser Aetna v. United States, 444 U.S. 164, 176 (1979)).
102. Id. at 288.
103. Id. at 283.
104. Id. at 283-84 (citations omitted).
105. See id.
106. See id. at 285.
107. Id.
mount; a contrary holding could encourage collusion to avoid taxes.\textsuperscript{108}

V. TENANCY BY THE ENTIRETY INTERESTS UNDER TRADITIONAL COMMON LAW

This section first analyzes the rights of a spouse holding a tenancy by the entirety interest. The discussion focuses on Maryland law; however, it applies to jurisdictions that also retain tenancy by the entirety ownership in its traditional common law form. Then, in light of the ownership of those interests, this section examines whether a tenancy by the entirety interest is an asset of one spouse for purposes of \textsection{108}.

\textbf{A. Incidents of Ownership Conferred Under Maryland Law}

In traditional common law jurisdictions such as Maryland, ownership of a tenancy by the entirety interest entitles each spouse to the whole property (its entirety), but neither spouse owns the property individually.\textsuperscript{109} One spouse may lease, dispose of, or encumber the property only with the consent of the other spouse,\textsuperscript{110} or after the tenancy has been severed by an absolute divorce or death of the other spouse.\textsuperscript{111} Upon the death of one spouse, the surviving spouse takes the entire estate.\textsuperscript{112} Each spouse generally has an equal right to income derived from the property.\textsuperscript{113} Finally, a judgment creditor of one spouse may not attach a lien to the property during the joint lives of the spouses.\textsuperscript{114}

\textsuperscript{108} \textit{Id.} The Supreme Court remanded the case for the lower courts to value the tenancy by the entirety interest. It bears noting, however, that the IRS did not attempt to recover more than half of the proceeds from the property. \textit{See id.} at 289. On remand, the United States District Court for the Western District of Michigan entered a stipulated judgment for the IRS to retain \$50,293.94 of net sales proceeds from the property. \textit{Craft v. United States,} No. 93-CV-306 (W.D. Mich. July 28, 2003). This amount ended up being about half of the net proceeds.


\textsuperscript{110} \textit{Id.} at 187, 533 A.2d at 667; \textit{Arbesman v. Wilner,} 298 Md. 282, 290, 468 A.2d 633, 637 (1983).

\textsuperscript{111} \textit{One 1984 Toyota Truck,} 311 Md. at 187, 533 A.2d at 667; \textit{Beall v. Beall,} 291 Md. 224, 234, 434 A.2d 1015, 1021 (1981).

\textsuperscript{112} \textit{Beall,} 291 Md. at 234, 434 A.2d at 1021.


\textsuperscript{114} \textit{See One 1984 Toyota Truck,} 311 Md. at 187, 533 A.2d at 666-67; \textit{Arbesman,} 298 Md. at 289, 468 A.2d at 636.
For purposes of § 108, insolvency is the excess of a debtor's liabilities over the fair market value of his or her assets. Looking at the word "assets" without reference to fair market value, a tenancy by the entirety interest should be considered an asset under Carlson and Craft. In Carlson, the Tax Court ended the long-standing practice of disregarding property protected under state law from creditors' claims. This holding opened the door to consider that kind of property as an asset when determining insolvency.

The court in Carlson based its query on what types of property increase a debtor's ability to pay the debt. Property owned by both spouses, regardless of how it is titled, increases their ability to pay when both spouses are obligated—it is additional property from which to derive income, to mortgage, and to sell.

In states retaining the common law incidents of ownership of tenancy by the entirety property, the Supreme Court has held that each spouse has property or rights to property. The Court reached this holding based on each spouse's right to use the property, exclude

---

116. See supra notes 70-86 and accompanying text.
117. See supra notes 84-86 and accompanying text.
118. The tenancy by the entirety conundrum arises only when the debt is owed by one spouse (alone), regardless of whether the spouses filed a joint return. When a husband and wife file a joint return, their tax is computed on the aggregate income of the couple; they are both jointly and severally liable for the collection of tax. See I.R.C. § 6013(d)(3) (West 2004); Treas. Reg. § 1.6013-4(b) (2002). Filing a joint return does not create a new tax personality—assets and liabilities owned by the individual spouses are not combined to become assets of the marital unit. Cf. Coever v. Comm'r, 36 T.C. 252, 254 (1961) (disregarding the idea that a new tax personality is created when spouses file jointly).

Insolvency under § 108 is determined by reference to the extent to which the debtor's assets are freed as a result of the discharge. See Carlson v. Comm'r, 116 T.C. 87, 98-99 (2001); Merkel v. Comm'r, 109 T.C. 463, 473-75 & n.7 (1997); cf. United States v. Kirby Lumber Co., 284 U.S. 1, 3 (1931). To determine whether assets are freed, a debtor's ability to pay must be enhanced as a result of the discharged debt. Had the debt discharged been jointly owned by the spouses, no assets jointly owned would be protected under state law from creditors' claims, as it is generally accepted that a judgment lien can attach to tenancy by the entirety property if both spouses owe the debt. The IRS reached a similar conclusion in a Private Letter Ruling in which it concluded that when determining whether a debtor-spouse was insolvent under § 108, the separate property of the non-debtor-spouse was not an asset when determining his insolvency because his spouse's assets were her own, even if they filed a joint tax return. Priv. Ltr. Rul. 89-20-019 (May 19, 1989).

119. See supra Parts IV and V.A (discussing tenancy by the entirety property), Part IV (discussing Craft).
others from the property, dispose of the property, and encumber the property (with consent of the other spouse).¹²⁰

At a minimum, the survivorship interest of each spouse enhances that spouse's ability to pay.¹²¹ As a practical matter, the other incidents of ownership (i.e., exclusion, alienation, and encumbrance) also enhance a spouse's ability to pay. This is because, in most circumstances, spouses act in concert to advance what is in their best interest. Joint action with regard to tenancy by the entirety property is one way to advance that interest: spouses can encumber their combined interest, sell their combined interest, or both, or refuse to do either. The Supreme Court has recognized that the inability of one spouse to unilaterally encumber property is not a significant restriction on the property that would undermine each spouse's other rights.¹²² Therefore, the incidents of ownership in a tenancy by the entirety interest enhance one spouse's ability to pay.

This conclusion is supported by the Supreme Court's analysis in Craft.¹²³ Acting with the other spouse, the debtor-spouse may encumber or sell the property, or both.¹²⁴ Selling and/or encumbering the property gives a debtor more resources to repay the debt. Failing to recognize this increased ability to pay would allow spouses to shield their property from federal taxation, something the Supreme Court recognized would facilitate abuse of the federal tax system.¹²⁵ Moreover, the Supreme Court recognized that the requirement of joint spousal action regarding a tenancy by the entirety interest is an inconsequential limitation.¹²⁶

For purposes of the § 108 exclusion, insolvency is the extent that liabilities exceed the fair market value of a debtor's assets.¹²⁷ If "assets" refers only to those with a fair market value, then a tenancy by the entirety interest can never be an asset because there is no market for the interest—only a spouse can hold a tenancy by the entirety interest with the other spouse—therefore, there can be no fair market value.¹²⁸

This syllogistic reasoning unduly focuses on the form of the property interest, not the substantive right created thereunder, and ignores the Supreme Court's analysis of a tenancy by the entirety

¹²⁰. See supra notes 99-108 and accompanying text (discussing the rights of a tenant by the entirety as set forth in Craft).
¹²¹. Cf. In re Ryan, 282 B.R. 742, 748 (Bankr. D.R.I. 2002). One spouse's survivorship interest is generally recognized as an alienable interest with a value, albeit speculative. Id.
¹²². See supra notes 102-03 and accompanying text.
¹²³. See supra notes 102-08 and accompanying text.
¹²⁴. See supra notes103-04 and accompanying text.
¹²⁵. See supra note 107 and accompanying text.
¹²⁶. See supra notes 102-04 and accompanying text.
interest in relation to the collection of federal income tax. Further, this argument fails to recognize that there is a market for the underlying property, and for either spouse's contingent survivorship interest. Also, failure to acknowledge that spouses, by acting in their best interest, can either shield assets from creditors or make them available to sell or to encumber ignores the economic reality of the property rights—and the resulting availability to pay a debt— inherent in tenancy by the entirety ownership. Finally, as discussed more fully in the following sections, even looking at the definition of assets only as those having an actual fair market value, tenancy by the entirety interests—both the present and future survivorship interests—should be deemed to have a fair market value based on how they are valued for other purposes of the Code, by courts, and by the IRS.

Where exclusion of a tenancy by the entirety interest would increase the tax benefit being conferred (as with the §108 insolvency exclusion), the tenancy by the entirety interest should be considered as an asset. Ownership of a tenancy by the entirety interest does increase a debtor's ability to pay tax—despite its strictures, it is a bona fide property interest. Moreover, consideration of a tenancy by the entirety interest is consistent with the judicial maxim that exclusions from income are to be narrowly construed. Failure to consider the interest would reduce the taxpayer's solvency, resulting in the exclusion from taxation of a greater portion of the discharged debt.

Because a debtor-spouse owns the underlying property as a party to a marriage, the value of his or her tenancy by the entirety interest should be limited. Any valuation of the interest should give appropriate consideration to the non-debtor-spouse's interest, as well as contemplate factors that otherwise affect the value of either spouse's interest, such as the impact of divorce and death.

129. See supra notes 102-08 and accompanying text.
130. See supra note 121 and accompanying text.
131. See supra notes 105-08 and accompanying text.
132. See infra notes 139-66 and accompanying text (discussing how courts value a tenancy by the entirety interest in bankruptcy proceedings); notes 177-84 and accompanying text (discussing how courts consider a tenancy by the entirety interest in a marital dissolution proceeding); notes 172-76 and accompanying text (discussing how a tenancy by the entirety interest is considered for estate tax purposes); notes 167-71 and accompanying text (discussing how the IRS values a tenancy by the entirety interest in collections).
133. See supra note 87 and accompanying text.
VI. FAIR MARKET VALUE OF TENANCY BY THE ENTIRETY INTEREST TO DETERMINE INSOLVENCY

A. Fair Market Value of Debtor's Interest in Tenancy by the Entirety Property

Insolvency is calculated by subtracting a debtor's liabilities from the fair market value of his or her assets.\textsuperscript{135} Fair market value is the price that a hypothetical willing buyer would pay, and a hypothetical willing seller would receive, for property.\textsuperscript{136} For this purpose, the property is valued at its highest and best use and without regard to events occurring subsequent to the valuation date, to the extent that those subsequent events were not reasonably foreseeable.\textsuperscript{137} Determining fair market value requires a factual inquiry, whereby all relevant evidence is weighed and appropriate inferences are drawn.\textsuperscript{138}

B. Application of Craft to Determine the Value of a Tenancy by the Entirety Interest

In several recent bankruptcy proceedings, courts have answered Craft's unanswered question: How should a spouse's tenancy by the entirety interest be valued? All courts deciding the issue have considered the incidents of ownership associated with the interest in the applicable jurisdiction. Depending on the purpose of the valuation (i.e., replacement value versus another value), courts are split regarding whether the value of one spouse's interest in tenancy by the entirety property should be adjusted further to account for each spouse's separate survivorship interest in cases concerning a debtor's federal tax obligation.

For example, in \textit{Popky v. United States},\textsuperscript{139} a federal district court in Pennsylvania held that a debtor-spouse's tenancy by the entirety interest under Pennsylvania law was half the value of the underlying property.\textsuperscript{140} In that case, the IRS assessed $42,799.20 of unpaid employment taxes owed by the debtor-spouse, Sheila Popky.\textsuperscript{141} Four years later, Mrs. Popky and her husband sold the property—titled as tenants by the entirety—that was subject to an IRS lien.\textsuperscript{142} After the title company sent the IRS a check for $42,324.43, the Popkys initiated a suit to quiet title to proceeds from the sale of property.\textsuperscript{143}

The first issue the court decided was whether, under Pennsylvania law, the tenancy by the entirety property held by Dr. and Mrs. Popky

\begin{footnotes}
\footnotemark[135]
\footnotemark[136]
\footnotemark[137]
\textit{Bank One Corp.}, 120 T.C. at 306.
\footnotemark[138]
\textit{Id.}
\footnotemark[139]
\footnotemark[140]
\textit{Id.} at 603.
\footnotemark[141]
\textit{Id.} at 597.
\footnotemark[142]
\textit{Id.}
\footnotemark[143]
\textit{Id.} at 596.
\end{footnotes}
could be subject to a federal tax lien where the tax was owed by only one spouse.\textsuperscript{144} After holding that the lien could attach to Mrs. Popky’s tenancy by the entirety interest, the court assigned a value to the interest.\textsuperscript{145} At the onset, the court recognized that under Pennsylvania law, while the Popkys were married, neither Mrs. Popky nor Dr. Popky could destroy the tenancy or alienate any portion of it without the consent of the other.\textsuperscript{146} On one hand, the court recognized that equal division of the entireties property “fails to account for the differing life expectancies of the spouses and . . . the probability that either spouse will ultimately have a right to the whole.”\textsuperscript{147} On the other hand, the court also recognized that consideration of the survivorship interests of the spouses relies

on a speculative prediction that both spouses will have an average life span and it neither accounts for the health of the spouses nor for the likelihood of divorce or a sale of the property with the consent of both spouses which could break up the tenancy by the entireties. To include these factors would make valuation infinitely more complicated and would again reach a valuation based merely on speculation.\textsuperscript{148}

The court held that the “only equitable solution” was to value Mrs. Popky’s tenancy by the entirety interest at half the net value of the underlying asset.\textsuperscript{149}

Similarly, in \textit{In re Gallivan},\textsuperscript{150} a federal bankruptcy court determined the value of each spouse’s tenancy by the entirety interest for purposes of a secured claim by the IRS against one spouse.\textsuperscript{151} The debtors were husband and wife, Jerry and Jeanette Gallivan, who filed a Chapter 11 bankruptcy petition.\textsuperscript{152} Prior to the filing, Mr. Gallivan was the sole proprietor of a trucking company that failed to pay employment tax.\textsuperscript{153} The IRS filed pre-petition notices of tax liens and a proof of claim (with both secured and unsecured components) regarding Mr. Gallivan’s employment tax.\textsuperscript{154}

\begin{footnotes}
\footnote{\textsuperscript{144} \textit{Id.} at 597.}
\footnote{\textsuperscript{145} \textit{Id.} at 601, 603.}
\footnote{\textsuperscript{146} \textit{Id.} at 601.}
\footnote{\textsuperscript{147} \textit{Id.} at 602-03.}
\footnote{\textsuperscript{148} \textit{Id.} at 603.}
\footnote{\textsuperscript{149} \textit{Id.} The court’s decision in \textit{Popky} was based in part on a Pennsylvania statute that provides that if tenancy by the entirety property is not otherwise divided by court order in a marital dissolution proceeding, then, upon divorce, each spouse holds half of the interest as tenant in common with the other spouse. \textit{Id.} at 600 (citing 23 PA. CONS. STAT. ANN. § 3507(a) (West 2001)).}
\footnote{\textsuperscript{150} 312 B.R. 662, 664 (Bankr. W.D. Mo. 2004).}
\footnote{\textsuperscript{151} \textit{Id.}}
\footnote{\textsuperscript{152} \textit{Id.}}
\footnote{\textsuperscript{153} \textit{Id.}}
\footnote{\textsuperscript{154} \textit{Id.}}
\end{footnotes}
The Gallivans argued that the amount of Mr. Gallivan’s tenancy by
the entirety interest, and therefore the amount of the IRS’s claim,
should be reduced based on Mr. Gallivan’s life expectancy.\textsuperscript{155} The
IRS countered that the value of Mr. Gallivan’s tenancy by the entirety
interest should be half the net value of the underlying asset.\textsuperscript{156}

The court rejected the debtor’s argument that the value of each
spouse’s tenancy by the entirety interest should be adjusted to account
for the life expectancies of the spouses, presumably to follow the
trend of other courts, stating that survivorship principles were not “en­
tirely applicable in the bankruptcy context” because the extent of the
IRS’s lien must be determined before a bankruptcy plan of reorgan­
ization could be confirmed.\textsuperscript{157} Once confirmed, the IRS’s lien would
not be increased if Mrs. Gallivan were to later predecease Mr. Gal­
livan.\textsuperscript{158} The court held that an equal division of the interests seemed
 equitable; it paralleled the distribution of the property after an entire­
ties estate is severed due to a sale, divorce, or some other reason.\textsuperscript{159}
Further, the court concluded that the spouses have a “unity of inter­
est, unity of entirety, unity of time, and unity of possession;” therefore,
they must each hold an equal interest.\textsuperscript{160}

While the foregoing cases have held that a debtor-spouse’s tenancy
by the entirety interest is half the net value of the underlying property,
courts considering the replacement value, and not the fair market value,
of the property have held differently.\textsuperscript{161} For example, the District
Court for the Middle District of Florida held that the replacement
value of a debtor-spouse’s tenancy by the entirety interest should re­
flex his life expectancy, citing federal estate tax regulations that value
life estates using actuarial tables.\textsuperscript{162} The court held that “[d]espite its
administrative inconvenience, . . . the value of a debtor’s interest in
tenancy by the entireties property must be determined by joint life
actuarial tables” although using actuarial tables “invites speculation

\textsuperscript{155} Id.
\textsuperscript{156} Id.
\textsuperscript{157} Id. at 665-66 (citing In re Garner, 952 F.2d 232, 236 (8th Cir. 1991); Popky v.
United States, 326 F. Supp. 2d 594 (E.D. Pa. 2004)).
\textsuperscript{158} In re Gallivan, 312 B.R. at 665.
\textsuperscript{159} Id. (citing Popky, 326 F. Supp. 2d at 602). The court’s statement that equal
division of interests parallels the distribution of tenancy by the entirety in­
terest after divorce may be inaccurate. As support for this statement, the
court in Gallivan relies in part in Popky. See supra notes 139-49 and accompa­
nying text. Although the court in Popky did state that a tenancy by the en­
tirety state is divided equally between spouses upon divorce, the court was
relying on a specific Pennsylvania statute. See supra note 149.
\textsuperscript{160} Id.
\textsuperscript{161} Replacement value is “the price a willing buyer in the debtor’s trade, business,
or situation would pay a willing seller to obtain property of like age and
condition.” Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 959 n.2
\textsuperscript{162} In re Murray, 318 B.R. 211, 214 (Bankr. M.D. Fla. 2004).
about the future and is administratively less convenient" than valuing
the debtor-spouse's interest at half the underlying asset value.\footnote{163}

In another case, \textit{In re Basher},\footnote{164} the United States Bankruptcy Court
for the Eastern District of Pennsylvania also held that the replacement
value of a debtor-spouse's tenancy by the entirety interest was affected
by each spouse's respective life expectancies because their rights of
survivorship altered their otherwise equal interests.\footnote{165} While these
courts' analyses are informative, they should not control in determin­
ing the value of property for purposes of insolvency because the value
of assets for insolvency is determined by reference to fair market
value, which may differ from replacement value.\footnote{166}

\textbf{C. Value Used In IRS Collection Proceedings}

The IRS considers the purpose for the valuation when determining
the value of the underlying asset. For purposes of imposing a federal
tax lien, as well as valuing a secured claim in bankruptcy, the IRS
deems a debtor-spouse's tenancy by the entirety interest to be half of
the net equity in the underlying property.\footnote{167} Similarly, in private fore­
closure actions, the IRS deems a debtor-spouse's tenancy by the en­
tirety interest to be half of the difference between the value of the
property and the amount of the senior lien.\footnote{168}

In evaluating an offer in compromise for doubt as to collectibility
under § 7122, the IRS generally values a debtor-spouse's tenancy by
the entirety interest at half of the net equity in the underlying prop­
erty.\footnote{169} However, the IRS has routinely recognized that it can be as
low as twenty percent if the non-debtor-spouse paid substantially all of
the purchase price or mortgage payments, or if the non-debtor-spouse

\begin{itemize}
  \item \footnote{163} \textit{Id.}
  \item \footnote{164} 291 B.R. 357 (Bankr. E.D. Pa. 2003).
  \item \footnote{165} \textit{Id.} at 362, 364, 366. In \textit{Pletz v. United States}, the Ninth Circuit affirmed a
decision by a bankruptcy court, in which the bankruptcy court consulted
actuarial tables to value one spouse's tenancy by the entirety interest. 221
F.3d 1114, 1118-19 (9th Cir. 2000). It is important to note that in \textit{Pletz}, the
underlying property being valued was situated in Oregon, where under
state law, creditors of one spouse can attach that spouse's interest. \textit{Id.} at
1117.
  \item \footnote{166} \textit{See, e.g.}, McGuire v. Comm'r, 44 T.C. 801, 806 (1965) (noting the taxpayers'
concession that replacement value may exceed fair market value); Under­
wood v. Comm'r, 58 T.C.M. (CCH) 751 (1989) (recognizing that replace­
ment value can enhance the fair market value of a used asset); Living­
ton v. Comm'r, 25 T.C.M. (CCH) 277 (1966) (recognizing that replacement
value is not a reliable indicator of fair market value but is worthy of consider­
ation for a new building); Himes v. Comm'r, 8 T.C.M. (CCH) 515 (1949) (recog­
nizing that the cost to replace a machine is not the proper basis for deter­
niming fair market value).
  \item \footnote{167} I.R.S. Notice 2003-60, 2003-2 C.B. 643.
  \item \footnote{168} \textit{Id.}
  \item \footnote{169} I.R.M. 5.8.5.3.11(4) (Nov. 1, 2000).
\end{itemize}
refuses to commit the property for sale or for collateral on a loan to help pay the offer.170

While the IRS's valuation of a tenancy by the entirety interest in bankruptcy proceedings and administrative settlements is not dispositive in determining valuation under § 108, it is instructive because the IRS will always be a party to litigation resulting from an incorrect insolvency determination. Therefore, a debtor can make a tenable argument that a valuation approach different from these may be contrary to the IRS's published guidance and prior litigating positions.171

D. Value of One Spouse's Tenancy by Entirety Interest for Estate Tax Purposes

In at least one instance, the Code expressly prescribes that the fair market value of one spouse's tenancy by the entirety interest is half of the underlying property's value. In § 2040(b), an estate tax provision, half the value of property owned as tenancy by the entirety by a decedent and his or her spouse is included in the decedent's gross estate.172 This valuation rule was intended to facilitate administration of the estate, and it applies regardless of which spouse paid the consideration for the property.173

The express language in § 2040(b) both favors and disfavors valuing a tenancy by the entirety interest as half the underlying property's net value for purposes of § 108. On one hand, the statutorily prescribed valuation method supports the conclusion that halving the underlying property's net value is a reasonable method of determining a fair market value for the interest.174 On the other hand, the express provision in § 2040(b), compared to the absence of similar language in § 108, supports the conclusion that Congress intentionally omitted the valuation method from § 108.175 Further, valuation is inherently

170. Id. The IRS revised this provision of the Internal Revenue Manual on November 15, 2004 to eliminate the twenty-percent valuation. I.R.M. 5.8.5.3.11(4) (Nov. 15, 2004), available at http://www.irs.gov/irm/part5/ch08s05.html. The IRS generally does not consider assets of the non-debtor-spouse in determining whether an offer is adequate unless applicable state law permits the non-liable spouse's assets to be collected. Treas. Reg. § 301.7122-1(c)(2)(ii)(A) (2002). Even if state law allows collection, the assets are considered only to the extent that collection of those assets would not materially and adversely affect the family's standard of living. Id. at § 301.7122-1(c)(2)(ii)(B).

171. Cf. Rauenhorst v. Comm'r, 119 T.C. 157, 170-72 (2002) (rejecting arguments advanced by the IRS that contradict its published rulings of general application that have not been modified or withdrawn).

172. I.R.C. § 2040(b) (West 2004).


175. See id. § 51:02.
factual and should only be uniform where the facts dictate. Moreover, analogous but unrelated legislation is often an unreliable means of discerning legislative intent. Therefore, the use of § 2040(b) to value a tenancy by the entirety interest for other purposes should only occur when § 2040(b)'s valuation method is endorsed expressly by Congress.

E. Treatment of Tenancy by the Entirety Interests in Marital Dissolution Proceedings

In marital dissolution proceedings in common law jurisdictions, property is distributed either equitably or equally. For example, Maryland is an equitable distribution state, which means that in marital dissolution proceedings, a court has discretion to award or apportion marital property between spouses as it deems equitable, just, and reasonable—but not necessarily equally. Marital property includes property titled as tenants by the entirety. When awarding marital property, a Maryland court cannot transfer ownership between spouses; it may only make an adjustment in the form of a monetary award. The amount of the monetary award is based on the following statutorily prescribed factors:

1. the contributions, monetary and non-monetary, of each party to the well-being of the family;
2. the value of all property interests of each party;

176. Id. § 53:05.
177. See Equal Versus Equitable: The Issue of Equal Division, 15 NO. 3 EQUITABLE DISTRIBUTION J. 25 (1998). In equal distribution states (e.g., New Hampshire), there is a strong presumption in favor of equal distributions of marital property. Id. at 26-28. In equitable distribution states (e.g., Hawaii, Kentucky, Maryland, Missouri, New York, Tennessee, Virginia, and Wyoming), there is no presumption favoring equal distribution. Id. at 27. In hybrid-distribution states (e.g., Arkansas, Florida, Indiana, Nevada, North Carolina, Ohio, West Virginia, and Wisconsin), courts will begin with a presumption that marital property shall be divided in half, but then each spouse’s respective value should be adjusted if the equities dictate. Id. at 26-27.
178. Alston v. Alston, 331 Md. 496, 508-09, 629 A.2d 70, 76 (1993) (“In Maryland, as in the majority of equitable distribution states, ‘equitable’ does not necessarily mean ‘equal.’”).
179. MD. CODE ANN., FAM. LAW § 8-201(e) (2004). If property is acquired before a marriage but title is changed to tenancy by the entirety after the marriage, the portion of the property paid for prior to the marriage is not marital property. Kline v. Kline, 85 Md. App. 28, 40-41, 581 A.2d 1300, 1306 (1990).
180. MD. CODE ANN., FAM. LAW § 8-202(a)(3) (2004) (“[T]he court may not transfer the ownership of . . . real property from one party to the other.”); MD. CODE ANN., FAM. LAW § 8-205(a) (stating that “[a]fter the court determines which property is marital property, and the value of marital property, the court may . . . grant a monetary award . . . as an adjustment of the equities and rights of the parties concerning marital property, whether or not alimony is awarded”).
(3) the economic circumstances of each party at the time the award is to be made;
(4) the circumstances that contributed to the estrangement of the parties;
(5) the duration of the marriage;
(6) the age of each party;
(7) the physical and mental condition of each party;
(8) how and when specific marital property . . . was acquired, including the effort expended by each party in accumulating the marital property . . . ;
(9) the contribution by either party of . . . [non-marital] property to the acquisition of real property held by the parties as tenants by the entirety;
(10) any award of alimony and any award or other provision that the court has made with respect to family use personal property or the family home; and
(11) any other factor the court considers necessary or appropriate to consider in order to arrive at a fair and equitable monetary award. 181

Each and all of the foregoing factors could affect the value of a spouse's tenancy by the entirety interest in Maryland after an absolute divorce, particularly the manner in which the tenancy by the entirety property was acquired and the extent to which it was acquired with non-marital property.

After applying these factors, a court could grant one spouse the entire value of the tenancy by the entirety property or none of it. 182 These factors are an express recognition by the Maryland General Assembly that courts are to look at all of the facts and circumstances before assigning a value to each spouse's interest in the underlying property. This valuation approach seems reasonable and, indeed necessary. 183 Not only is each property unique, 184 the contributions to acquire and maintain property can vary greatly. Although there is no market per se for a tenancy by the entirety interest, the multitude of factors used by Maryland and other states to determine a fair market value for the tenancy by the entirety interest in a divorce proceeding

181. MD. CODE ANN., FAM. LAW § 8-205(b).
182. See Alston, 331 Md. at 508, 629 A.2d at 76.
183. Id. at 506-07, 629 A.2d at 75.
184. The fact that land is unique is supported by the fact that specific performance, an equitable remedy, is preferred over an award of damages with regard to realty. See, e.g., Leet v. Totah, 329 Md. 645, 665, 620 A.2d 1372, 1381-82 (1993) (clarifying that specific performance is an available remedy for purchase of realty); Manning v. Potomac Elec. Power Co., 230 Md. 415, 422, 187 A.2d 468, 472 (1963) (granting specific performance for realty); Archway Motors Inc. v. Herman, 37 Md. App. 674, 682, 378 A.2d 702, 725 (1977) (recognizing that "specific performance is not only available but a preferred remedy to a contract seller of land is firmly rooted in the law of Maryland").
appears to replicate what a willing buyer and a willing seller would consider in valuing property.

VII. PROPOSED VALUATION OF A TENANCY BY THE ENTIRETY INTEREST UNDER MARYLAND LAW

Since United States v. Craft, federal courts have generally valued a tenancy by the entirety interest for purposes of a federal tax lien at half the net value of the underlying property.185 These courts use half the value because the lien immediately encumbers the debtor-spouse’s interest, which eliminates speculation regarding the effect of death or a possible divorce.186 Beginning the valuation at half the net value of the underlying property is also consistent with the general approach of the IRS.187

This approach offers simplicity in a tax system based on self-assessment, whereby taxpayers are responsible for initially reporting their taxes. This simplicity is particularly important where property laws of each state could afford different rights and impose different restrictions on tenancy by the entirety ownership, and where tax parity between common law and community property jurisdictions is a goal. This starting point is also consistent with, but not motivated by, the valuation approach in § 2040(b).

From this point, one spouse’s interest should be adjusted based on equitable distribution factors enumerated under state law in marital dissolution proceedings, in which the tenancy is severed and each spouse’s interest is valued. The adjustment results because Maryland (and many other states) has specifically recognized that each spouse’s interest in marital property, including tenancy by the entirety interests, may not necessarily be equal.188 As explained above, if one spouse demonstrates an overwhelming existence of any of the monetary award factors, then a Maryland court is likely to give that spouse an award that represents a much greater, if not entire, interest in the property.189 The reverse is also true: if the other spouse can demonstrate the overwhelming existence of any of the factors, then the other spouse’s award should be greater. Therefore, it should follow that if a debtor-spouse can demonstrate the non-debtor-spouse’s hypothetical award would be greater, then the debtor-spouse’s value in the tenancy by the entirety interest should be reduced for purposes of determining insolvency under § 108. Consideration of these factors is consistent with the IRS’s willingness to adjust valuation of a tenancy by the entirety interest (in some cases calculating the value as low as twenty percent of the net value of the underlying property) when consider-

185. See supra notes 141-61 and accompanying text.
186. See, e.g., supra note 148 and accompanying text.
187. See supra notes 167-69 and accompanying text.
188. See supra notes 178-85 and accompanying text.
189. See supra notes 182-84 and accompanying text.
ing offers in compromise. In applying this approach, it is critical that the debtor-spouse remember that he or she bears the burden of proof to establish valuation, and therefore the factors to support the valuation, regardless of judicial forum.

Under state property law, each spouse's survivorship interest is the only consistent difference between the tenancy by the entirety interests held by each spouse that may cause a significant difference in the value of the interest between spouses. If a debtor-spouse can demonstrate an appreciable difference in life expectancies that would affect the value of his or her survivorship interest, then that difference should also be considered. As in most bankruptcy cases addressing the issue, routine consideration of life expectancies would make valuation more complicated and based largely on speculation, particularly because in the average case, any difference in value attributable to life expectancies is likely negligible. Therefore, this factor should affect the valuation only when, based on the facts and circumstances, there is an appreciable difference in life expectancies that may yield an appreciable difference in the valuation.

Applying this approach to our example, if Paul provided all of the funds for the house he owns with Mary (and that can be proven), the entire value of the underlying property should be considered as an asset when determining whether he is insolvent. Therefore, his assets of $360,000 would exceed his liabilities of $250,000 by $110,000, which means that he would be solvent and the $100,000 of discharged debt would be includible in his gross income. If, however, Paul could demonstrate that the house was purchased entirely with Mary's separate, non-marital funds (for example, with money devised only to her), then none of the value of the house should be considered his asset because, were they to get a divorce, he would likely not receive any interest in the property. Thus, Paul would be insolvent to the extent of $190,000, the amount that his liabilities of $250,000 exceed the fair market value of his assets of $60,000. Similarly, if Paul were much older than Mary, then a court may reduce the value of his tenancy by the entirety interest to account for his small survivorship interest.

190. See supra note 170 and accompanying text.
191. See, e.g., I.R.C. § 7491 (West 2004) (imposing the initial burden on the taxpayer to introduce credible evidence in court proceedings arising in connection with examinations by the Commissioner of Internal Revenue); United States v. Janus, 428 U.S. 433, 440 (1976) ("In a refund suit the taxpayer bears the burden of proving the amount he is entitled to recover."); Higbee v. Comm'r, 116 T.C. 438, 440-41 (2001) (recognizing the burden of proof is on the taxpayer in a deficiency case); see also Tax Ctr. R. 142.
192. See supra notes 147-49, 157-59 and accompanying text.
193. See supra note 17 and accompanying text.
VIII. CONCLUSION

Based on the precedent of the Supreme Court and the United States Tax Court, a tenancy by the entirety interest in a traditional common law jurisdiction, such as Maryland, should be considered an asset for purposes of determining the insolvency of one spouse under § 108. Consistent with the Tax Court's opinion in Carlson v. Commissioner, courts should look behind the veil of tenancy by the entirety ownership to determine whether property affords the debtor-spouse an enhanced ability to pay.194 Based on the rationale of the Supreme Court in Craft, along with the methods employed by other courts and the IRS, valuation of a tenancy by the entirety interest should begin at half the net value of the underlying property.195 The value should then be adjusted to reflect special circumstances, such as a de minimus contribution by the debtor-spouse to the acquisition of the property or an extraordinary difference in the spouses' life expectancies. Throughout, the burden of proof to show these special circumstances exist would be on the proponent, who is most likely the debtor-spouse.

194. See supra Part III.
195. See supra Parts IV-VI.