No. 00-1831

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

SANDRA L. CRAFT

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR PETITIONER

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1. Respondent errs in asserting (Br. in Opp. 1-2) that the United States may not obtain review of the final judgment entered in this case because that judgment rests, in part, on the interlocutory order entered by the court of appeals on the first appeal in this case. Respondent claims that "[t]he fact that [on the first appeal] the Sixth Circuit remanded the case back to the District Court for consideration of an entirely different issue, does not alter the finality of the Sixth Circuit's reversal of the earlier District Court's decision on the issue raised by the Petitioner's petition." *Id.* at 1.

In making that contention, respondent ignores the settled rule that "the Court on certiorari to review a final decree can reach back and correct errors in the interlocutory proceedings below, even though no attempt was made to secure review of the interlocutory decree or even though such an attempt was made without success." R. Stern, E. Gressman et al., *Supreme Court Practice* 40 (7th ed. 1993), citing, *e.g.*, *Mercer* v. *Theriot*, 377 U.S. 152, 153-154 (1964); *Toledo Scale Co.* v. *Computing Scale Co.*, 261 U.S. 399, 418 (1923). Indeed, it is the Court's "normal practice" to deny "interlocutory review." *Estelle* v. *Gamble*, 429 U.S. 97, 114 (1976) (Stevens, J., dissenting).[1] Review by writ of certiorari is ordinarily from the final order that disposes of all issues in the case rather than "from an interlocutory order." *American Construction Co.* v. *Jacksonville, T. & K.R. Co.*, 148 U.S. 372, 384 (1893).[2]

On the first appeal in the present case, the Sixth Circuit did not address or resolve the question whether the Crafts had fraudulently conveyed the property to respondent. Instead, the court of appeals remanded the case for consideration of this issue by the district court. Pet. App. 3a, 58a. On remand, the district court held that the property had not been fraudulently conveyed

[1] See also *Columbia Union College* v. *Clarke*, 527 U.S. 1013, 1015 (1999) (Thomas, J., dissenting from the denial of certiorari) ("the Court declines to grant certiorari today—perhaps because this case comes to us in an interlocutory posture"); *Randolph Central School Dist.* v. *Aldrich*, 506 U.S. 965 (1992) (White, J., dissenting from the denial of certiorari).

[2] The cases on which respondent seeks to rely (Br. in Opp. 2) are inapposite. For example, *FTC* v. *Minneapolis-Honeywell Regulator Co.*, 344 U.S. 206, 211-213 (1952), addresses whether the 90-day period for the filing of a petition for a writ of certiorari may be renewed when, without the filing of a petition for rehearing, the court of appeals issues a second opinion on a single appeal. That question is not presented here. Similarly, this case does not present the question addressed in *FTC* v. *Colgate-Palmolive Co.*, 380 U.S. 374, 378 (1965), concerning the circumstances in which a *final* order in prior litigation may be reviewed in connection with a separate but related later suit.

to respondent but concluded that the government could recover the amounts by which Don Craft had enhanced the value of the property during his insolvency by making mortgage payments. *Id.* at 79a-86a. On the government's appeal from the judgment entered on remand, the court of appeals declined to reconsider its rulings on the first appeal and affirmed the district court's ruling on the fraudulent enhancement issue. *Id.* at 6a-20a. The petition for a writ of certiorari is timely because it was filed by the United States within 90 days of the judgment entered by the court of appeals following the proceedings on remand. See Pet. 1.

2. Respondent errs in asserting (Br. in Opp. 8-9) that this case became moot upon the death of Don Craft in 1998. Respondent contends that, upon her husband's death, respondent obtained fee simple title to the property by right of survivorship and is therefore entitled to the sale proceeds that have been held in escrow pending the conclusion of this case. Respondent argues that this conclusion is required both by general principles of succession and by "[t]he original escrow stipulation signed between the parties" (*id.* at 9).

(i) The escrow agreement to which respondent refers was formed at the time of the sale of the subject property, and it specifies that one-half of the proceeds were to be released to respondent (representing "her share" of the proceeds) and that "[t]he remaining one-half, or $59,944.10 will be placed in an interest bearing account at [respondent's counsel's law firm] until such time as a resolution of the tax lien dispute is reached and an agreement is signed by both the Internal Revenue Service and representatives of Don Craft or until ordered to release those funds by an appropriate court order." C.A. App. 147. Nothing in that escrow agreement addresses or resolves the proper disposition of these funds upon the death of Don Craft.

(ii) The correct disposition of these escrowed funds can be determined only upon resolution of the question presented in this case. If, as the government submits, the federal tax lien attached to the interest of Don Craft in the tenancy-by-entirety property, that lien attached to his interest in the proceeds of that property upon its sale—a sale that occurred six years *prior* to his death. Pet. App. 3a. That sale terminated the tenancy-by-entirety and, upon its termination, each of the tenants became individually entitled to receive one-half of the proceeds. Mich. Comp. Laws Ann. § 557.71 (West 1988); see *Rogers* v. *Rogers*, 136 Mich. App. 125, 135, 356 N.W.2d 288, 293 (1984). See also Pet. 12.[3] The valuable and legally protected right of each member of a tenancy by the entirety to share as individuals in the proceeds of the sale is one of the "rights to property" to which the federal tax lien attaches by operation of law under 26 U.S.C. 6321. *United States* v. *National Bank of Commerce*, 472 U.S. 713, 725 (1985) (the "right to receive property is itself a property right" to which the federal tax lien attaches). See Pet. 11-15.

As Judge Ryan explained in his separate opinion below, before the property was sold, the federal lien had attached to Don Craft's "future right to half of the proceeds." Pet. App. 69a. And, when the property was thereafter sold, the taxpayer's "future right to half of

[3] Even under state law, the proceeds of entirety property that are available for meeting personal expenses may be attached for the debts of one spouse. See *Muskegon Lumber & Fuel Co.* v. *Johnson*, 338 Mich. 655, 62 N.W.2d 619 (1954); *In re Wickstrom*, 113 B.R. 339, 349 (Bankr. W.D. Mich. 1990); *In re Jackson*, 92 B.R. 211, 214 (W.D. Mich. 1988); *In re Jones*, 31 B.R. 372, 375 n.4 (Bankr. E.D. Mich. 1983).

the proceeds became a present interest" to which the federal lien continued to attach. *Ibid.* Because the death of Don Craft occurred many years *after* the tax lien had attached to his separate interest in the proceeds, and because these proceeds were not themselves entirety-property, his death does not make the government's claim for enforcement of its lien moot. See, *e.g.*, *United States* v. *Rodgers*, 461 U.S. 677, 691 n.16 (1983) (the federal tax lien "cannot be extinguished * * * simply by a transfer or conveyance of the interest").[4]

3. a. Respondent principally contends on the merits (Br. in Opp. 9) that the federal tax lien can attach only to interests that the State has itself characterized as "property." It is well established, however, that whether or not the State characterizes the interest as "property" is not controlling. Instead, courts are to look to "federal law to determine whether the taxpayer's state-delineated rights qualify as 'property' or 'rights to property' within the compass of the federal tax lien legislation." *Drye* v. *United States*, 528 U.S. 49, 58 (1999). Because the governing question of statutory

[4] Indeed, in the district court, respondent took the position that the tenancy by the entirety had been terminated even *prior* to the sale, when the property was quitclaimed by Don Craft to respondent in 1989. Pet. App. 3a. Respondent maintained in the district court that "[t]he tenancy by the entireties in the case before the Court was destroyed by operation of law when the tenancy was terminated in accordance with the provisions of MCLA § 557.101 as shown on Government Exhibit 3." C.A. App. 204-205. Of course, the conveyance of property to which the federal tax lien has attached does not destroy the lien, for the lien passes with the property and also attaches to any proceeds. See, *e.g.*, *Drye* v. *United States*, 528 U.S. 49, 53-54 (1999); *United States* v. *Rodgers*, 461 U.S. at 691 n.16; *United States* v. *Bess*, 357 U.S. 51, 57 (1958) (property subject to a federal lien can only be passed "cum onere").

interpretation is controlled by federal law, "it is not material that the economic benefit to which the [taxpayer's] right pertains is not characterized as 'property' by local law." *Id.* at 58 n.5 (quoting W. Plumb, *Federal Tax Liens* 27 (3d ed. 1972)).

As demonstrated in the petition (Pet. 12-13), the spouse's interest in a tenancy by the entirety in Michigan is a valuable, legally protected "species of right or interest" to which the federal tax lien attaches. *Drye* v. *United States*, 528 U.S. at 56. Under Michigan law, each spouse has the right to reside on the property, to exclude third parties from the property, to join or refuse to join in the mortgage, lease or sale of the property, and to share individually in the proceeds of a sale. See *Farmers' & Merchants' Nat'l Bank & Trust Co.* v. *Globe Indemnity Co.*, 264 Mich. 395, 399, 249 N.W. 882, 883 (1933); *Eadus* v. *Hunter*, 249 Mich. 190, 193-196, 228 N.W. 782, 783-784 (1930); Mich. Comp. Laws. Ann. § 557.71 (West 1988). Each spouse also has the right of survivorship, which is the right to receive the property in fee simple absolute upon the death of the other spouse. See *Rogers* v. *Rogers*, 136 Mich. App. at 135 n.14, 356 N.W.2d at 293 n.14; Mich. Comp. Laws. Ann. § 554.872(g) (West Supp. 1997), recodified at Mich. Comp. Laws Ann. § 700.2901(g) (West Supp. 2001).[5]

[5] The Michigan legislature has specified that a tenancy by the entirety "consist[s] of a present interest and a future interest" and has itself characterized each of these interests as "property." Mich. Comp. Laws. Ann. § 554.872(g), (i) (West. Supp. 1997), recodified at *id.* § 700.2901(g), (i) (West. Supp. 2001). The Michigan Supreme Court has accordingly held that each spouse holding entirety property has "a significant interest in property" protected

These state-created rights, which are protected by law and have undeniable value, constitute "property or rights to property" within the broad scope of the federal tax lien. See *Drye* v. *United States*, 528 U.S. at 56; Pet. 11-13.

b. Respondent is wrong in suggesting that a State may avoid the consequences of federal tax law simply by adopting a "state law fiction [as] part of the definition of property rights" (Br. in Opp. 11). It is well established that federal tax law—and the operation of the federal tax lien in particular—is not governed by state legal fictions concerning property ownership. *Drye* v. *United States*, 528 U.S. at 59. Federal tax law looks to "the actual results" rather than "the artificial rules" of state law in determining the nature and taxability of rights possessed by tenants by the entirety. *Tyler* v. *United States*, 281 U.S. 497, 503 (1930). See Pet. 17-20.

c. Respondent also errs in suggesting (Br. in Opp. 28) that the general exemption from creditors for entireties property under the Bankruptcy Code (11 U.S.C. 522(b)(2)(B)) reflects an intention of Congress that the federal tax lien should not be understood to

by the Due Process Clause. *Dow* v. *State*, 396 Mich. 192, 204, 240 N.W.2d 450, 456 (1976).

Recent Michigan legislation makes it even more apparent that each spouse's interest in entirety property constitutes an interest in "property" or a "right to property" that is subject to the federal tax lien. Prior to 1975, the husband had exclusive control of the property and enjoyment of its income and profits. In 1975, however, the legislature amended state law to specify that the two spouses are equally entitled to the control and management of entirety property and to its rents, income, and profits. Mich. Comp. Laws. Ann. § 557.71 (West 1988). See *Dow* v. *State*, 396 Mich. at 198 n.10, 240 N.W.2d at 453 n.10.

reach such property. In fact, this provision clearly reflects precisely the opposite conclusion. The statute describes the interest of each spouse in a tenancy by the entirety as a "property" right and specifies that, notwithstanding any discharge in bankruptcy, such property remains subject to any "tax lien, notice of which is properly filed." 11 U.S.C. 522(c)(2)(B). Respondent's contention that the federal tax lien does not attach to entirety property is plainly inconsistent with, and would simply nullify, this carefully crafted statutory provision.

4. As Judge Ryan emphasized in dissent, the majority opinion in this case "not only contravenes established precedent, but provides an avenue for easy avoidance of federal income-tax laws." Pet. App. 69a. Under the reasoning of the decision below, one or both spouses may earn income, fail to file returns or file only separate returns, and immunize unlimited amounts of entirety property from tax collection. Indeed, a prominent Michigan lawyer has pursued precisely such a path in accruing federal tax debts in excess of $8,000,000 while "sheltering" his assets in several tenancies by the entirety.[6] See *Hatchett* v. *IRS*, 126 F. Supp. 2d 1038, 1047, 1050-1051 (E.D. Mich. 2000), appeal docketed, No.

[6] There is no basis for respondent's suggestion (Br. in Opp. 4) that the "fraudulent enhancement" theory (see Pet. App. 85a-86a) will enable the government to collect the tax liabilities of other taxpayers who have employed tenancies by the entirety to avoid payment of taxes. The fraudulent enhancement theory allows recovery only of nonexempt funds that an insolvent debtor has used to enhance the value of exempt property during the period after the lien arose. *Ibid.* In this case, recovery under this theory was limited to the funds ($6,693) that Don Craft had used to reduce mortgage principal. *Id.* at 92a. The outstanding tax liability, with interest, however, exceeds $482,446. *Id.* at 45a.

00-1645 (6th Cir. June 13, 2000). Review of the important and recurring question presented in this case is needed to close the "ready pathway for tax avoidance" sanctioned by the decision below. S. Johnson, *Fog, Fairness, and the Federal Fisc: Tenancy-by-the-Entireties Interests and the Federal Tax Lien*, 60 Mo. L. Rev. 839, 888 (1995).

For the reasons stated above and in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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