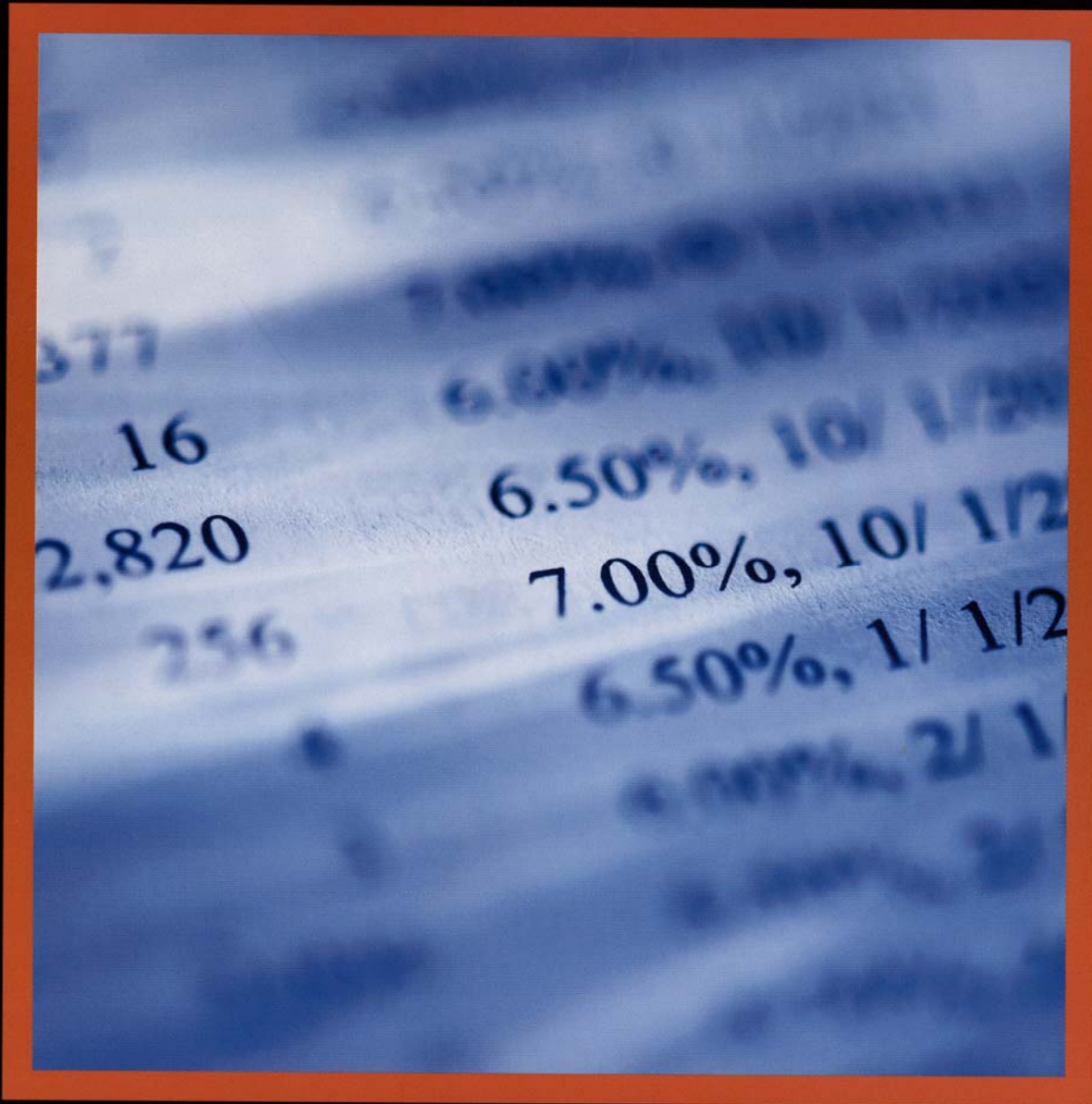


Valuation

STRATEGIES


MAY/JUNE 2010



DISCOUNTED CASH FLOW

LACK-OF-MARKETABILITY DISCOUNTS

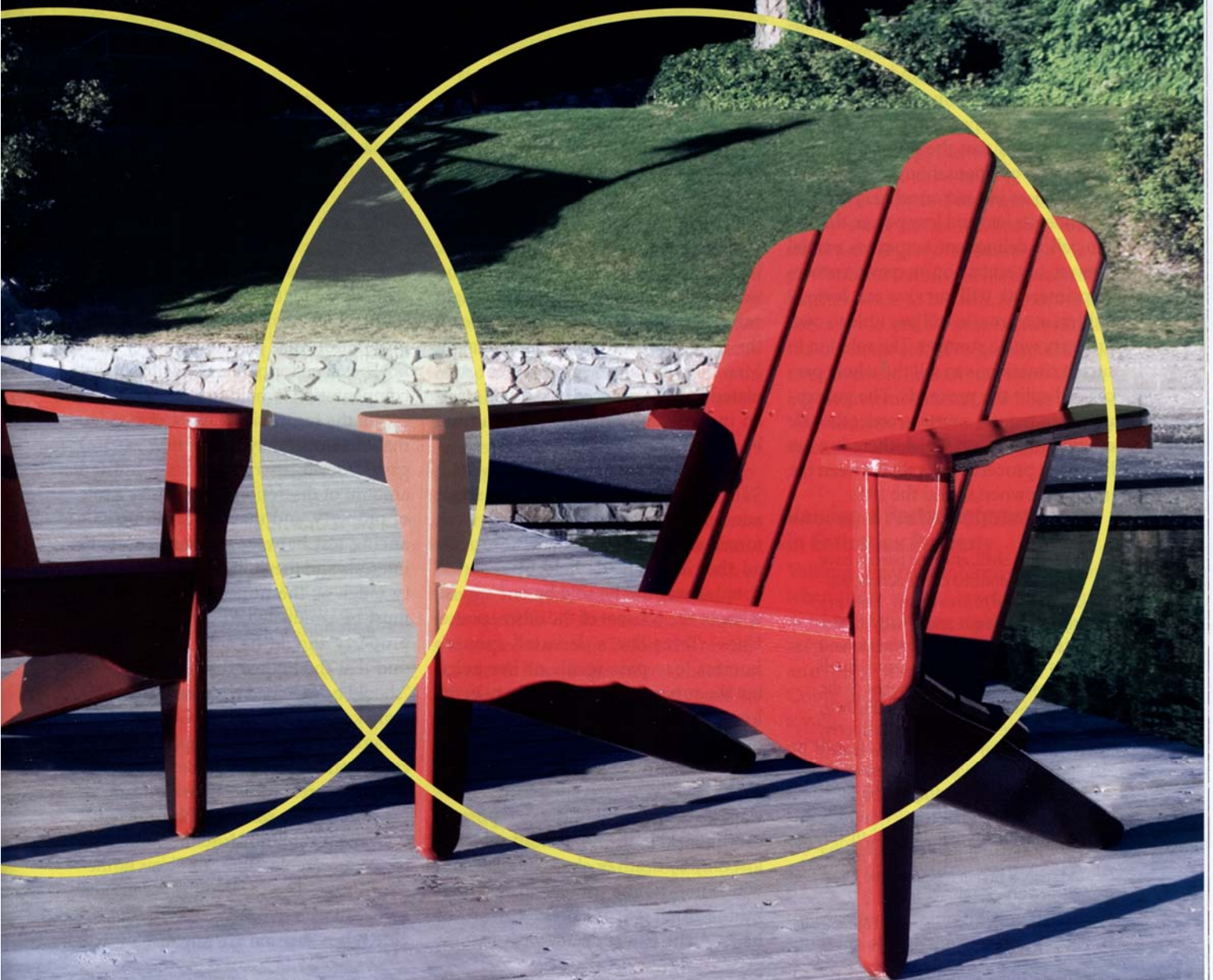
CONCURRENT INTERESTS



CARE NEEDS TO BE TAKEN WHEN
VALUING CONCURRENT
INTERESTS IN PROPERTY SOUGHT
BY THE GOVERNMENT IF THE
BENEFITS OF CONTINUED
OWNERSHIP EXCEED A PRO RATA
SHARE OF THE SELLING PRICE.

NEAL NUSHOLTZ

VALUING CONCURRENT HOME OWNERSHIP INTERESTS UNDER IRS COLLECTION LAW



Valuation professionals

are accustomed to the world of discounts for marketability and minority when someone owns less than the entire property. Value is lost from the inability to sell and from a lack of control over the entire property. This world changes when a partial interest in property such as a home is valued. That sort of partial interest does not diminish the use of the entire property and the primary value of the property is from its use and not from its sale. The Supreme Court, for example, has said that a right to live in a home for a 30-year-old woman could be 99% of the value of the entire home.¹

A collision occurs between partial interest discounts and valuation of a home based on use when the IRS seeks to sell property owned by a taxpayer concurrently with someone else who does not owe taxes. On one hand, the IRS will obtain little from selling the partial interest; on the other hand, the Fifth Amendment requires that the innocent owner receive just compensation and that standard focuses instead on what is lost.

Under its lien and levy power, the IRS can sell a delinquent taxpayer's partial interest, but since non-taxpayer ownership interests will survive tax levies,² bidders at a tax sale will pay little to own property with a stranger. The solution in such a situation is to sell the whole parcel and split the proceeds. The government can request courts to order the sale of any property on which there is a tax lien.³ Net proceeds are split between the innocent owner(s) and the IRS.

Section 7403(c) describes the process:

The court shall, after the parties have been duly notified of the action, proceed to adjudicate all matters involved therein and finally determine the merits of all claims to and liens upon the property, and, in all cases where a claim or interest of the United States therein is established, may decree a sale of such property, by the proper officer of the court, and a distribution of the proceeds of such sales according to the findings of the court in respect to the interests of the parties and of the United States. If the property is sold to satisfy a first lien held by the Unit-

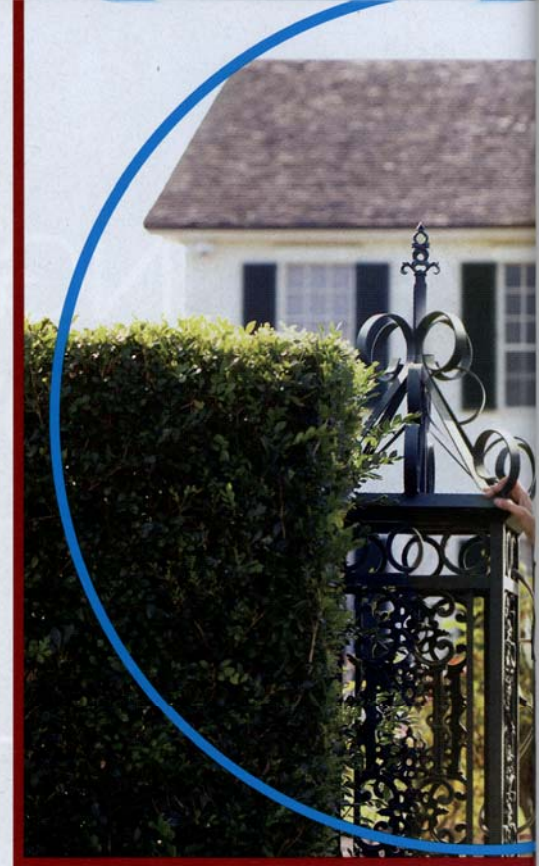
ed States, the United States may bid at the sale such sum, not exceeding the amount of such lien with expenses of sale, as the Secretary directs.

Rodgers—Supreme Court Values a Homestead Interest

In 1983, the Supreme Court considered the constitutionality of taking a wife's interest in a Texas homestead to pay her deceased husband's taxes under Section 7403.⁴ *Rodgers* was an appeal of two separate cases that were joined together, *Rodgers*⁵ and *Ingram*.⁶ The two spouses in the cases did not owe taxes, but both had a Texas homestead right to live in their homes for their lifetimes, and both had had husbands who had owed taxes.

Mrs. Rodgers was a widow and held half the home at the time of the lawsuit. The other half was held by the heirs of her deceased husband (his personal representative, his son, and his daughter). Mrs. Ingram owned her home at the time of the suit by the government. She had been getting divorced when the home burned down. The Ingram home was deeded to her in the divorce and was sold after the government brought suit under Section 7403 to foreclose on the home for her ex-husband's taxes. Mrs. Ingram and the government stipulated that the proceeds would be treated in the case as if the home had not been sold.

The Texas Constitution provided: "The homestead of a family, or a single adult person, is hereby protected from forced sale...."⁷ Texas law also provided that homesteads held by married couples may not be sold by one spouse without the consent of the other spouse. Under Texas law, a deceased spouse's interest may pass to his or her heirs, but the survivor has a right to stay in the home for his or her lifetime, and the property may not be partitioned among the heirs. The *Rodgers* Court said that Texas law gives "each spouse in a marriage a separate and undivided possessory interest in the homestead, which is lost only by death or abandonment, and which may not be compromised either by the other spouse or by his or her heirs."⁸ The Court decided two issues:



1. The constitutionality of taking third-party property to pay taxes of a taxpayer co-owner when the taxpayer could not cause a sale of the property.
2. The meaning of the phrase "may decree a sale" under Section 7403(c).

On the first issue, the Court held that if "compensation" was awarded to the innocent party after the property was ordered sold, the Fifth Amendment constitutional prohibition that private property shall not "be taken for public use, without just compensation" would be satisfied.⁹

On the second issue, the Court ruled that the word "may" in Section 7403(c) gave federal district courts a limited amount of discretion not to order a sale of property, and that a four-prong balancing test between the government's interests and the interests of a third party (such as the non-taxpayer spouse) must be conducted to determine if the property should be sold.¹⁰ The Court said that the limited discretion allowed "should be exercised rigorously and sparingly, keeping in mind the Government's paramount interest in prompt and certain collection of delinquent taxes."¹¹ Courts have interpreted this language to mean that, ordinarily, a sale should be ordered.¹²

A question not before the Court was the compensable value of a Texas homestead right. The issue must have been argued, however, because the Court provided the valuation anyway:

NEAL NUSHOLTZ is a tax attorney in Birmingham, Michigan.



The exact method for the distribution required by § 7403 is not before us at this time. But we can get a rough idea of the practical consequences of the principles we have just set out. For example, if we assume, *only for the sake of illustration*, that a homestead estate is the exact economic equivalent of a life estate, and that the use of a standard statutory or commercial table and an 8% discount rate is appropriate in calculating the value of that estate, then three non-delinquent surviving or remaining spouses, aged 30, 50, and 70 years, each holding a homestead estate, would be entitled to approximately 97%, 89%, and 64%, respectively, of the proceeds of the sale of their homes as compensation for that estate. In addition, if we assume that each of these hypothetical non-delinquent spouses also has a protected half-interest in the underlying ownership rights to the property being sold, then their total compensation would be approximately 99%, 95%, and 82%, respectively, of the proceeds from such sale.¹³

In this example, the court first valued the undivided life estate by actuarial tables and then valued the “protected interest” at one half of the balance.

The valuation raises a question: If a husband and wife in Texas are both 50 years old and the Supreme Court rules that the wife has a protected “undivided

life estate” interest equal to 95% of the value of the marital home, how does that determination fit with the idea that the husband and wife have equal interests?

It fits in one of two ways. The first is that the interests of the husband and wife are valued in different contexts. The value of the wife’s interest is based upon replacing her use of the home which is close to its entire value diminished only slightly by her husband’s use. The value of the husband’s interest is based upon the sale value of his ownership interest which is unsalable and defeasible.

A second way to look at the wife getting a larger chunk of the Texas proceeds than the husband is to treat the government lien and the wife’s interest as competing interests in the same property. If so, a junior lienor, such as the government, will get shorted.¹⁴ A wife is ahead of the tax lien in time if she owned the home before the tax lien occurred. The *Rodgers* Court held that the reason the whole house could be sold, as opposed to just the husband’s separate interest, was because the husband had an interest in the entire house.¹⁵ If both husband, and, consequently, the wife, own the entire parcel, then the wife’s ownership and the government lien on the husband’s ownership are competing interests in the same property. When that happens, the wife takes first.

Craft—Supreme Court Does Not Value an Entireties Interest

States have differing forms of creditor protections for marital homes. Michigan and some other states have entireties property. Entireties property is a breed of marital ownership in which: (1) neither husband nor wife can sell or encumber the property; (2) the property is inherited by the survivor upon the death of the first spouse; and (3) creditors cannot reach such property in the event of a debt of only one of the spouses.

For at least 30 years prior to 2002, the rule in Michigan was that the IRS could not even put a lien on entireties property, and the property could not be used to pay the tax debt of one spouse.¹⁶ To this end, entireties property was treated like partnership property. Partners do not own partnership property and the debts of a particular partner are not a basis for seizing partnership assets. Entireties property was exempt from collection even under *Rodgers*, because Section 7403 applies only to property that is subject to a tax lien.

However, the Supreme Court in *Craft*¹⁷ ruled that an IRS lien attaches to entireties property. In that case, a Michigan husband transferred his interest in his marital home to his wife free of his tax lien, and she sold the property, leaving the IRS out in the cold. The government sued to enforce the lien. On the issue of valuing the entireties interest, the Court wrote: “We express no view as to the proper valuation of the ...husband’s interest.”¹⁸

Valuing a Partial Interest in Entireties Property

Valuing a partial interest in property when there is no market value can be done by identifying rights in the property, assigning a value to each right and then summing the parts. The Court in *Rodgers* did this when it put a value on a life estate and put a value on the “protected interest.”

Entireties property consists of a number of rights that can be identified in a step-by-step analysis, starting with two separate parcels of equal value and then advancing to entireties property in stages. If a right by each spouse to use the property belonging to the other spouse is added, the addition results in

what is called a tenancy in common. If mutual rights of survivorship are added to the tenancy in common, a joint tenancy with rights of survivorship results. Adding the right to prevent the sale (or transfer or encumbrance) of the home without consent of either spouse will result in a tenancy by the entirety. (See Exhibit 1.)

A Michigan wife (or husband) would have three rights in entirety property if she (or he) is using the property:

1. A life estate in the entire parcel subject to the rights of her husband (or his wife) (which includes her (or his) right to use and her (or his) right to exclude others).
2. A survivorship right in her husband's (or his wife's) interest.
3. A right to prevent the sale or encumbrance of the property without her (or his) consent.

A Michigan wife (or husband) would also have rights if she (or he) was not living on the property, such as a right to an equal share in the income from the property, a right to half the property on sale, and a right to one-half of the property on divorce unless a divorce court orders otherwise.¹⁹

Rev. Rul. 78-166. In Rev. Rul. 78-166²⁰ the IRS valued a separate interest in jointly held property for estate tax purposes. The situation was one in which one spouse had murdered the other. A murderer can not inherit the property of his or her victim, so the property interest would not qualify for a marital deduction and had to be valued for estate tax purposes. The value of the half interest was "one-half of the value of the jointly owned property plus the present value of the remainder interest in the other half." The Revenue Ruling sets the value of a one-half interest at something greater than 50%.

Gibbons. In *Gibbons*,²¹ the Tenth Circuit reversed a Colorado federal district court ruling that a spouse had only a 50% interest in her home. In that case, a marital separation agreement provided that a wife could reside in the home held in joint tenancy unless she moved or remarried, after which it was to be divided equally. Her interest was valued at the sum of a "50% remainder interest plus the value of her possessory interest."²²

The Tenth Circuit remanded the case, indicating that if the lower court found

that the wife had a life estate (which depended on her intentions to move or remarry), the wife's interest was 91.311%. To get an idea of the value of an entirety interest if both the husband and wife had resided in the *Gibbons* home, the life estate could be cut in half, to 20.6555%. Under *Gibbons*, an entirety spouse would have, at a minimum, a 70.655% interest, if the use of the home by one spouse diminishes the use of the home by the other by 50%.

Right to Prevent Sale. When an owner of property has a right to prevent sale of an adjoining parcel, that right can enhance that owner's property values when it perpetuates a current use.²³ The right to prevent sale is compensable. The Fifth Amendment "is addressed to every sort of interest the citizen may possess."²⁴ A right to prevent sale of property is a salable capital asset, and the profits from its sale are taxed at capital gains rates.²⁵ A homestead right to prevent sale was recognized as a basis for an injunction against a tax seizure in Minnesota. The Eighth Circuit ruled that the government could levy a husband's survivorship interest only subject to certain restrictions assuring there would be no irreparable injury to the non-taxpayer spouse.²⁶

In *Rodgers*, the Supreme Court's illustration of the value of a homestead for a spouse aged 30, 50, and 70 years made two calculations. The first was a life estate and the second valued a protected interest (the right to prevent a sale):²⁷ The Court calculated the value of the "protected interest" at one-half of the balance of the property over and above the spouse's separate interest in the property. The protected interest in *Rodgers* was the portion of the homestead protected from creditors. The identical right exists for entirety property. According to the example provided in *Rodgers*, the value of the right to prevent sale is one half of the balance over and above the spouse's interest under Rev. Rul. 78-166 (one half the life estate plus the net present value of the survivorship interest).

Although one might argue that no right to prevent sale exists because the government can force a sale under Section 7403, that position is inconsistent with *Rodgers*, in which the life estate was valued without reduction for a termination of that interest under Section 7403. The power to take property

EXHIBIT 1 Property Rights

H + W Separate Ownership.

Two adjacent identical parcels.

H + W Tenancy in Common

Right to use entire parcel;
Either party may sell;
Purchaser takes subject to other owners rights of use;
Undivided half descends to heirs on death.

H + W Joint Tenancy With Rights of Survivorship

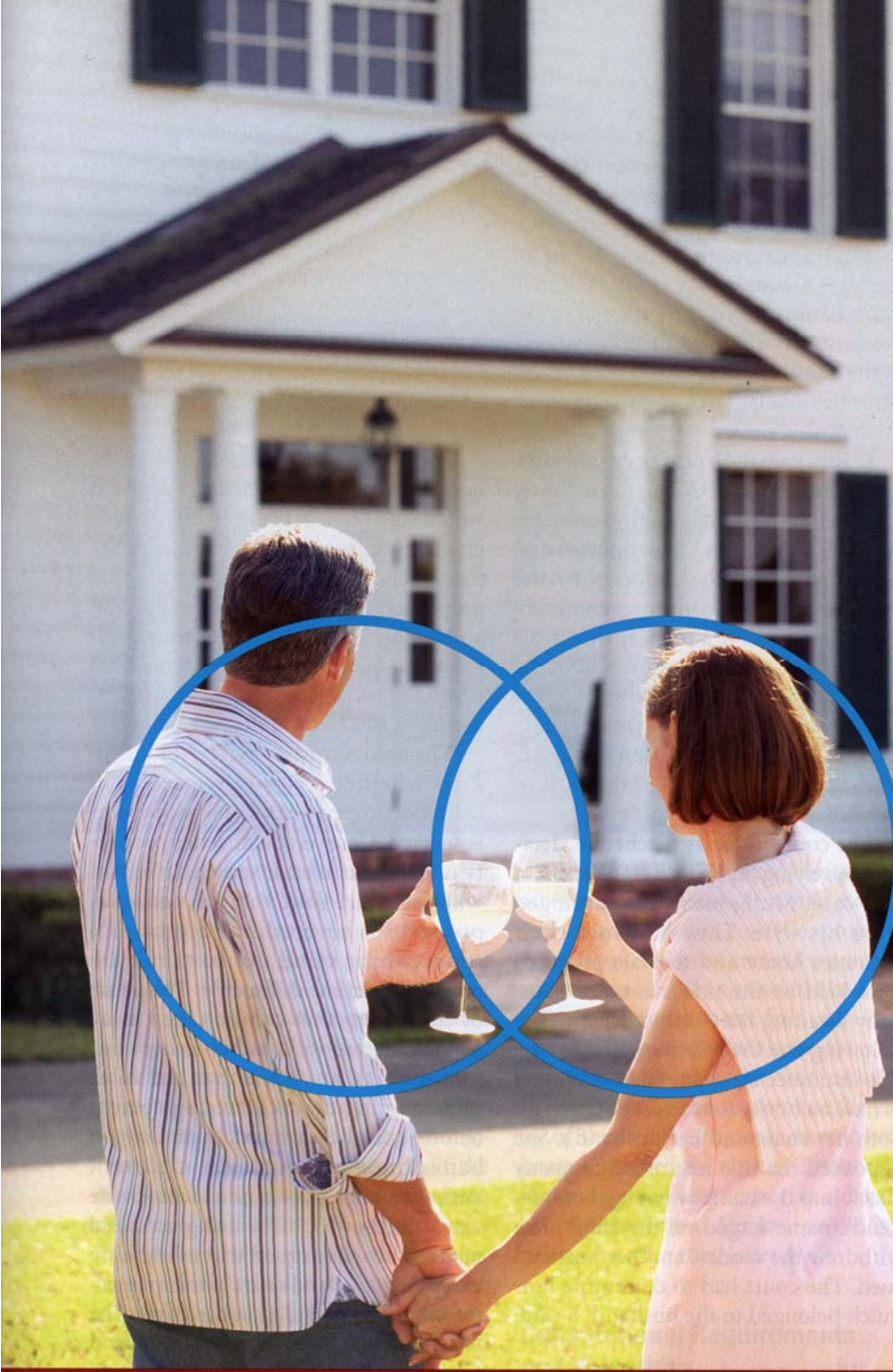
Right to use entire parcel;
Either party may sell;
Purchaser takes subject to survivorship rights and right of use;
Entire parcel inherited on death of the other owner.

H + W Tenancy by the Entireties

Owners are husband and wife;
Right to use entire parcel;
Entire parcel inherited on death of the other owner;
Cannot be sold or encumbered by one without consent of the other;
Property is not available for the debts of one co-owner.

is always accompanied by compensation for whatever is taken.

A broader issue is the impact of taking on valuation. The Eleventh Circuit addressed the question of the impact of a drug forfeiture on the valuation of a wife's entirety rights.²⁸ The case involved an innocent owner's entirety interest in a drug forfeiture proceeding. The government had argued that "forfeiture should occur before calculation of the interest of the innocent owner."²⁹ If the forfeiture occurred before valuation, the entirety interest would be severed and the residence could be partitioned. The Eleventh Circuit disagreed, stating:



To convert this right into a tenancy in common, where she has only the right to a portion of the property or a portion of the proceeds should the government pursue partition—which could not occur with an entireties estate—appears to us to be a taking without due process violating the Fifth Amendment of the federal Constitution.³⁰

The effect of the taking on valuation should be irrelevant. When an Illinois condemnee asked for more compensation due to increased neighborhood property values resulting from public knowledge of anticipated city planning, the evidence of increased property values was excluded as irrelevant.³¹

Under the Fifth Amendment, the proper rule is to compare the value of what a spouse has before the taking to what the spouse has after the taking; the power to take should not mean that the spouse has less in property rights. The three rights of a life estate, a survivorship right, and a right to prevent sale exist before the taking and are all compensable after a taking.

Calculating the Net Present Value of the Future Interest. Under Rev. Rul. 78-166, a spouse's interest is equal to one half plus the net present value of the survivorship interest. The net present value of the survivorship interest is: (1) the probability of that spouse being the survivor; multiplied by (2) the future value of the home at the time of death; (3) discounted to a present value; and then multiplied by (4) the spouse's one-half interest in the property. If the rate of inflation and the discount rate are the same, the net present value of the

¹ Rodgers, 461 US 677, 698 52 AFTR 2d 83-5042 (1983).

² See *Mansfield v. Excelsior Refining Co.*, 135 U.S. 326, 4 AFTR 4640 (1890), in which the Supreme Court held that the tax collector could not pass good title to property leased by a delinquent taxpayer. See also *In Re Wheeler*, 252 Bkrptcy Rptr. 420, 85 AFTR2d 2000-1921 (DC Mich., 2000) and *Patej*, 91 AFTR2d 2003-875 (DC Mich., 2003), *aff'd* 95 Fed. Appx. 750, 93 AFTR2d 2004-1018 (CA-6, 2004), in which a levy on real estate did not destroy dower rights. The Fifth Amendment prohibits the taking of property without just compensation.

³ Section 7403.

⁴ Note 1, *supra*.

⁵ 649 F.2d 1117, 48 AFTR 2d 81-5526 (1981).

⁶ 649 F.2d 1128, 48 AFTR 2d 81-5534 (1981).

⁷ The IRS is free to ignore any state provisions that prevent a creditor from seizing a particular asset under the Supremacy Clause of the Constitution. *Bess*, 357 US 51, 1 AFTR2d 1904 (1958). (If states

could pass laws to prevent the payment of federal taxes, the result is not hard to imagine.)

⁸ Note 1, *supra*, at 685.

⁹ Note 1, *supra*, at 697.

¹⁰ The four factors were: (1) prejudice to the government from not forcing a sale; (2) the innocent owner's expectation that the property would not be subject to forced sale (aside from Section 7403 and eminent domain); (3) prejudice to the innocent owner from dislocation costs and under compensation; and (4) the relative character and value of the liable and nonliable interests.

¹¹ Note 1, *supra*, at 711.

¹² *Bierbrauer*, 936 F.2d 373, 68 AFTR 2d 91-5050 (CA-8, 1991).

¹³ Note 1, *supra*, at 698 (emphasis added).

¹⁴ The rule is first in time, first in right. "Federal tax liens do not automatically have priority over all other liens. Absent provision to the contrary, priority for purposes of federal law is governed by the com-

mon-law principle that "the first in time is the first in right." *McDermott*, 507 U.S. 447, 449 (1993).

¹⁵ In *Rodgers*, the Fifth Circuit Court of Appeals had ruled that the government could only take the delinquent taxpayer's interest in jointly held property, which meant that sale of the wife's interest could not be sold under Section 7403. The Supreme Court reversed that ruling on the theory that Section 7403 permits the sale of any property in which the taxpayer has an interest. The Court noted that:

Section 7403(a) provides, not only that the Government may "enforce [its] lien," but also that it may seek to "subject any property, [of] whatever nature, of the delinquent, or in which he has any right, title, or interest to the payment of such tax or liability" (emphasis supplied). This clause in and of itself defeats the reading proposed by the Court of Appeals. (*Rodgers* p. 693).

The husband must have had an interest in the entire parcel in order to foreclose on it.

survivorship interest should be the probability of survival times one-half.

Entireties Equation. Assigning the letter P as a probability of surviving a spouse, using the method of valuation in Rev. Rul. 78-166, using the method in *Rodgers* for valuing a "protected interest," and assuming that the discount rate and rate of inflation are the same, the equation for value of an entireties interest under *Rodgers* and Rev. Rul. 78-166 would be:

$$\frac{1}{2}(1 + P) + \frac{1}{2}(1 - \frac{1}{2}(1 + P))$$

which reduces to:

$$\frac{1}{2}(1 + P + 1 - \frac{1}{2} - \frac{1}{2}(P))$$

$$\frac{1}{2}(1.5 + \frac{1}{2}P)$$

Substituting a zero probability of survival for P yields .75 and substituting 1 (100% chance of survival) for P yields 1.

If an individual has a 100% chance of surviving his or her spouse, he or she would have 100% of the value of the home and the other spouse would have a .75 interest (his or her one-half plus one-half of the balance). Does it seem unreasonable to say that a spouse's interest in a home is 75% of its value if: (1) he or she has a right to the use of the home for a lifetime; (2) that right cannot be taken away; (c) he or she has a right to 50% of the home's sale proceeds after consenting to a sale; and (d) his or her spouse takes the property on first spouse's death?

A 100% valuation for guaranteed survivorship approximates reality. When a person has both a life estate and a remainder interest in a piece of property, he or she is considered to own the whole property. The life estate of a spouse might be slightly diminished by the presence of the other spouse, if at all.

The One-Half Conundrum

Is the value of what each entireties spouse has in a home equal to one half of the selling price of the property? Each spouse has their own half and they have rights in the half owned by the other spouse. This means the interest of each spouse will exceed 50% (assuming each spouse has been improved by living together and wretched cohabitation is not a factor). In other words, when two spouses pool their resources to purchase a single larger and more attractive home, they incur an immediate increase in their wealth.

Severed Joint Ownership Valued at 50%.

When entireties property is severed, it

converts the entireties property into a tenancy in common. Survivorship rights and the right to prevent sale do not exist in a tenancy in common. In *In re Spears*,³² a bankruptcy court held that filing bankruptcy severs a tenancy by the entireties and held that the interest of the bankrupt debtor was 50% of the entireties assets. The case was reversed on appeal.

A 50% valuation also occurred after severance in *Popky*.³³ That case involved a tax lien on proceeds from the sale of entireties property in Pennsylvania. After the sale of the property by the Popkys, the title insurance company sent the IRS a check to clear title in an amount that covered the amount of the wife's tax lien. The husband sued to get some or all of that money back claiming that his money was used to pay his wife's taxes. The court ruled that 50% of the money belonged to him.

The court in *Popky* reached its decision by relying on *Spinelli v. Spinelli*.³⁴ In that case, Mr. Spinelli was estranged from his wife. They had sold their entireties home and the sale proceeds were held by the title insurance company awaiting later disbursement. The following day, the wife showed up at the title insurance company falsely claiming to have authority to receive the check for both her share and her husband's. She deposited the title insurance company check into the bank by having her husband's name forged on the check. She withdrew the money, and her husband sued. The court had to determine how much belonged to the husband. It said:

[I]f one spouse does in any way prejudice the rights of the other in such property, the latter has the right to demand an accounting, to have severed all entireties property held by them and to have awarded to him in his own right one half of it.³⁵

In reaching its 50% ruling, the court in *Popky* relied on this language from *Spinelli* and said:

Mrs. Popky has prejudiced the rights of Dr. Popky in the proceeds from the sale of their home by becoming a delinquent taxpayer. ... Following the reasoning in *Spinelli*, Dr. Popky should therefore be given a fifty percent share in the proceeds.³⁶

The Third Circuit affirmed the lower court in *Spinelli*, stating:

As the District Court correctly observed, "the equal division of assets between spouses... parallels the distribution of entireties property when an entireties estate is severed because of a sale with consent of both tenants, divorce or other reasons."³⁷

Popky raises two questions. First, do tax liens sever all entireties property? It would seem not. A tax lien did not sever the entireties interest in *Craft*. Further, there is a longstanding rule that property rights are defined by state law³⁸ and "[t]he federal tax lien statute itself creates no property rights."³⁹ If tax liens deprive non-taxpayers of property rights, the filing of a lien would be a taking.

The second question raised by *Popky* is whether a separate interest in entireties property is 50% if the property is severed. Unsevered entireties property is treated as if each spouse is "vested with the entire title."⁴⁰ When entireties property is severed, the rights of a spouse that extend out to the entire property become defeasible. The value of something that can be taken away from someone without his or her consent is worth much less than the value of something that requires agreement before it can be acquired. In an Oregon bankruptcy proceeding,⁴¹ a current entireties interest of a non-debtor wife was valued at 53.207% using actuarial tables. The wife argued that everything except her husband's survivorship interest should be included in her share. The Ninth Circuit disagreed because "Oregon law permits the creditor of one spouse to execute on that spouse's interest in property held as a tenancy by the entirety with a nondebtor spouse."⁴² The wife could not claim rights to her husband's interest, because those rights could be taken from her by any creditor.

Joint Ownership of Cash Valued at 50%. This section and the next one address what happens when the right of survivorship and the right to prevent sale disappear.

The conversion of real estate to cash necessitates the removal of concurrent rights.⁴³ Cash is fungible and divisible. Either spouse may withdraw funds from a bank account.⁴⁴ An interest in cash held by a husband and wife in



such an account is held as a tenancy in common because their rights of withdrawal permit them to defeat the survival rights and right to prevent sale of the other owner.⁴⁵ In a New York case, a survivor sued for amounts withdrawn by the co-owner decedent. The court held that the decedent's withdrawals terminated the survivor's right to the amounts withdrawn.⁴⁶ In one bankruptcy case, the court split in half the proceeds of stock that had already been sold because the stock was easily divisible.⁴⁷ For the reasons outlined, parties in litigation have sometimes stipulated that sold real estate should retain the characteristics of protected property before the sale.⁴⁸

Notice 2003-60 and the 50% Rule on Sale or Transfer. After the Supreme Court

decided *Craft*, the IRS issued Notice 2003-60,⁴⁹ addressing how it would handle valuing an interest in entireties property. On sale or transfer of entireties property subject to a lien, the lien would be treated as being equal to one half of the value of the property.⁵⁰ The Notice discussed foreclosures under *Rodgers* but indicated that the courts would determine the value of the lien.⁵¹ Although some courts have mentioned the notice without relying on it as binding authority, a district court has based two decisions on the 50% rule as stated in the Notice.⁵²

Constitutional Requirements and Valuation

Under the Fifth Amendment, an "owner must be put in as good position pecu-

niarily as if his property had not been taken."⁵³ "Just compensation" ordinarily means fair market value from comparable sales prices unless there is no value from fair market value sales. (No comparable sales prices exist for spousal interests in marital homes.) In *Commodities Trading Corp.*, the Supreme Court stated:

Fair market value has normally been accepted as a just standard. But when market value has been too difficult to find, or when its application would result in manifest injustice to owner or public, courts have fashioned and applied other standards.⁵⁴

This is the basic rule. If there are market sale prices for something, those prices are evidence of its value. If there are no market values or if the only available market data does not seem to match reality, some other method is used to value the property. The method used in *Gibbons, Rodgers*, and Rev. Rul. 78-166, was to value each right of the property owner separately and then add them together.

Why Value From Use Is Greater Than Value From Sale

When the Court in *Rodgers* calculated the life estate of Mrs. Rodgers, it was computing the value of her use of the property over her lifetime. Value from use is a legitimate method to value an asset for which there is no market value. Justice Cardozo explained this in a patent case, in which there was no market for a patent, and the only evidence of its value was its use:

The use that has been made of the patented device is a legitimate aid to the appraisal of the value of the patent at the time of the breach. This is not a case where the recovery can be

¹⁶ *Cole v. Cardoza*, 441 F.2d 1337, 27 AFTR2d 71-1204 (CA-6, 1971).

¹⁷ 535 U.S. 274, 89 AFTR 2d 2002-2005 (2002).

¹⁸ *Id.* at 289.

¹⁹ *Id.* at 281.

²⁰ 1978-1 CB 283.

²¹ 71 F.3d 1496, 76 AFTR 2d 95-7825 (CA-10, 1995).

²² *Id.* at 1500-1501.

²³ See *City of Huntington Woods v. City of Detroit*, 761 NW2d 127 (Mich. S. Ct., 2008). In that case, the neighbors around a Detroit city-owned golf course had standing to sue to prevent Detroit from selling the golf course. A deed restriction prevented sale.

²⁴ *General Motors Corp.*, 323 U.S. 373, 378 (1945).

²⁵ *Ferrer*, 304 F.2d 125, 9 AFTR2d 1651 (CA-2, 1962).

²⁶ *O'Hagan*, 86 F.3d 776, 77 AFTR 2d 96-2467 (CA-8, 1996).

²⁷ See Note 13, *supra*.

²⁸ *One Single Family Residence With Out Buildings Located at 15621 S.W. 209th Avenue, Miami, Florida*, 894 F.2d 1511 (CA-11, 1990).

²⁹ *Id.* at 1515.

³⁰ *Id.* at 1516.

³¹ *Kerr v. South Park Commissioners*, 117 U.S. 379 (1886).

³² 308 Bkrptcy. Rptr. 793 (Bkrptcy. DC Mich., 2004), *rev'd* 313 Bkrptcy. Rptr. 212 (DC Mich., 2004).

³³ 326 F. Supp.2d 594, 94 AFTR2d 2004-5157 (DC Pa., 2004), *aff'd* 419 F.3d 242 (CA-3, 2005).

³⁴ 264 F. Supp. 107 (DC Pa., 1967).

³⁵ *Id.* at 109.

³⁶ Note 33, *supra*, at 602.

³⁷ Note 33, *supra* at 419 F.2d 245.

³⁸ *Aquillino*, 363 U.S. 509, 5 AFTR2d 1698 (1960).

³⁹ Note 17, *supra* at 278.

⁴⁰ *Id.* at 282.

⁴¹ *In re Pletz*, 221 F.3d 1114, 86 AFTR 2d 2000-5575 (CA-9, 2000).

⁴² *Id.* at 1117.

⁴³ See, for example, *Dougherty*, 292 F.2d 331, 8 AFTR2d 6031 (CA-6, 1961), in which a dower interest was converted to cash to remove third party interests. See also *In re Garner*, 952 F.2d 232 (CA-8, 1991), involving cash proceeds of investment stock that were split 50%.

⁴⁴ *Nat. Bank of Commerce*, 472 U.S. 713, 56 AFTR2d 85-5210 (1985).

⁴⁵ See *Batjes Fuel & Building Material Co. v. Milanowski*, 211 N.W. 27 (Mich. S. Ct., 1926).

measured by the current prices of a market. A patent is a thing unique. There can be no contemporaneous sales to express the market value of an invention that derives from its novelty its patentable quality.⁵⁵

Justice Cardozo later explained in the same opinion:

Value for exchange is not the only value known to the law of damages. There are times when heed must be given to value for use, if reparation is to be adequate. The market test failing, there must be reference to the values inherent in the thing itself, whether for use or for exchange. These will not be known by first imagining a forced sale, and then accepting as a measure its probable results.⁵⁶

The terms "value for exchange" and "value for use" harken back to Adam Smith, who wrote:

The word VALUE, it is to be observed, has two different meanings, and sometimes expresses the utility of some particular object, and sometimes the power of purchasing other goods which the possession of that object conveys. The one may be called "value in use"; the other, "value in exchange." The things which have the greatest value in use have frequently little or no value in exchange; and on the contrary, those which have the greatest value in exchange have frequently little or no value in use. Nothing is more useful than water: but it will purchase scarce any thing; scarce any thing can be had in exchange for it. A diamond, on the contrary, has scarce any value in use; but a very great quantity of other goods may frequently be had in exchange for it.⁵⁷

The main characteristic of entireties ownership is that inalienability perpetuates use. To say that an owner of entireties property is entitled to 50% because if the owner consents to a sale he or she receives only that amount is like valuing lakefront property based on how close it is to a subway stop. Alienability is the one condition that diminishes the value of a separate interest in entireties property. Normally, spouses sell homes with the intention of repurchasing and furthering their use.

Compensation for the Use of the Entire Home

On a forced sale of a home, the innocent owner loses the value of the use of his or her entire home.⁵⁸ Under the Takings Clause, a person is entitled to compensation for the use of an entire parcel if it is "used and treated as an entity."⁵⁹ The value to a spouse of a home in which two people live is marginally distinguishable from the value to a spouse of the use of a home by himself or herself. The value is not diminished by the number of occupants.

Similarly, under the federal tax law, the value of the joint use of property is determined independently. It is not done by dividing the whole by the number of persons involved. The deductible amount by one person of a shared hotel room, for example, is the amount associated with engaging in the transaction separately. An example in IRS Publication 463 provides: "Jerry drives to Chicago on business and takes his wife, Linda, with him.... Jerry pays \$199 a day for a double room.

A single room costs \$149 a day. He can deduct the total cost of driving his car to and from Chicago, but only \$149 a day for his hotel room." The Tax Court in *United Title Insurance Co.*⁶⁰ also noted that if there is only one hotel room rate, that rate is deductible regardless of the number of occupants.

Under a pro rata valuation, Jerry would be entitled to only 50% of the hotel room he shares with his wife. He is instead entitled to 75% because the additional cost of adding his wife is 25% of the cost. What is the additional cost of adding someone as an occupant to a home? If the cost of adding another person to a *small* hotel room is 25% of the cost of the room, adding another occupant to an entire two or three floor home should be close to 0% of the cost of the home. Consider that the Supreme Court in the *Rodgers* calculated the value of a homestead for a 30-year-old Texas spouse at 99% of its value.⁶¹ The notion that a single spouse owning entireties property would derive close to 100% of its value is not far from reality.

The Sum of the Parts Exceeds the Total

In *Rodgers, Gibbons*, and Rev. Rul. 78-166, the rights of the husband and wife, when added together as percentages of the sale price, exceed 100%. The *Rodgers* Court acknowledged this possibility in the following statement: "It requires no citation to point out that interests in property, when sold separately, may be worth significantly more

⁴⁶ In re Suter's Estate, 258 N.Y. 104, 179 N.E. 310 (N.Y. Ct. of App., 1932).

⁴⁷ In Re Garner, *supra*, note 41.

⁴⁸ Mrs. Ingrams did it in *Rodgers* and it was done by the wife in Certain Real Property Located at 2525 Leroy Lane, West Bloomfield, Michigan 972 F.2d 136 (CA-6, 1992).

⁴⁹ 2003-2 CB 643.

⁵⁰ See Question 3 of the Notice.

⁵¹ See Question 8 of the Notice.

⁵² City of Grandview v. Ryan, 2005 WL 6153137 (DC Mo., 2005).

⁵³ Note 24, *supra* at 379.

⁵⁴ 339 U.S. 121, 123 (1950).

⁵⁵ Sinclair Refining Co. v. Jenkins Petroleum Process, Co., 289 U.S. 689, 697 (1933).

⁵⁶ *Id.* at 699 (citations omitted).

⁵⁷ Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Book 1, Chapter 4, Of the Origin and Use of Money (1776), p.84.

⁵⁸ "And the question is [under the Fifth Amendment], what has the owner lost?" Boston Chamber of Commerce v. City of Boston, 217 U.S. 189, 195 (1910).

⁵⁹ Miller, 317 U.S. 369, 375 (1943).

⁶⁰ TCM 1988-38.

⁶¹ In the *Rodgers* case, the property was held by Mrs. Rodgers as community property. Her husband's interest was held by his estate. Both his estate and his son and daughter were joined in the proceeding under Section 7403(c). An argument could be made that the *Rodgers* court was valuing a single life estate, but the Supreme Court said that the Texas homestead interest was "akin to an undivided life estate in the property," (at 686) which implies that the court was valuing one of two undivided life estates. The homestead inter-

est of a Texas spouse is, according to the IRS, less than a life estate for purposes of the QTIP provisions of the Code. See Ltr. Rul. 8736004.

⁶² Note 1, *supra* at 694.

⁶³ Virginia Elec. & Power Co., 365 U.S. 624, 632 (1961).

⁶⁴ McCandless, 298 U.S. 342 (1936).

⁶⁵ Note 26, *supra*.

⁶⁶ Oral Tr. p. 15. Alderson Reporting Company. The transcript can be found at 2002 WL 73224 (Oral Argument) (U.S. January 14, 2002), Oral Argument, (No. 00-1831). This nugget of information was found and published by Fred Franck in his article, *Asset Protection and Tenancy By the Entirety*, 34 ACTEC Journal 210 (2009), p. 218. The article includes a current description of the entireties statutes in all of the states and the Virgin Islands.

⁶⁷ *National Taxpayer Advocate, 2009 Annual Report to Congress, Executive Summary, Prefaces & Highlights*, 12/31/09, p. 42.



or significantly less than the sum of their parts.”⁶² The fact that the value of the rights of the use of a home by a husband and wife add up to more than 100% is just the consequence of valuing the concurrent use of property.

Sameness

Because both a husband and a non-taxpayer wife can be said to have an equal interest in their entireties home, how does a 90% plus ownership interest by a wife correspond with the idea of splitting the proceeds from sale under Section 7403(c)? The answer is that the valuation of the non-taxpayer wife’s interest is subject to constitutional limitations and the valuation of the taxpayer husband’s interest is not. Compensation under the Takings Clause is determined “by taking the difference between the value of the property before and after the Government’s” taking.⁶³ The non-taxpayer wife is entitled to compensation for the most advantageous use of the land.⁶⁴

The dollar value of the marital home to the wife who is not planning on selling is the value of living in a

creditor-proof home with a welcomed visitor, plus her survivorship interest, and plus her protected interest. The government, for purposes of tax collection, has no right to the most profitable valuation. The actual selling price of a separate entireties interest is little, if anything at all.⁶⁵

Conclusion

During the oral argument in *Craft*, the Supreme Court questioned Kent Jones, the Assistant to the Solicitor General, about valuing a spousal interest in entireties property:

QUESTION: But in your view, you always value the taxpayer’s interest at 50 percent?

MR. JONES: No. I think in the *Rodgers* — well, if the property’s been sold, yes. If the property hasn’t been sold, and we’re talking about in a foreclosure context, I believe the *Rodgers* court goes through the example of the varying life expectancies of the two tenants, and which one — and I believe what the Court in *Rodgers* said was that each of them should be treated as if they have a life estate

plus a right of survivorship, and the Court explains how that could well — I think in the facts of *Rodgers* resulted in only 10 percent of the proceeds being applied to the husband’s interest and 90 percent being retained on behalf of the spouse, but — [Mr. Jones was interrupted with an unanswered: QUESTION But there must be a foreclosure to that extent?]⁶⁶

This statement by Jones is a fair summary of the two different valuations of a spousal interest in entireties property that can occur before severance and after severance (by sale or transfer) as detailed in the discussion of law outlined in this article.

Valuing concurrent interests is an area of valuation science and law that really hits home. In 2009, government lawsuits under Section 7403 became one of the top ten most litigated tax issues for the first time.⁶⁷ As deficits and the national debt move in an upward trajectory, a body of expertise will be needed in the area of valuing concurrent interests in property sought by the government where the benefits of continued ownership exceed a pro rata share of the selling price. ●