TAX TALK

Published by the Section of Taxation of the Maryland State Bar Association, Inc.

• Jeffrey A. Markowitz, Chair •

Catherine Mary Rafferty, Editor

Volume XII Number 2 *Winter 2004*

From the Chair

Jeffrey A. Markowitz

I wish to extend to all our members best wishes for a happy 2004. I am pleased to report that the 2003 Advanced Tax Institute was one of the best as far as the quality of speakers. The new location in Columbia had pros and cons, but it has been determined that we will try it again for next year and I hope that its more centralized location will draw practitioners from throughout the State.

Many of you will probably have received recently your questionnaire from the Court of Appeals involving pro bono legal services. This, hopefully, will serve as a good reminder for you to participate in the Baltimore Cash Campaign, which is the new umbrella for providing tax preparation services to low income taxpayers. You can sign up for the campaign at the Tax Section's website. Also, please note the Section has both legislation and general suggestion boxes on the website. Please feel free to use these so that the Section Council can make the Section more responsive and a better service to its members. The Section Council is currently working on our program for the annual meeting in Ocean City. At this point it is likely that we will present an update on tax issues involving real estate, including the new Maryland rules on sales by out of state real property owners. At this point we are leaving the program flexible depending upon what happens in this year's general assembly.

Our work on substantive law committees is still progressing. The Section Council has also been contacted by parties desiring to revive the employee benefits tax study group, which has been dormant. If you practice in this area and have an interest in participating in a tax study group, please contact me and we will take steps in getting this group up and running again. By the time you receive this, we will have had our Tax Networking Night at the Furnace Inn. This is our third year of this highly successful program inviting accountants and members of other bar sections to meet and exchange ideas in a social setting. I feel this has been one of the best programs that we have added as a section and am very grateful to Jim Dawson and Bryan Young for arranging it again this year.

On the CLE front, Caroline Ciraolo has been working with other sections to give a MICPEL presentation on the Craft case and the ramifications, which flow from that case. The decision in Craft about the IRS' ability to attach tenants by the entireties property, as well as the IRS' interpretation of the decision is one of the most significant developments in recent years. I encourage all of you to attend the seminar as well as to alert your fellow practitioners in the family law, bankruptcy, real property and estates and trusts sections of the importance of this decision.

COMING IN FEBRUARY!

Tax Controversy Study Group

This group is open to all members of the Maryland State Bar Association Tax Section and will focus on issues that arise in federal and state tax controversy practices, including (but not limited to) audits, exams, appeals, innocent spouse claims, trust fund recovery issues, collections, tax litigation and criminal tax matters. The group will meet once a month for breakfast at various locations. Anyone interested in joining this study group, please contact Caroline D. Ciraolo, cdc@msbpa.com or 410.547.7852.

U.S. v. Craft - Where Do We Go From Here?

By Caroline D. Ciraolo and Shannon Chilcoate

Editor's Note: This article is an abbreviated version of an article scheduled to be published in the Journal of Tax Practice and Procedure (CCH), January, 2004.

Introduction

On April 17, 2002, the Supreme Court issued its opinion in *United States* v. *Craft*[1] and, in so doing, created a new rule of federal law by which the IRS may, based on the federal tax debt of a single taxpayer, attach property held as tenancy by the entirety.

Tenancy by the Entirety

Tenancy by the entirety is a form of concurrent property ownership unique to married couples, where title is vested completely in both the husband and wife.[2] To form a tenancy by the entirety, the traditional unities of joint tenancy must exist (interest, title, time, and possession), along with a fifth unity, that of person (encompassed in the marriage).[3] Tenancy by the entirety is often characterized by the rights and protections it affords, foremost of which is the indestructible right of survivorship of each spouse.[4] Each spouse has a right to possess, use and enjoy the property, and to protect the property from entry by third parties.[5] Entireties property cannot be partitioned by the unilateral acts of either spouse, nor can one spouse convey an individual interest in the property to a third party.[6] In Maryland, a "full bar jurisdiction," creditors are prohibited from reaching entireties property to satisfy the debts of one spouse.[7] A handful of jurisdictions have adopted a modified bar approach, allowing creditors to reach entireties property for debts of a liable spouse, subject to the rights of the non-liable spouse.[8]

The Federal Tax Lien

The federal government is granted a broad lien against a delinquent taxpayer's property: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount … shall be a lien in favor of the United States upon *all property and rights to property*, whether real or personal, belonging to such person."[9] This lien arises when the Service assesses a tax and, after notice and demand, the taxpayer fails to pay.[10] The effective date of the lien is the date of assessment and the lien remains in existence until either the liability is fully satisfied or becomes unenforceable by passage of time.[11]

The Service may seek to enforce its lien through administrative levy of the taxpayer's interest.[12] It may also seek judicial foreclosure of the entire property pursuant to IRC § 7403.[13] In a § 7403 proceeding, the Service must show that it has a lien on the property it seeks to foreclose – in other words, that the asset is property or a property right of the taxpayer. If the lien attaches, the court determines whether the property should be sold under factors discussed in *United States* v. *Rodgers*.[14] If those factors are satisfied, the court then "determine[s] both the relative interests in the property of the parties involved and the priority of the parties' interests to any proceeds."[15]

Prior to *Craft*, federal courts and the Service respected a tenancy by the entirety and the firmly established principle that a federal tax lien against one taxpayer did not attach to entireties property because the taxpayer's interest therein was not "property" or a "property right."[16]

The Craft Decision

In May 1972, Don and Sandra Craft purchased property in Michigan and held it as tenants by the entirety.[17] Mr. Craft failed to file federal income tax returns for years 1979 through 1986. In response, the Service prepared substitute returns on his behalf and assessed unpaid taxes, penalties and interest of $482,446.73.[18] When Mr. Craft failed to pay, the Service filed a Notice of Federal Tax Lien in March 1989.[19] In August 1989, the Crafts transferred the property to Mrs. Craft through the execution of a quitclaim deed for one dollar.[20] In June 1992, Mrs. Craft attempted to sell the property and a title search revealed the tax lien.[21] The Service agreed to release its lien in exchange for the escrow of half of the proceeds ($59,944.10), pending a determination of the Service's right thereto.[22] Mr. Craft died in August 1998.[23]

Mrs. Craft filed a quiet title action against the United States in the United States District Court for the Western District of Michigan.[24] In response, the government claimed that its lien attached to Mr. Craft's interest in the property, despite the property being held in tenancy by the entirety, and that the conveyance from the Crafts to Mrs. Craft was fraudulent.[25] Thus began a series of proceedings in the district court and the Sixth Circuit. The Supreme Court eventually granted *certiorari* to consider the government's claim that a federal tax lien could attach to Mr. Craft's separate interest in the entireties property.[26] In a 6-3 decision, the Court reversed the Sixth Circuit, holding that a husband's interest in entireties property constitutes "property" or "rights to property," which allows for attachment of a federal tax lien.[27]

Writing for the majority, Justice O'Connor stated that while the issue of whether Mr. Craft's interest in the entireties property constituted "property and rights to property" under IRC § 6321 was a matter of federal law, the answer to this federal question relied heavily on state law.[28] In analyzing state law, Justice O'Connor emphasized that the Court's obligation was "to consider the substance of the rights state law provides and not merely the labels the State gives these rights or the conclusions it draws from them."[29] Using the common "bundle-of-sticks" analogy to describe property rights, the Court noted under Michigan law, Mr. Craft had the following "sticks" with respect to the entireties property: (1) the right to use the property; (2) the right to exclude third parties from it; (3) the right to a share of income produced from it; (4) the right of survivorship; (5) the right to become a tenant in common with equal shares upon divorce; (6) the right to sell the property with his wife's consent and to receive half

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MICPEL and the MSBA Sections of Taxation,
Real Property, Planning & Zoning and Business Law
In Cooperation with the University of
Maryland School of Law and the University of
Baltimore School of Law
Present:

U.S. v. Craft:

Where Do We Go From Here?

THURSDAY, MARCH 25, 2004
Ecker Business Training Center
6751 Columbia Gateway Drive
Columbia, Maryland
9:00 a.m. - 1:15 p.m.

4 CLE HOURS

MICPEL®

U.S. V. Craft: Where Do We Go From Here?

What you will learn & why you should attend...

On April 17, 2002, the United States Supreme Court decided the case of *U.S. v. Craft*. In doing so, the Court found that a federal tax lien may attach to a tenant's "property" or "rights to property" held as tenants by the entireties despite a state law which held to the contrary.

Attendees will learn about the federal tax lien statute and its applications to property held as tenants by the entireties, the specifics of the Supreme Court's decision in *U.S. v. Craft*, and the impact of the *Craft* decision on areas of the law including real estate, bankruptcy, family and domestic relations, estates and trusts and tax controversies. In addition, legislative initiatives to combat the *Craft* decision will be discussed.

This program is a must for practitioners advising or dealing with clients that hold property as tenants by the entirety, that owe unpaid taxes or that are simply planning on getting married and want to be advised of their legal rights. A panel discussion will address the implications of *U.S. v. Craft* from the perspective of practitioners in the areas of tax, family, bankruptcy, estates and trusts and real property law.

Faculty

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Baltimore

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Report on the 2004 Heckerling Institute on Estate Planning

By Harold W. Pskowski
BNA Tax Management, Washington, D.C.

Introduction

The 38th Heckerling Institute on Estate Planning began on January 5, attended by approximately 2,700 attorneys, C.P.A.s, trust officers, and financial planners. The premier estate planning conference in the U.S., it offers the serious estate planner top-notch speakers, topics, and exhibitors. The Institute's primary focus remains on tax planning for inter-generational transfers, although it continues to broaden the scope of its offerings and draw a wider audience. The Basics Program that began several years ago continues to be a success, with well-known speakers and large audiences. This year's Basics speakers included Conrad Teitell on charitable organizations and Jeffrey Pennell on drafting for the marital deduction. A new feature of the 2004 Institute was two afternoon breakout sessions on "Financial Assets in Estate Planning." The speakers were financial professionals and the topic was investment options for wealthy clients. Although the speakers were competing with other well-known speakers, they drew approximately 300 attendees, and it seems likely that this area will be addressed again.

This report focuses on the sessions that should be of most interest to the tax practitioner. It is recommended that you also look at the web site of the ABA Real Property, Probate and Trust Section (www.abanet.org/rppt), which contains daily reports, written by Section members, on Heckerling speakers and exhibits.

Current Developments

The Institute always begins with a Current Developments session, reviewing the important events of the past year. The Current Developments outline was written by Richard Covey and Dan Hastings, and presented by Dennis Belcher, Carol Harrington, and Jeffrey Pennell. Although the outline provided a good review of all the significant income and transfer tax developments relating to trusts and estates, the one development that stood out in discussion was the Tax Court's 2003 decision in *Estate of Strangi v. Commissioner*, otherwise known as "*Strangi II*."

In *Strangi II*, Judge Cohen concluded that the assets of a family limited partnership were includible in the estate of its transferor for tax purposes, with no discount for the partnership wrapper. This holding was based on her conclusion that the decedent: (1) had retained the possession or enjoyment of the partnership property under §2036(a)(1), and (2) had, under §2036(a)(2), retained the right to designate the persons who will possess or enjoy the property. *Strangi II* was a jolt to the estate planning profession because it denied any discount for the decedent's partnership interest. The decision has engendered much commentary.

The consensus of the Heckerling speakers was that the Tax Court correctly decided the §2036(a)(1) issue, thereby bringing the partnership assets back into the estate. Even for a family limited partnership case, *Strangi* had bad facts – the decedent had transferred 98% of his assets, including his home, to the partnership only two months before his death by cancer. After he funded the partnership, it paid his personal expenses with partnership funds. The speakers concluded, however, that it would not be difficult to avoid the §2036(a)(1) trap with proper funding and operation of the partnership. There seemed to be general agreement that §2036(a)(1) can be avoided by not funding the partnership with personal use assets and leaving sufficient assets outside the partnership for the transferor's support.

There was no such agreement among the speakers with respect to the court's interpretation of §2036(a)(2). The court's application of §2036(a)(2) to the partnership assets was based on its conclusion that the decedent had retained control over partnership distributions by reason of his indirect control of the corporate general partner. Although the decedent had only a 47% interest in the general partner (with 52% held by his children and 1% by a charity), his son-in-law, who was also his attorney-in-fact, controlled the general partner under a management agreement. Under the partnership agreement, the general partner (acting through the son-in-law) had the ability to make distributions to the limited partners and in fact made distributions to the decedent. This distribution power, Judge Cohen concluded, was sufficient to bring §2036(a)(2) into play.

The authors of the Current Developments outline showed considerable concern about the §2036(a)(2) holding and suggested that the drafting of family limited partnership agreements must be rethought. To avoid the application of §2036(a)(2), they recommend that: (1) the transferor retain no rights as a general partner or the right to appoint a general partner; (2) the transferor be given no right as a limited partner to vote on any event, such as a dissolution, that could shift partnership income; and (3) gifted partnership interests be placed in trust with an independent trustee so that it is clear that the trustee's fiduciary duties override any retained control of the transferor over the partnership assets.

This may be an excess of caution, as a number of Heckerling speakers did not share this level of concern about the §2036(a)(2) holding in *Strangi II*. Their arguments, which have some merit, fell into the following categories: (1) *Strangi II* is currently on appeal to the Fifth Circuit, which will reverse the Tax Court; (2) the §2036(a)(2) portion of the opinion was only *dicta*, the court having already found that the property

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NOTICE OF NEW ESTATE TAX FORM

Effective January 2004, the new MET 1E, Application for Extension of Time to File the Maryland Estate Tax Return, became available for requesting an extension to file the Maryland estate tax return. This form will be used in conjunction with the federal extension application, IRS Form 4768.

The new form with instructions is available on the Comptroller's Website www.marylandtaxes.com. The online version utilizes Adobe's fill-in feature. Printed forms are also available from the Estate Tax Section of the Comptroller's Office (410-260-7850 or 1-800-638-2937).

Form MET 1E

Comptroller of Maryland
Revenue Administration Division
Estate Tax Section
P.O. Box 828
Annapolis, MD 21404-0828

APPLICATION FOR EXTENSION OF TIME TO FILE THE MARYLAND ESTATE TAX RETURN

DO NOT WRITE IN THIS AREA
Reference numbers:
Comptroller___________________
Register______________________

SECTION I

Decedent Information

First name | Middle name | Last name | Social Security number

Address at date of death (number and street)

City | County | State | Zip code

Date of death | Due date | Requested extension date (Not to exceed six months. Attach Form 4768 including attachments

Application Filer: ____

Address: ____

____

____

Jurisdiction of Probate:____

Jurisdiction of Maryland property: ____________________________
(if decedent is not a Maryland resident)

Personal Representative(s)

Name | Complete mailing address | Social security number

Name | Complete mailing address | Social security number

Name | Complete mailing address | Social security number

SECTION II

Estimated Tax Calculation:

Estimated gross estate	$________________________
Estimated deductions	$________________________
Estimated taxable estate	$________________________
Estimated federal credit for state death taxes	$________________________
Percentage of Maryland estate	___________%
Estimated Maryland estate tax liability	$________________________
Less: Inheritance tax **paid** to-date (attach receipts)	$(________________________)
Estimated Maryland estate tax (remit with this request)	$________________________*

SECTION III

Signature and Verification:

Under penalties of perjury, I declare that I have examined this form, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct and complete; and, if prepared by someone other than the personal representative, that I am authorized to prepare this form.

Signature of personal representative____ Date

OR

Signature of preparer other than personal representative____ Date

*Make check payable to Comptroller of Maryland. Send payment and this form to address above.

A copy of the signed federal Form 4768, including attachments, must be attached.

COM/RAD-313 PN: 00235 (12/03)

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the proceeds from such a sale; (7) the right to place an encumbrance on the property with his wife's consent; and (8) the right to block his wife from selling or encumbering the property unilaterally.[30]

The Court next turned to the federal question of whether these rights rose to the level of "property" or "rights to property."[31] Relying on *Drye v. United States,* 528 U.S. 49 (1999), the Court focused on the breadth of control Mr. Craft could have exercised over the property.[32] Although it acknowledged that he did not have the right to unilaterally alienate the property, the Court held that the absence of such a right does not preclude Mr. Craft from possessing "property and rights to property" within the meaning of IRC § 6321.[33]

Finally, the Court addressed Michigan's exemption of entireties property from the reach of creditors for a spouse's individual debt.[34] Justice O'Connor stated that this exemption was irrelevant to the Court's decision because the interpretation of IRC § 6321 was a federal question to be decided on federal law, and "exempt status under state law does not bind the federal collector."[35] The Court held that Mr. Craft's rights to the entireties property were sufficient to represent "property" or "rights to property" under the broad federal tax lien statute.[36]

The Service's Response

On September 11, 2003, the Service issued Notice 2003-60 in an attempt to answer some of the questions raised by the *Craft* decision. In reviewing the general principles upon which it will rely in addressing *Craft*-related issues, the Service states: "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 Service therefore rejects the view that *Craft* represents new federal law.

Although the Service takes the position that a federal tax lien, for which a notice has been filed, has priority over any interest of a subsequent purchaser, holder of security interest, a mechanic's lienor, or a judgment lien creditor (i.e., those protected by IRC § 6323(a)), the Service will not assert its lien "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."[37] However, this only protects those in full-bar jurisdictions and if the interests were created pre-*Craft*. In modified or partial bar jurisdictions, where a creditor has always been permitted to attach the debtor-spouse's interest in entireties property, the Service will assert its lien against those protected by IRC § 6323(a), "as long as those interests were acquired after notice of the federal tax lien was filed."[38]

In the case of a divorce, where entireties property was transferred to the non-taxpayer spouse before *Craft*, the Service maintains that its lien attaches to the transferred property. Nonetheless, the Service will, "as a general rule, if the transfer occurred before *Craft*, 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" unless the transfer was fraudulent.[39] If the transfer occurs after *Craft*, the Service maintains that the property remains encumbered in the hands of the ex-spouse.

The Service assures that it will not use *Craft* to rescind accepted offers in compromise, terminate installment agreements, or revoke certificates of discharge and subordination. It also will not "routinely amend bankruptcy proofs of claim" filed pre-*Craft*, but may do so under certain circumstances "depending on the value of the property, and the status of the bankruptcy case."[40] In the future, the Service will consider entireties property when filing proofs of claim and may revisit a prior determination that an account is currently not collectible.[41]

As to transfers of entireties property post-*Craft*, the Service contends that a federal tax lien will encumber "a one-half interest in the hands of the transferee, regardless of whether the transferee is a donee or gives value."[42] This valuation will apply in the context of private foreclosures, bankruptcy cases, and Offers in Compromise.[43]

The Service next addresses how it will enforce its liens post-*Craft*. It advises that, while it has the right to "administratively seize and sell a taxpayer's interest in real and personal property held in a tenancy by the entirety," it recognizes the difficulty in finding a buyer for such interests, since it may only sell the taxpayer's interest (unlike in a judicial action under IRC § 7403, discussed below).[44] "Therefore, the Service has determined that an administrative sale is not a preferable method of collection with respect to [real or personal property held as] entireties property."[45] The Service warns, however, that it will levy on "cash and cash equivalents held as entireties property," where the taxpayer has the right to withdraw the funds.[46] "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."[47]

In "appropriate cases," the Service advises that it will seek to foreclose on a federal tax lien under IRC § 7403, which allows the Service to sell the entire property, as long as the *Rodgers* factors are satisfied.[48] The Service recognizes that the court will determine the respective interests of the parties (including the non-liable spouse) pursuant to IRC § 7403(c), but, as noted, the Service contends that it is entitled to 50% of the proceeds of the sale, after taking into account the amount of senior liens.

Unfortunately, despite the issuance of IRS Notice 2003-60, significant questions remain. For example, after the Service forecloses on entireties property and seizes the portion determined to be the debtor spouse's interest therein, what is the nature of the funds that remain? Does the foreclosure by the Ser-

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vice dissolve the tenancy by the entirety? If so, it appears that the remaining funds would be converted to individual property of the non-liable spouse, subject to that spouse's creditors. If not, and the remainder maintains its status as entireties property, does this mean the Service can come back for seconds? It appears that the only court that has addressed this issue to date chose to punt rather than to answer the question.[49]

Conclusion

As Notice 2003-60 indicates, the Service is taking *Craft* and running with it. Yet issues that significantly impact an individual's rights to property remain unaddressed. One can only hope that Congress will act swiftly to protect the concept of tenancy by the entirety and prevent further encroachment upon states' rights to define property interests. In the meantime, state legislatures should take note of the *Craft* decision, and act to preserve their constituents' long held property rights and creditor protections.

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Caroline is a partner with Rosenberg | Martin | Funk | Greenberg, LLP in Baltimore, Maryland, and focuses her practice on criminal and civil tax controversy and litigation. She is active in the ABA Tax Section, Civil and Criminal Tax Penalties committee, and is chair of the State Legislation and Tax Controversy Committees of the Maryland State Bar Association Tax Section.

Shannon Chilcoate

Shannon is a third year law student at the University of Maryland School of Law and a law clerk with Rosenberg | Martin | Funk | Greenberg, LLP. She will begin a judicial clerkship with the Maryland Court of Special Appeals in August, 2004.

Endnotes:

[1] 535 U.S. 274 (2002).

[2] Cornelius J. Moynihan & Sheldon F. Kurtz, Introduction to the Law of Real Property ch. 9 § 6 (3d ed. 2002); 2 William Blackstone, Commentaries on the Laws of England 182 (9th ed. 1783) ("If an estate in fee be given to a man and his wife, they are neither properly joint-tenants, nor tenants in common; for husband and wife being considered one person in law, they cannot take the estate by moieties, but both are seised of the entirety… the consequence of which is, that neither the husband nor the wife can dispose of any part without the assent of the other, but the whole must remain to the survivor.").

[3] 4 Thompson on Real Property, Thomas Edition § 33.06(b) (David A. Thomas ed. 1994 & Supp. 2003).

[4] Thompson, *supra* note 3, at § 33.05; Moynihan, *supra* note 1, at ch. 9 § 6.

[5] 7 Powell on Real Property § 52.03[4], note 7 (Michael Allan Wolf, ed., Matthew Bender 2003).

[6] *Id.* at § 52.03[1], *but see* Moynihan, *supra* note 2, at 277-78 (noting that seven jurisdictions allow, in some form, unilateral conveyance or encumbrance by one spouse, subject to the other spouse's survivorship rights).

[7] *See id.*, *supra* note 6, at §§ 52.01[3], 52.03[4]; MD Code Ann. Real Prop. § 4-108 (West 2003). The following are full-bar jurisdictions: Delaware, District of Columbia, Florida, Hawaii, Illinois, Indiana, Maryland, Michigan, Mississippi, Missouri, North Carolina, Ohio, Pennsylvania, Vermont, Virginia, and Wyoming.

[8] *See id.* The following jurisdictions allow creditors of the liable spouse to reach the T by E property, subject to the non-liable spouse's right of survivorship: Alaska, Arkansas, New Jersey, New York, and Oregon. Kentucky, Massachusetts, Rhode Island, and Tennessee allow creditors of either spouse to reach the debtor spouse's contingent right of survivorship, but not the life estate.

[9] 26 U.S.C. ("IRC") § 6321 (emphasis supplied).

[10] IRC § 6322.

[11] *Id.*

[12] IRC § 6331(a).

[13] IRC § 7403.

[14] 461 U.S. 677 (1982).

[15] Wilson v. Wilson, 90 A.F.T.R.2d 2002-7242, 2003-1 USTC P 50,153 (October 21, 2002).

[16] United States v. Hutcherson, 188 F.2d 326, 330 (8th Cir. 1951); For a thorough review of the history of the federal tax lien, *see* William H. Baker, Drye *and* Craft – *How Two Wrongs Can Make a Property Right*, 64 U. Pitt. L. Rev. 745, 769 n. 190 (Summer 2003); *see also Craft*, 535 U.S. at 300 n.9 (2002) (Thomas, J., dissenting); Benson v. United States, 442 F.2d 1221, 1225 (D.C. Cir. 1971) (IRS conceded federal tax lien did not attach to entireties property); Cole v. Cardoza, 441 F.2d 1337 (6th Cir. 1971) (IRS conceded that it had no valid claim against entireties property); Internal Revenue Manual 5.17.2.4.2.4 (October 31, 2000); IRS Chief Counsel Advisory (August 17, 2001); IRS Litigation Bulletin No. 407 (August 1994); IRS Litigation Bulletin No. 388.

[17] Craft v. United States, 140 F.3d 638, 639 (6th Cir. 1998).

[18] *Id*; *see also* 26 U.S.C. § 6020(b).

[19] *Craft*, 140 F.3d at 639; *see also* 26 U.S.C. § 6321.

[20] *Craft*, 140 F.3d at 639.

[21] *Id.*

[22] *Id.* at 640.

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[23] Craft v. United States, 65 F.Supp.2d 651, 654 (W.D.Mich 1999)
[24] *Id.*
[25] *Id.*
[26] United States v. Craft, 533 U.S. 976 (2001).
[27] *Craft,* 535 U.S. at 288-89.
[28] *Id.* at 278.
[29] *Id.* at 279.
[30] *Id.* at 282.
[31] *Id.* at 283.
[32] *Id.* In *Drye*, for purposes of the application of a federal tax lien, the Court rejected the state fiction that allows an heir, who is subject to the lien, to disclaim his interest in the estate and, as a result, remove his inheritance from the reach of the Service. *Id.* at 59-61.
[33] *Id.*at 283-85. The Court emphasized that to hold otherwise would exempt a large amount of property, namely homesteads and community property, from the reach of § 6321.
[34] *Id.* at 286.
[35] *Id.* at 288 (quoting *Drye*, 528 U.S. at 59).
[36] *Id.* at 283 ("The statutory language authorizing the tax lien 'is broad and reveals on its face that Congress meant to reach every interest in property that a taxpayer might have.'") (citing National Bank of Commerce, 472 U.S. at 719-20).
[37] IRS Notice 2003-60, at 2.
[38] *Id.*at 3.
[39] *Id.*
[40] *Id.*
[41] *Id.* at 3-4.
[42] *Id.* at p. 4; *Cf.* Basher v. United States, 291 B.R. 357 (Bankr.E.D.Pa. 2003) (court rejected Service's attempt to value debtor's interest in entireties property at 50% of the encumbered equity).
[43] *See* Internal Revenue Manual § 5.8.5.3.11.
[44] *See Id*.
[45] IRS Notice 2003-60, at 5.
[46] *Id.* The Service does not explain whether the taxpayer must have the unilateral right to withdraw the funds, or simply the right to withdraw with the consent of the co-tenant.
[47] *Id.*
[48] *Id.*; *see*, United States v. Rodgers, 461 U.S. 677 (1983).
[49] *See* Manufacturers and Traders Trust Co. v. Ruff, 2003 WL 21439883 (N.D.Ill. 2003), where the parties appeared to concede that the Service was entitled, and limited to, 50% of the proceeds from entireties property sold at foreclosure and to which a lien had attached as the result of Mr. Ruff's federal tax liabilities. In that case, the court was asked by a general creditor to determine the nature of the surplus: was it entireties property, or did it represent Mrs. Ruff's share of the property? The court found that surplus after sale was either (a) that of nondebtor based on dissolution of tenacy by the entirety, followed by creation of a tenants in common and seizure of the debtor taxpayer's share, or (b) that of nondebtor based on survival of tenancy by the entireties in the surplus, thereby preventing creditors of debtor spouse from collecting from funds. Either way, the non-debtor spouse was permitted to retain the funds. *Id.* at *2.

CALLING FOR NOMINATIONS FOR THE TAX EXCELLENCE AWARD

The Tax Section seeks nominations for candidates for the 2004 Tax Excellence Award. The Tax Excellence Award is presented annually to an attorney, law school professor, public official or member of the judiciary who exemplifies professional, academic or public service excellence, integrity, compassion, and commitment in the areas of practicing, teaching, or developing tax law or tax policy.

If you know an individual who should be considered, please email Elissa Borges, Chair of this year's Awards Committee, at efborges@ober.com, with your recommendation as well as a brief statement as to why you feel the suggested person is worthy of consideration. Please submit nominations by March 12, 2004.

The Tax Section sincerely thanks

Lexis Publishing

for providing the door prizes for the Tax Professionals' Networking Night held at Elkridge Furnace Inn on January 20, 2004.

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was includible under §2036(a)(1); and (3) the opinion was issued as a Memorandum decision, which is not binding on other Tax Court judges.

Domestic Asset Protection Trusts

Dick Nenno of Wilmington Trust spoke about the rise of domestic asset protection trusts as an alternative to the use of offshore entities. Five states – Delaware, Alaska, Rhode Island, Nevada, and Utah – have taken advantage of the interest in asset protection by enacting trust laws that purport to protect self-settled trust assets from the grantor's creditors. Mr. Nenno did a good job of comparing the different state statutes, as well as comparing the use of a domestic trust to an offshore trust, and had some helpful hints for establishing a domestic trust. He also provided a sample form for a Delaware trust.

Retaining Strings Over Trust Assets

Steve Akers of Bessamer Trust did a good job of explaining the application of the "string" provisions of the Code (§§2036, 2037, and 2038) to transfers in trust, and how to avoid them when selecting a trustee. He also discussed special issues affecting beneficiaries, such as powers of appointment and beneficiaries serving as trustees. This is an area with many traps for the unwary, and Steve's detailed outline will be a valuable reference for the practitioner when these issues arise.

Effect of *Cottage Savings* on Trust Reformations

Lloyd Plaine of Sutherland, Asbill & Brennan LLP addressed an important, but little understood, income tax issue that can arise during the reformation of a trust. Commonly known as "*Cottage Savings*" after the 1991 Supreme Court case that highlighted the issue, this doctrine holds that a non-pro rata distribution to trust beneficiaries is treated as a taxable exchange under §1001 unless it is authorized under the trust instrument or state law. This issue commonly arises in the context of trust reformations, and Lloyd pointed out that it must be addressed if a trust is reformed to take advantage of recent state trust laws allowing the use of unitrusts and equitable adjustment among beneficiaries.

Reforming Irrevocable Trusts

Ron Aucutt of McGuireWoods LLP talked about the reformation of irrevocable trusts, with an emphasis on generation-skipping trusts. He pointed out that, although we have detailed regulations governing the reformation of pre-1985 "grandfathered" trusts, there is no formal guidance from the IRS on reforming post-1985 trusts that are subject to the GST tax. These trusts are increasingly subject to reformation. He also spent time on the new "income" regulations that were issued by the IRS shortly before the conference, observing that there are several gaps in the regulations with respect to the use of unitrusts. He noted that the regulations are not clear on whether the trust assets can be valued quarterly, or whether the trustee can use a three-year rolling average value as a "smoothing" technique in computing the unitrust amount. He also pointed out that the regulations allow the use only of unitrusts that are authorized by state statute. A unitrust created by judicial decision, i.e., in a reformation proceeding, cannot take advantage of the regulations unless a state statute specifically allows the form of the trust distribution.

Bulletproofing the Family Limited Partnership

John Porter, a partner at Baker & Botts who has litigated many of the important family limited partnership cases, reviewed the history of the IRS attacks on FLPs and how practitioners have responded. His outline has some useful advice on preserving attorney-client privilege in the context of a family limited partnership audit. It also includes, as an exhibit, 23 pages of Information Requests that he has received in gift and estate tax audits of family limited partnerships. Among other matters, in estate tax audits the IRS is now seeking a complete medical history of the decedent for the 10 years leading up to his death, most likely to show that the formation of the partnership was tax-motivated.

Implementing and Operating the FLP to Avoid § 2036

Randall Grove from Vancouver, Washington, followed up with a practical discussion of: (1) deciding whether an FLP is appropriate for your client, and (2) how to implement and operate the FLP in a manner suited to avoiding an IRS challenge. He pointed out that many clients are not capable of operating an FLP in a manner that will achieve the intended tax result. His material included some valuable exhibits, including a checklist for determining whether your client is ready for an FLP and a memorandum to the client explaining how the FLP should be managed.

Defined Value Clauses

Another recurring theme at the conference was the recent IRS attacks on defined value clauses, most prominently in *McCord v. Comr.*, 120 T.C. No. 13 (2003) (reviewed). Christopher Sega of Venable LLP discussed *McCord* and several other recent decisions. He pointed out that defined value clauses are commonly used in estate planning documents, citing the formula clauses that are used to allocate the marital deduction, credit shelter amount, and the GST exemption. Chris said that the IRS is primarily concerned with "price adjustment" clauses that attempt to change the amount of a gift after the fact. He suggested that most IRS challenges could be avoided with good appraisals and proper drafting.

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Credit Shelter/Marital Deduction Planning

Barbara Sloan of McLaughlin & Stern in New York talked about the problem of drafting for the unified credit and marital deduction after EGTRRA. In light of the increasing unified credit and the uncertainty of estate tax repeal, she described the options available for minimizing estate tax for married couples without undue complexity. These techniques are: (1) a formula credit shelter trust with a cap; (2) a bequest of everything to the surviving spouse, with the ability to disclaim into a credit shelter trust; (3) everything to a QTIP trust, with the executor making a partial QTIP election; (4) everything to a *Clayton* trust that is eligible for QTIP treatment, with an alternate disposition for any property that is not subject to the QTIP election; and (5) various combinations of the above. Barbara cautioned that the surviving spouse should not be the person making the QTIP election for a *Clayton* trust, because the spouse will probably be making a gift to the recipients of the alternate disposition. Since Regs. §20.2056(b)-7(b)(3) states that the QTIP election must be made by the executor, the spouse cannot serve as executor in this situation.

She also pointed out that drafters must now take into consideration that states are "de-coupling" from the federal estate tax unified credit. If you are dealing with a state that has de-coupled from the federal unified credit, she suggests that you look into whether a QTIP election is available at the state level, separate from any federal election. If so, your documents may have to provide for two separate QTIP elections to minimize both federal and state tax.

Financing Split-Dollar Insurance

Donald Jansen of Fulbright & Jaworski addressed the financing of split-dollar arrangements after the September 2003 final regulations. He acknowledged that the split-dollar arrangements as we have known them have ceased to exist (other than pre-September 2003 agreements, which are grandfathered), and offered some suggestions for financing split-dollar in a costlier environment. His detailed outline considers the loan approach, the employer money approach, and sales to a defective grantor trust. He suggested an interesting variation on the loan approach, which is to borrow the premium money from a third-party commercial lender. Although the interest rate would be higher than the applicable federal rate, this method would avoid the income and gift tax issues created by the new regulations. He noted that there are several financial institutions that specialize in making large premium loans.

Foreign Trust Classification

Robert Lawrence of Cadwalader, Wickersham & Taft talked about classification under the Code as a foreign trust and the resulting income tax results. Although most estate planners do not often deal with foreign trusts, the rules are complex and his outline offers some helpful guidance. He included some interesting ideas for allowing the grantor to easily "turn on" and "turn off" foreign trust status, depending upon which is most beneficial to the client.

Planning for the Phaseout of the State Death Tax Credit

This year (2004) is the last year for the state death tax credit, which is worth only 25% of what it was before EGTRRA. Robert Pomeroy of Goodwin Proctor LLP noted in his talk that 15 states (including the District of Columbia) have decoupled from the federal estate tax, thus avoiding the disappearance of their pick-up tax with the demise of the federal credit. He also reported that California, Florida, and Nevada are unlikely to become de-coupled states, as their state constitutions mandate the tie to the federal provisions.

Mr. Pomeroy cautioned that estate planners should be familiar with the state estate tax in any state in which their clients own real estate. If a resident of a coupled state dies owning real estate or other tangible property in a de-coupled state, it is likely that the home state will not grant a full credit for the tax paid to the other state. He advised that in this situation you might want to place the real estate in an LLC, making it intangible property not subject to tax. He cautioned that this does not work in every state.

Other Topics

Several other topics were addressed in the primary sessions of the Institute. All had well-written outlines, which will be available for purchase when the proceedings are published later this year.

· "Charitable Trust Litigation: Enforcing Donor Intent When the Ties That Bind Become Frayed," Howard M. McCue
· "The Rules of Engagement: Managing Liability for Nonprofit Boards," Kathryn W. Miree
· "When the Kids Won't Play Well Together: Tax-Free Corporate Divisions in Family Business Succession Planning," Michael V. Bourland
· "Tax Shelters—The Ethical Dilemma," Andrew H. Weinstein
· "Old Age With Fears and Ills: Planning for the Very Old Client," Lawrence A. Frolik

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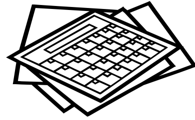

MARK THE DATE!!

2004 Shulbank Dinner

Details will be mailed to members later in the Spring!

MSBA Annual Meeting
June 16-19, 2004
Ocean City, Maryland

If you are interested in participating in the Tax Section's program at the Annual Meeting, please contact Chaya Kundra (301-424-7585 or ckundra@kundrataxlaw.com).

TAX TALK

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