ENVIRONMENTAL LAW & PROPERTY RIGHTS

UNITED STATES V. CRAFT: CREATING A FEDERAL COMMON LAW OF PROPERTY?

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The meaning of "property" in the federal context is not always clear—and courts have given the term vastly different meanings and scope depending on whether the Due Process Clause or Takings Clause or at issue. In many cases, however, the existence of property— as federally or constitutionally defined— is dependent on rights created by state law. As expressed in *Board of Regents of State Colleges v. Roth*:[1]

> Property rights… are not created by the Constitution. Rather, they are created and their dimensions defined by existing rules or understandings that stem from an independent source such as state law—rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.[2]

This dependence on independent sources to delimit the federal understanding of property is a longstanding part of our legal tradition.[3] It recognizes the role of state law in the federal system, and allows for some objective standard as to what federal property may be in specific cases.

At the same time, there is clearly a federal element in determining when an independently created interest is "property." An interest does not become or fail to become property based upon a legislature's saying so. The Supreme Court has occasionally outlined qualities which property must have to be protected by the Constitution. Thus, for example, the Court held in *College Savings Bank v. Florida Prepaid Postsecondary Educ. Expense Bd*.,[4] that enforcement of the Lanham Act's false advertising provision did not implicate the Fourteenth Amendment Due Process clause because "the hallmark of a protected property interest is the right to exclude others."[5]

The distinction between the state definition of property interests (which may or may not turn out to be federal property), and the federal standards which determine if state-created interests are in fact federal property, is an important one if courts are to show continued deference to state law. Should courts have leeway to pick and choose among state-defined interests, the deference to state law becomes meaningless. Yet recent decisions suggest the Court is having trouble with the distinction between state and federal definitions of property.

In *United States v. Craft*,[6] the Supreme Court addressed the question whether a tenant by the entirety owns "property," or "rights to property," to which a federal tax lien may attach under 26 U.S.C § 6321. *Craft* was a sequel to another recent decision applying the same statute, *Drye v. United States*.[7] In *Drye*, the Court announced the quite reasonable rule that "[w]e look initially to state law to determine what rights the taxpayer has in the property the Government seeks to reach, then 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."[8] *Craft* substantially expanded the holding in *Drye*.

In *Craft*, the respondent, Sandra Craft, and her husband owned a piece of real property as tenants in the entirety. The IRS placed a federal tax lien on "all property and rights to property" belong to Mr. Craft. After notice of the lien, Craft and her husband executed a quitclaim deed transferring the husband's interest to Craft for one dollar. Upon trying to sell the property a few years later, a title search revealed the lien, and the IRS permitted the sale on condition that half the proceeds be held in escrow pending determination of its interest in the property. Craft brought suit in federal district court to quit title.

The IRS argued that its lien attached to the husband's interest in the tenancy by the entirety, and also that the transfer of the property was a fraudulent conveyance. The district court granted the government's motion for summary judgment, but on appeal the Sixth Circuit held the tax lien did not attach to the property since, under Michigan law, the husband had no separate interest in property held as a tenant by the entirety. On remand, the district court concluded that there could be no fraudulent conveyance if the tax lien could not attach to the property. The Sixth Circuit affirmed. The Supreme Court granted certiorari to decide whether Craft's husband had a separate interest in the entireties property to which the federal tax lien attached.

As the *Craft* majority noted, the English common law understood each joint tenant to possess an entire estate, rather than a fractional share. In contrast, in a tenancy in the entirety, the common law understanding was that there was no concurrent ownership. Instead, there was a form of single ownership by the marital entity—neither spouse owned an individual interest in the property. In Michigan, neither tenant has an "interest separable from that of the other."[9] However, a tenant by the entirety in Michigan possesses the right to use the property, receive income from it, and exclude others from it. The tenant also has a right of alienation—with the spouse's consent.

The majority noted Mr. Craft possessed a number of "essential" property rights. Without deciding whether the Craft case implicated "property" or "rights to property", the Court concluded that a federal tax lien could attach the based on the "bundle of sticks" possessed by Mr. Craft. The majority further concluded that the state law that a tenancy in the entirety is not owned by the individual spouses was a legal fiction. Citing *Drye*, it concluded that such legal fictions may be ignored when interpreting the federal tax lien, since state fictions do not define the meaning of property under the federal statute.

Justice Thomas's dissenting opinion, joined by Justices Scalia and Stevens, argued that the majority was improp-

erly defining property interests pursuant to federal law, rather than looking to state definitions of the property interests at issue. As Thomas noted, the Court's announcement that the state's definition of a tenancy in the entirety was a legal fiction proved too much. A partnership or a corporation are as much legal fictions as the tenancy, and yet presumably the unique forms of property in those cases would not be disregarded by the *Craft* majority. Justice Scalia, in a separate dissent, noted that a partnership's property cannot be encumbered by the debts of the individual members.

According to Thomas, *Drye* "was concerned not with whether state law recognized property as belonging to the taxpayer in the first place, but rather with whether state laws could disclaim or exempt such property from federal tax liability after the property interest was created."[10] *Drye*, like its predecessors, involved exemptions or disclaimers which operated under state law to end the state property rights after they had been created. Because the property interest already existed, the federal tax lien could attach to it in those cases.[11]

The result of the Court's holding, according to the dissent, was the creation of a "new federal common law of property."[12] A review of the decision shows this is true. The property interest from its inception was owned by the marriage entity, as defined by state law. The *Craft* majority simply rejected this idea, based on the number of property rights possessed by Mr. Craft. But this actually changed the tenancy property interest into a different property interest, not just owned by the marriage entity. Notably, the majority's opinion did not actually define what the property was that Mr. Craft owned that triggered the federal tax lien.

Although *Drye* and *Craft* may not appear at first glance to have broad import for property rights cases, the *Craft* majority's willingness to ignore state definitions of property interests is significant since it could be expanded to other contexts. Professor Thomas Merrill had argued (prior to the *Craft* decision) that the opinion in *Drye* provides a useful model for a federal "patterning" definition of constitutional property.[13] He proposed that, as in *Drye*, courts look to state law to determine what rights are at stake, and then to federal law to see if those rights fit into an understood pattern that characterizes property under a specific constitutional provision. As an example, the right to exclude others would indicate that property is at issue for Takings Clause purposes.

Craft represents a federal redefinition of what property rights existed under state law in light of policy. Merely looking at state law to determine what rights existed for purposes of the federal tax statute could not be squared with the Court's policy views—the fear that tenancy by the entirety as understood in Michigan might permit married couples to flout the tax laws encouraged a finding that Mr. Craft possessed property to which a lien could attach. Once the line between state and federal definitions of property is blurred, however, it is increasingly difficult to define property for federal purposes.

The potential for selective application of state property law by federal courts is evident in the Takings Clause context. State legislatures may not *retroactively* decree what property rights were possessed by a property owner for purposes of applying the Takings Clause. This principle parallels the holding in *Drye* that state laws cannot disclaim or exempt state-created property interests from federal tax liability after the interest was created. Yet, in *Palazzolo v. Rhode Island*[14] the Court recently held that *prospective* state regulation of property might be the subject of a regulatory taking claim brought by a post-enactment purchaser. This holding potentially redefined the collection of property rights owned by the landowner under state law in light of the onerous ripeness requirements which might apply to a prior owner's taking claim.

Although the *Palazzolo* holding was supported by very strong policy considerations, it selectively ignored state property law. Following *Palazzolo*, it is no longer as clear what a background principle of state law is for purposes of the Takings Clause. Property owners benefited in that case, but this doubtful state of affairs may come back to haunt them in future cases. Craft achieves a similar uncertainty in the federal tax lien context. As different as the two decisions are, they both indicate a willingness by federal courts to discard inconvenient, prospective state regulations in determining the existence of interests which may be property under federal law.

Craft might prove to be an isolated case, and *Palazzolo* was dictated by the pre-existing mess of modern regulatory takings jurisprudence. The effect of such holdings, however, is to make it less clear *ex ante* what state-created interests will qualify as federal property. Since the Court already differing standards in due process and takings cases, it is hard to think of a more confused, variegated subject than the federal common law which could result from such holdings.

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Footnotes

[1] 408 U.S. 564 (1972).
[2] *Id*. at 577.
[3] Excepting of course examples such as federal copyrights or patents.
[4] 527 U.S. 666 (1999).
[5] *Id*. at 673.
[6] 122 S.Ct. 1414 (2002).
[7] 528 U.S. 49 (1999).
[8] *Id*. at 58.
[9] *Long v. Earle*, 277 Mich. 505, 517, 269 N.W. 577, 581 (1936).
[10] Craft, supra note 6, at 1428 (Thomas, J., dissenting).
[11] Justice Thomas also noted that the rights which Mr. Craft possessed in the entireties property were not properly understood as the "rights to property" for purposes of the statute, since they either lacked exchangeable value, or had not yet ripened into a present estate. See *id*. at 1429-31 (Thomas, J., dissenting).
[12] See *id*. at 1428 (Thomas, J., dissenting).
[13] See Thomas W. Merrill, The Landscape of Constitutional Property, 86 Va. L. Rev. 885, 927 (2000) ("Federal constitutional law prescribes the set of criteria an interest must have to qualify as property; whether the claimant has an interest that fits the pattern is then determined by examining independent sources such as state law. The patterning definition approach is essentially the method for identifying property recently adopted by the Court for federal tax purposes in *Drye*.").
[14] 533 U.S. 606 (2001).