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## SUMMARY JUDGMENT MOTIONS IN IRC §7403 CASES

By Neal Nusholtz

Tax Court practitioners are accustomed to judges determining the dollar value of something like a partial interest in real estate even when there is no evidence of actual sales upon which to base a valuation. Such valuations in the absence of market data are a fact of life. But could a court rule that the cash value of property rights in the absence of market data is a fact that cannot even be litigated? That issue was appealed in the *Barr* case.<sup>1</sup>

Specifically, the issue in the *Barr* case was whether, in a motion for summary judgment where no evidence was proffered as to the value of a wife's interest in Michigan marital home, a district court could conclude that the following three rights were equal to 50% of the net selling price as a matter of law:

- the right to the use of the entire home with her husband during their joint lifetime;
- the right to inherit the home; and
- the right to prevent its encumbrance or forced sale.

The *Barr* case arose when the government sought to sell the entire marital home in an IRC §7403 foreclosure to satisfy the husband's sole tax liability. The district court, upon ordering the sale of the marital home, was required to compensate the wife with "just compensation" for a taking for public use. The lower court determined, without any evidence of value, that there was no genuine issue of fact for trial on the question of valuation of spousal rights in a homestead. The *Barr* case was the first §7403 case of a foreclosure on an entireties interest where the home had not been previously sold or transferred to a third party.

In a majority opinion, the Sixth Circuit affirmed the district court's 50% ruling and held that both the right to prevent sale and the survivorship right have a zero value. The court ruled:

Mrs. Barr presents no compelling reason why this court should not apply the presumption of equal spousal life expectancy implicit in Michigan law. (*Id* at 374)

Whether the above language settles the issue of whether spousal entireties rights are worth 50% of the net selling price as a matter of law is not clear. According to the So-

licitor General in its Brief in Opposition to a Petition for Certiorari in the *Barr* case, the government said:

Contrary to petitioner's suggestion, however, the court of appeals' decision in this case does not require that a 50-50 division be made in "every situation where a court is asked to order a sale of entireties property under 7403." Rather, the court simply concluded that petitioner had "present[ed] no compelling reason why this court should not apply the *presumption* of equal spousal life expectancy implicit in Michigan law."<sup>2</sup>

### HISTORY

In January of 2002, when the *Craft* case<sup>3</sup> was being argued, the Supreme Court wanted to know from the assistant solicitor general how a ruling that tax liens applied to entireties property would impact tax foreclosures under §7403:

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 then interrupted with the following unanswered question: "But there must be a foreclosure to that extent?"]<sup>4</sup>

The *Rodgers* case<sup>5</sup> was a reference to language in a 1983 Supreme Court case regarding valuing a spousal interest in Texas homestead property. There, a husband had died with a tax lien on his one-half community share. The Supreme

Court held that a sale of the entire home under IRC §7403 was permitted as long as the surviving wife was compensated for her interest. The court considered the interests as “akin to an undivided life estate” and a “remainder interest”<sup>6</sup> and proposed this valuation:

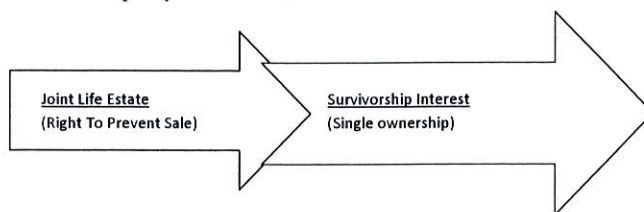
The exact method for the distribution required by §7403 is not before us at this time. But we can get a rough idea of the practical consequences of the principles we have just set out. For example, if we assume, *only for the sake of illustration*, that a homestead estate is the exact economic equivalent 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. (*Rodgers* at 698)

In 1976, the Internal Revenue Service valued a spousal interest in joint property with rights of survivorship. If a man murders his wife and, therefore, cannot inherit her interest, her interest in joint property for estate tax purposes is 50% plus the net present value of inheriting the other half of the interest.<sup>7</sup>

### CO-OWNERSHIP VALUATION PRINCIPLES

Three concepts guide the valuation of a concurrent interest in a home. The first concept is sharing. When two or more people share property “Each cotenant has the right to use and enjoy the entire property as if he or she were the sole owner, limited only by the same right in the other cotenants.”<sup>8</sup> The second concept is “use in the reasonably near future.” When you value property under the Fifth Amendment takings clause, “the rule is well settled that, in condemnation cases, the most profitable use to which the land can probably be put in the reasonably near future may be shown and considered as bearing upon the market value.”<sup>9</sup> The third concept is actuarial statistics. In the *Rodgers* case, the court said, “any calculation of the cash value of a homestead interest must of necessity be based on actuarial statistics.”<sup>10</sup>

A Michigan Entireties interest can be visualized as a continuum of a joint life estate followed by a survivorship interest when one party becomes deceased:



### VALUING THE JOINT LIFE ESTATE

If a married couple lives together in a home, how does the presence of one affect valuation of the other’s interest in the home during the joint life estate? In the *Rodgers* case, Mrs. *Rodger’s* kids were grown and out of the house. She had remarried after her former husband’s death and was living with her second husband.<sup>11</sup> The owner of the other half of the house was the husband’s estate and the husband’s heirs were joined in the case. Using the 99% *Rodgers* calculation for a 30 year old widow in *Rodgers*, would that 99% interest be reduced if, instead, a wife is sharing her home with a husband who is also an owner?

A home is an asset typically not diminished by its use. The rule is that property rights of co-owners are not diminished by use of another co-owner if “enjoyment of [the] property [by a cotenant] does not consume or diminish it; and (2) “the collective desires of all cotenants to use such asset [does not] exceed that asset’s capacity for use.”<sup>12</sup> Contrast the use of a home with the use of cash. Cash is consumed by the singular use of a co-tenant and, therefore, can be divided but not shared like a home can be shared. Equal rights in cash means one-half each. In *Popky*<sup>13</sup> a district court held that a tax lien on cash proceeds of the sale of entireties property applied to one half of the cash. In *Craft*, the Supreme Court held that while rent and sale proceeds from entireties property are split 50-50, for purposes of a tax lien on non cash entireties property, the Court “express[ed] no view as to the proper valuation of respondent’s husband’s interest in the entireties property.”<sup>14</sup>

Another factor to be considered is that marriage is the most intimate of all personal relationships. A “husband’s use of the property by occupancy... is a natural use which does not diminish [the] wife’s enjoyment and possession and which grows out of a congenial and happy family relationship.”<sup>15</sup> In the *Rodgers* case, the wife’s use of the property included her right to co-occupation with a husband. The presence of a husband is actually an enlargement of spousal use of the property. Nevertheless, the impact of cohabitation on

valuation of one spouse's interest in the joint life estate could be different for different people, making its valuation inappropriate in a motion for summary judgment without actual evidence that a spouse does not benefit from 100% of the joint life estate.

### THE IMPACT OF SALE OR DIVORCE

A sale or a divorce would control the rights of the parties. On divorce, assets are not divided equally but equitably.<sup>16</sup> On sale, proceeds are divided in half.<sup>17</sup> If a court were to value a spousal interest by reference to sale or a divorce, the court would first have to determine if those were the most profitable uses of the property contemplated in the reasonably near future.<sup>18</sup> That requires evidence. A 50-50 split by analogy to a consensual sale would only be appropriate in a government §7403 motion for summary judgment if it has been established that a sale is contemplated by a married couple in the reasonably near future.

### ACTUARIAL DETERMINATIONS

An actuarial calculation of the value of the joint life estate and the survivorship interest can be quite simply based on government tables. IRS Publication 1457 example C. 6. tells you how to calculate the present worth of a survivorship interest in a first to die joint life estate and, conversely, the percentage value of the joint life estate. Four facts need to be addressed in that calculation. First, the use of the tables assume that the value of the home will not increase over the period of the joint life estate and, in today's down market, that might not be appropriate.

Second, the tables in Publication 1457 do not factor longevity differences for sex. After 1986, the government started using unisex tables.<sup>19</sup> An adjustment can be made by considering that in 2003 the government considered the lifespan of a female to be five years longer than a male of the same age.<sup>20</sup> Third, calculations of the relative probability of inheriting the entire home by a husband or a wife has to be made based on life expectancies. Fourth, the calculation of a spousal share of the joint life has to be made as discussed above. These are all factual questions that require evidence, but, according to Sixth Circuit, in Michigan, actuarial calculations are not permitted in a motion for summary judgment under §7403:

This kind of actuarial calculation is not appropriate in the present case. *Rodgers* used actuarial valuation only out of necessity: one cannot determine the value of a life estate-which is effectively what *Rodgers* possessed-without estimating the length of the measuring life. The Supreme Court thus based its choice of valuation method on the fact that "any

calculation of the cash value of a homestead interest must of necessity be based on actuarial statistics." *Id.* at 704, 103 S.Ct. 2132. No such necessity exists here, and Mrs. Barr presents no compelling reason why this court should not apply the presumption of equal spousal life expectancy implicit in Michigan law.<sup>21</sup>

Providing a compelling reason not to apply a presumption is difficult when said presumption was unknown until the paragraph above had been read, but it would be worthwhile for litigants in spousal interest cases to explore the area of compelling reasons under §7403.

### THE STARTING POINT

Spousal rights extend to the entire property. For that reason, when the government files a tax lien on the husband's interest, its lien is junior to the rights of the wife<sup>22</sup> because when it comes to competing interests in the same property, it is "the first in time is first in right."<sup>23</sup> The interest of the government and the interest of a non delinquent spouse cannot be equal in the same way that a junior mortgage and a senior mortgage of equal amounts do not have equal rights to proceeds of a sale. In the *O'Hagan* case,<sup>24</sup> the survivorship interest of the husband was the only property interest upon which the government could levy and sell. Under that analysis, a non delinquent spouse is entitled compensation for everything over and above the delinquent spouse's survivorship interest. It would therefore seem that in government §7403 motions for summary judgment that the court would first determine the dollar value of the government lien which is not preempted by the property rights of the non-delinquent spouse. Lien priority law requires that a wife has not *equal* but *superior* property rights over the government.

### CONCLUSION

With a national debt at the \$14 trillion mark, more and more §7403 foreclosures seem likely. In 2009, for the first time, §7403 litigation made the top ten list of IRS litigated issues in the federal courts.<sup>25</sup> In summary judgment motions, courts do not try facts but determine if there are facts to be tried. A summary judgment order that allows for a rough and ready calculation of the dollar value of property rights may permit the government rapid access to taxpayer property but it may or may not compensate an injured owner. Moreover, a balance in favor of quick collection over property rights will shift in the power of the United States government as courts in summary judgment motions become an adjunct of the collection division of the Internal Revenue Service. At a minimum, the value of a spousal interest in foreclosure cases is something to argue about.

In a case similar to the *Barr* case, on August 17, 2011, the 6<sup>th</sup> Circuit issued a per curiam unpublished opinion in *U.S. v. Barczyk* 2011 WL 3624947 (C.A.6 (Mich.)). Honorable Judge Helene White wrote a separate concurring opinion in *Barczyk* stating:

As observed by Chief Judge Batchelder in her partial dissent in *Barr*, “[t]he weight of federal law argues strongly against the majority opinion’s conclusion that [a non-defaulting spouse] is entitled to a simple fifty percent interest because she is a tenant by the entireties.” *Id.* at 379 (Batchelder, C.J., concurring in part and dissenting in part). Like Chief Judge Batchelder, I believe that an automatic fifty-percent valuation of the non-defaulting spouse’s interest in the property is incorrect, and that courts should consider actuarial evidence in calculating the spouses’ respective shares in the property.

There are at least two judges in the Sixth Circuit who have openly indicated that the *Barr* case was wrongly decided. Perhaps it is an issue worth revisiting.

**ABOUT THE AUTHOR**

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**ENDNOTES**

- 1 *U.S. v. Barr*, 617 F3rD 370 (6<sup>th</sup> Cir. 2010) *Cert Denied* \_U.S.\_ (3/21/2010)
- 2 Brief for the United States in Opposition (p.10)
- 3 *United States v. Craft*, 535 U.S. 274 (2002)
- 4 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)
- 5 *U.S. v. Rodgers*, 461 U.S. 677 (1983)

- 6 See *Rodgers* at 685-686
- 7 Rev. Rul. 78-166, 1978-1 CB 283
- 8 *Georgia v. Randolph*, 547 U.S. 103 (2006)
- 9 *McCandless et ux.v.United States*, 298 U.S. 342, 345 (1936)
- 10 *Rodgers*, at 704.
- 11 *U.S. v. Rogers(sic)*, 649 F.2d 1117 (5<sup>th</sup> Cir. 1981)
- 12 *Marion I. Powell*, TC Memo 1992-367
- 13 *Popky v. U.S.*, 326 F Supp. 2d 594 *aff'd* 419 F.3d at 244 (3<sup>rd</sup> Cir. 2005)
- 14 *U.S. v. Sandra L. Craft*, 535 U.S. 274, 282, 289 (2002)
- 15 *Estate of Allen D. Gutchess*, 46 TC 554, 557 (1966)
- 16 *Tkachik v. Mandeville*, 764 N.W.2d 318, 324 (Mich. App. 2009), *rev'd on other grounds*, 790 N.W.2d 260 (Mich. 2010)
- 17 See note 14.
- 18 See note 9
- 19 IRS Publication 939 p. 8
- 20 *ibid*, tables I and II.
- 21 See note 1 at p. 374
- 22 *O'Hagan, Ann H. v. United States*, 86 F3d 776 (8<sup>th</sup> Cir. 1996)
- 23 *U.S. v. McDermott, et. al.* 507 U.S. 447, 449 (1993)
- 24 See note22
- 25 National Taxpayer Advocate 2009 Annual Report to Congress, Executive Summary Preface & Highlights, p. 42.

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