TENANCY BY THE ENTIRETY IN BANKRUPTCY

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I. Introduction.

Tenancy by the entirety was formerly the only way in a which a husband and wife could own real property.[1] Under modern law, TBE has become an optional form of joint ownership through which, under the law of some states, a husband and wife may be able to exempt unlimited amounts of property from creditors with claims against only one of the spouses.[2] In its modern form, tenancy by the entirety has given rise to a number of problems in bankruptcy, including both the extent to which property is exempt under the Bankruptcy Code, and the manner in which its proceeds should be distributed when it is not exempt.

To assist in understanding these problems, this outline presents a historical context of tenancy by the entirety and an overview both of the relevant provisions of the Bankruptcy Code and the case law. Much of the research and analysis presented here is drawn from *In re Chinosorn*, 2000 WL 46074 (Bankr. N.D. Ill .Jan 19, 2000), which considers tenancy by the entirety issues raised by Illinois law.

II. The Historical Roots of TBE Problems.

A. The common law treatment of property owned by married persons.

A thorough description of the operation and history of the estate of tenancy by the entirety in the United States, set out in Oval A. Phipps, *Tenancy by Entireties*, 25 Temp. L.Q. 24 (1951), is summarized here. (The estate was abolished in England by the Law of Property Act, 15 & 16 Geo. 5, ch. 2, § 37 (1925).)

The common law treated all ownership of property by a married couple under the concept of "coverture," which arose from the principle that a husband and wife were one person and that the husband made all of the decisions for that person. *See Osborn v. Horine*, 19 Ill. 124, 125 (1857):

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[1]In the case law, "tenancy by the entirety" is used interchangeably with "tenancy by the entireties." For convenience, this outline often abbreviates the term as "TBE."

[2]It appears that some form of TBE is recognized in the following jurisdictions: Arkansas, Delaware, District of Columbia, Florida, Hawaii, Illinois, Indiana, Kentucky, Maryland, Massachusetts, Michigan, Missouri, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Tennessee, Vermont, Virginia, and Wyoming. However, bankruptcy courts in other jurisdictions may be required to address TBE issues if the debtor owns out-of-state property as a tenant by the entirety. *See, e.g., In re Cochrane*, 178 B.R. 1011, 1021 (D. Minn. 1995) (Minnesota court required to apply Florida law regarding TBE); *In re Hidler*, 192 B.R. 790 (Bankr. D. Me. 1996) (Maine court required to apply Massachusetts law regarding TBE).

> The very term coverture implies that [a wife] is, during its continuance, under the protection of her husband, and the common law will not allow her to do anything which may prejudice her rights or interests, without his advice, consent and approval. In this respect, she is incapable of acting alone. In defining the meaning of the word coverture, Mr. Webster has laid down this rule of law, with such succinctness and perspicuity, that I gladly adopt his language. He says: "The coverture of a woman disables her from making contracts to the prejudice of herself or husband, without his allowance or confirmation."

1. Personal property: a gift to the husband. As concerned a wife's personal property, coverture implied an absolute gift to her husband. All personalty that a wife owned at the time of the marriage or that she acquired during it became the exclusive property of her husband. Phipps, *supra*, at 24.

2. Real property: TBE. As to real property, coverture brought about tenancy by the entirety—real property owned by either the husband or the wife at the time of their marriage, or acquired by either during the marriage, was deemed owned by the marital entity, but subject to exclusive control by the husband. The only limit on the husband's control was that he could not unilaterally alienate the wife's right to the property if she survived him. Thus, to alienate the entire ownership interest, both husband and wife would have to consent, and only creditors with claims against the husband and wife jointly could enforce their claims by sale of complete title to the property. However, consistent with his control, the husband could employ his rights in the property—to use it during his life and to own it outright if he survived his wife—to obtain credit, and his individual creditors could attach these rights if he defaulted on his obligations. In contrast, the wife had no right to the property other than her contingent right of survivorship, and her individual creditors could take no interest in the property during her husband's life. Phipps, *supra*, at 25-26.

B. The impact of Married Women's Property Acts.

Unsurprisingly, these aspects of the common law were seen as inequitable in their treatment of women, and, beginning in the middle 1800's, nearly all American jurisdictions enacted "married women's property acts," allowing wives to own property separately from their husbands. Phipps, *supra*, at 27. Illinois enacted its Married Women's Act in 1861. 1861 Ill. Laws 143; *Douds v. Fresen*, 392 Ill. 477, 479, 64 N.E.2d 729, 730 (1946).

The courts of the various states differed in the way that they applied the married women's property acts to tenancies by the entirety. As outlined by Phipps, *supra*, at 27-32, there were at least five different approaches:

1. Retaining common law TBE as an option. The courts of a few states held that, under the applicable married women's property act, tenancy by the entirety continued to exist, with all of its common law features. In this way, although a married woman could hold her own property, she could also hold property as a tenant by the entirety with her husband, and as to such property, the husband would have full power of

control. *See, e.g., Arrand v. Graham*, 297 Mich. 559, 563, 298 N.W. 281, 283 (1941); *Voight v. Voight*, 252 Mass. 582, 147 N.E. 887 (1925). At least in Massachusetts, this meant that an "individual creditor of the husband could levy and sell on execution his interest in the tenancy," subject to the wife's contingent survivorship interest, but that the wife's individual creditors could obtain no interest in the entireties property. *Coraccio v. Lowell Five Cents Sav. Bank*, 415 Mass. 145, 150, 612 N.E.2d 650, 654 (1993) (discussing the state of the law prior to a 1980 statute).

2. Changing TBE so that both spouses have the common law rights of the husband. In several other states, tenancy by the entirety was also held to continue to exist after the married women's property acts, but both spouses were given the rights of the husband under the common law. Thus, either husband or wife could exercise control over the property (short of unilaterally alienating the other's survivorship interest), and individual creditors of either spouse could enforce their claims against that spouse's interest in the tenancy, subject to the other's right of survivorship. *See, e.g., Wilde v. Mounts*, 95 Or. App. 522, 524-25, 769 P.2d 802, 803 (1989); *Finnegan v. Humes*, 252 App. Div. 385, 387, 299 N.Y.S. 501, 503, *aff'd* 277 N.Y. 682, 14 N.E.2d 389 (1937). This is also the rule in Massachusetts, under the 1980 statute noted above. *Corraccio*, 415 Mass. at 153-54, 612 N.E. 2d at 655.

3. Changing TBE so that both spouses have the common law disabilities of the wife. In a larger number of states, the courts found that while tenancy by the entirety survived the married women's act, it afforded both spouses only the limited interests of a wife under the common law. Thus, neither party could unilaterally control the property, and the creditors of neither could enforce their claims against any individual interest in the tenancy; only joint creditors had enforceable claims to the property while the property was held by the entirety. *See, e.g., Citizens Savings Bank v. Astrin*, 44 Del. 451, 454-55, 61 A.2d 419, 421 (Del. Super. Ct., 1948); *Klebach v. Mellon Bank*, 388 Pa. Super. Ct. 203, 208, 565 A.2d 448, 450 (1989).

4. Changing TBE to allow attachment of liens but not transfer. In at least one state, Rhode Island, TBE has been interpreted to allow creditors with a claim against one of the tenants individually to attach that tenant's individual interests in the property, even though these interests could not be transferred to the creditor by execution of the lien (the lien would only be enforceable in the event that the debtor tenant obtained a different interest in the property, through death or divorce). *In re Gibbons*, 459 A.2d 938, 940 (R.I. 1983).

5. Eliminating TBE. Finally, in many other states, the courts held that the estate of tenancy by the entirety had been effectively abolished by the married women's acts, or that the estate had never been a part of the state's common law. *See, e.g., Walthall v. Goree*, 36 Ala. 728, 735, 1860 WL 619, *5 (1860); *Schimke v. Karlstad*, 87 S.D. 349, 353-57, 208 N.W.2d 710, 712-14 (1973) (collecting authorities).

6. The Extent of TBE. The states recognizing tenancy by the entirety also differed in the extent to which it was allowed. Some allowed the estate to encompass any form of property, real or personal. *See, e.g., Cross v. Pharr*, 215 Ark. 463, 466, 221 S.W.2d 24, 25-26 (Ark. 1949). Others allowed the estate to include only real property. *See, e.g.,*

Franklin Nat'l Bank v. Freile, 116 N.J. Eq. 278, 282-83, 173 A. 93, 96 (N.J. Ch. 1934); and by statute, Massachusetts provided that only entireties property used as a marital domicile would be protected against "seizure or execution" to satisfy the debts of an individual spouse. Mass. Gen. L. ch. 209, § 1; *see Coraccio v. Lowell Five Cents Sav. Bank*, 415 Mass. 145, 150, 612 N.E.2d 650, 654 (1993) (applying the statute).

C. TBE under the Bankruptcy Act.

1. The potential for fraud. Section 70a of the Bankruptcy Act of 1898 set out the Act's definition of property of the estate. In contrast to § 541 of the current Code, it did not set out a broad definition, but rather a set of narrow categories of estate property, and specifically excluded from the estate property that was exempt under state law. Real estate interests owned by the debtor could only enter the estate pursuant to §70a(5), which required that the debtor be able to transfer the property or that creditors be able to levy upon it.

This framework did not present any particular problem with respect to claims against an individual tenant by the entirety. In states that interpreted TBE after the married women's property acts, to give both tenants the common law rights of a husband, each tenant had property interests (such as the right to present use of the property) that could be transferred by that tenant alone or used to satisfy the claim against that tenant alone. These interests would have become property of the estate under the Act, subject to liquidation by the trustee. In states that interpreted TBE to impose on both tenants the common law disabilities of a wife, each tenant would have no property interests that could be transferred or levied on, and so no interests that would have become part of the estate under the Act. Thus, holders of individual claims were treated under the Act in much the same way as they would have been treated under applicable state law.

However, the Act's definition of property of the estate presented a substantial problem in connection with joint claims against tenants by the entirety. In all of the states that continued to recognize TBE after the enactment of married women's property acts, one aspect of the common law remained constant—a creditor with a claim against both tenants could enforce this joint claim against the entireties property. But if only one of the tenants filed a bankruptcy case under the Act, then only the property interests of *that* tenant could enter the estate and only to the extent that those individual interests could be transferred by that tenant or could be levied on by that tenant's creditors. As a result, the "entirety," not being an interest of a single tenant, never entered the estate, and hence could not be administered by a bankruptcy trustee, even to the extent of joint claims. Compounding this problem, the tenant who filed the bankruptcy case would be discharged, with the result that a formerly joint claim would only be valid against the non-filing spouse. Without a claim against both tenants, a creditor would be unable to force a sale of the property after the bankruptcy. The Seventh Circuit, in *In re Hunter*, 970 F.2d 299, 302 (7th Cir. 1992), summarized the problem this way:

> Under this pre-Code scheme, there was a potential for legal fraud against joint creditors of a husband and wife. The couple could shelter their assets as unencumbered entirety property, then one spouse could file bankruptcy and obtain a release form his share of all joint debts without

exposing the entirety property to any claims because it would not enter the bankruptcy estate. After bankruptcy, all joint creditors could sue only the remaining spouse, a judgment against whom would be ineffective as against the entirety property.

2. Judicial responses. To avoid this potential for fraud, the courts devised two methods by which creditors with joint claims against tenants by the entirety could continue to pursue the entireties property even though one of the tenants filed a bankruptcy case under the Act.

a. Stay of discharge. Some courts would, on motion of a creditor holding a joint claim, delay the entry of a discharge so that the creditor could sue both tenants in state court and obtain a judgment lien against the entireties property that would survive the bankruptcy. *See, e.g., Phillips v. Krakower*, 46 F.2d 764, 765 (4th Cir. 1931).

b. Limitation of discharge. Other courts held that a discharge in bankruptcy of one of the tenants did not serve to eliminate the liability of the entireties *property* for a debt incurred by both tenants, thus allowing the joint creditor to pursue the property, in an in rem proceeding, after the bankruptcy. *See, e.g., Smith v. Beneficial Finance Co.*, 139 Ind. App. 653, 218 N.E.2d 921, 923 (1966). This approach had the effect of recognizing a lien on the property.

III. The Framework of the Bankruptcy Code.

After an initial period of uncertainty, the courts have arrived at a general consensus as to the basic principles for treating entireties property in bankruptcy.

A. Entireties property included in the estate.

In contrast to § 70a(5) of the Bankruptcy Act, § 541 of the Code puts all property interests of a debtor into the debtor's estate in bankruptcy, regardless of whether the debtor would have been able to transfer the interest or whether the interest would be subject to levy under applicable nonbankruptcy law. Given the broad language of § 541, the courts have uniformly concluded that all interests of a debtor in entirety property are included in the estate. *See, e.g., Sumy v. Schlossberg,* 777 F.2d 921, 925 (4th Cir. 1985); *Liberty State Bank & Trust v. Grosslight (In re Grosslight),* 757 F.2d 773, 775 (6th Cir. 1985); *Napotnik v. Equibank & Parkvale Sav. Ass'n*, 679 F.2d 316, 318 (3d Cir. 1982); *Hunter,* 970 F.2d at 305; *Arango v. Third Nat'l Bank (In re Arango),* 992 F.2d 611, 613-14 (6th Cir. 1993).

B. Entireties property may be exempted from the estate pursuant to state law.

Exempt property is removed from the estate, and so is retained by the debtor rather than being liquidated by the trustee. *See* 11 U.S.C. § 542(a) (exempt property need not be turned over to the trustee); *Sherk v. Texan Bankers Life & Loan Ins. Co. (In re Sherk)*, 918 F.2d 1170, 1174 (5th Cir. 1990) (exempt property is "no longer property of the estate"). Section 522(b) of the Code defines what property interests can be exempted by the debtor, and gives debtors their choice of state exemption law or exemptions defined by

the Bankruptcy Code. Section 522(b)(1) allows a debtor to exempt property that is listed in the Bankruptcy Code itself—the "federal" exemptions of § 522(d)—and § 522(b)(2) includes exemptions defined by state law.[3] Section 522(b)(2) includes two parts: (A) "any property that is exempt under Federal law [other than the Bankruptcy Code] . . . or State or local law [of the debtor's domicile]," and (B) certain joint property interests, including "any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety . . . to the extent that such interest as a tenant by the entirety . . . is exempt from process under applicable nonbankruptcy law."

C. Section 522(b)(2)(B): Entireties property exempt "to the extent exempt from process" under state law.

The critical language of § 522(b)(2)(B) of the Bankruptcy Code—allowing a bankruptcy exemption for TBE property "to the extent" that state law makes such property "exempt from process"—is not elucidated by the legislative history.[4] However, the apparent intent of the provision is to provide, in bankruptcy, a level of protection from claims of creditors identical to the protection that owners of entireties property would have in collection proceedings outside of bankruptcy, under applicable state law, and the provision has been so interpreted by the courts.

1. Formal exemption not required, common law limitations on enforcement of judgments recognized. Courts have consistently held that, in order to be exempt under § 522(b)(2)(B), entireties property need not be listed in a formal state exemption statute, but may merely be simply protected, either by the common law or a separate statute, against enforcement proceedings by creditors holding certain claims. To the extent that the property is thus "immune from process" under state law, it is exempt under § 522(b)(2)(B). *In re Ford*, 3 B.R. 559, 573-75 (Bankr. D. Md. 1980), *aff'd sub nom. Greenblatt v. Ford*, 638 F.2d 14 (4th Cir. 1981); *Napotnik v. Equibank & Parkvale Sav. Ass'n*, 679 F.2d 316, 319 (3d Cir. 1982); *In re Hunter*, 970 F.2d 299, 307 (7th Cir. 1992).

2. Individual claims subject to exemption of varying extent. In accord with the general rule that the Code applies state law limitations on enforcement of claims against entireties property, the extent of the entirety exemption varies with respect to the claims against the debtor individually. Where state law provides that a creditor with a claim against only one tenant by the entirety cannot obtain any interest in the entireties property, courts have held that the property is fully exempt as to such individual claims. *See, e.g., Coughlin v. Cataldo (In re Cataldo)*, 224 B.R. 426, 429 (9th Cir. B.A.P. 1998)

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[3]However, because states may make the federal exemptions unavailable, the ultimate determination of exemptions is left to state law. See 4 Lawrence P. King, et al., Collier on Bankruptcy ¶ 522.02[2] at 522-13 n. 3(15th ed. rev. 1999) (listing 34 states that have opted out of the federal exemptions). Section 522 (b)(2), which allows for "state" exemptions, specifically includes TBE property as potentially exempt.

[4]The Congressional Reports bearing on the Bankruptcy Code merely paraphrase the language of § 522(b)(2)(B). *See* H.R. Rep. No. 595, 95th Cong., 1st Sess., 360-61 (1977); S.Rep. No. 989, 95th Cong., 2d Sess. 75-76 (1978).

(applying Hawaii law); *In re Barsotti*, 7 B.R. 205, 209 (Bankr. W.D. Pa. 1980) (applying Pennsylvania law). On the other hand, where state law allows a creditor with a claim against only one tenant by the entirety to pursue that tenant's contingent interests in the entireties property, the exemption under § 522(b)(2)(B) has been held not to apply to those contingent interests. *See, e.g., Arango v. Third Nat'l Bank (In re Arango)*, 992 F.2d 611, 614 (6th Cir. 1993) (applying Tennesse law and refusing to avoid lien on contingent interests); *Community Nat'l Bank & Trust Co. v. Persky (In re Persky)*, 893 F.2d 15, 19 (2d Cir. 1989) (applying New York law).

3. Joint claims generally not subject to exemption. On the other hand, nearly every decision to consider the issue has held that entireties property is not exempt with respect to claims against both of the tenants, since, under the applicable state law, such joint claims may always be enforced against entireties property. *See, e.g., Edmonston v. Murphy (In re Edmonston)*, 107 F.3d 74 (1st Cir. 1997) (applying Massachusetts law); *Garner v. Strauss (In re Garner)*, 952 F.2d 232 (8th Cir. 1991) (applying Missouri law); *Napotnik*, 679 F.2d 320 (applying Pennsylvania law). The only exception to this rule has been in connection with the law of Indiana, which expressly renders property held by the entirety exempt even from claims against the tenants jointly. *Hunter*, 970 F.2d at 306-07; *In re Paeplow*, 972 F.3d 730 (7th Cir. 1992). Thus, in nearly all of the states that recognize TBE, a trustee should seek to administer TBE property to the extent of any joint claims.

a. Sale of the nondebtor's interest. Because it is not possible to sell the debtor's interest in TBE property separate from the other tenant's interest, courts dealing with joint claims have routinely allowed trustees to sell both tenants' interest in the property, pursuant to § 363(h), with the debtor's share of the proceeds belonging to the estate, and the nondebtor receiving the remainder (subject to the balance of any joint claims remaining unpaid after the bankruptcy). *See, e.g., Garner v. Strauss (In re Garner)*, 952 F.2d 232, 235-36 (8th Cir. 1991); *In re Persky*, 893 F.2d 15, 19-20 (2d Cir. 1989); *Sapir v. Sartorius*, 230 B.R. 650, 654 (S.D.N.Y. 1999) ("[N]umerous cases decided in this Circuit and elsewhere since *Persky* . . . have continued to apply Section 363(h) to authorize the sale of property owned as tenants by the entireties.") (collecting authorities).

b. The amount of exemption. The courts have arrived at a straightforward manner of applying the applicable state law: where there are joint claims against the debtor's estate, excluded from exemption, the debtor's exemption is simply reduced by the amount of the joint claims. *See, e.g., In re Wenande*, 107 B.R. 770, 774 (Bankr. D. Wyo. 1989) ("[D]ebtors may exempt out of their estate . . . their equity in the entireties property, less the total sum of all joint claims against both debtors."): *Sumy v. Schlossberg (In re Sumy)*, 777 F.2d 921, 928 (4th Cir. 1985) (a debtor's interest in entireties property is exempt under the Bankruptcy Code "to the extent that there are only individual claims," but the debtor "does not benefit from [a § 522(b) exemption] to the extent of joint claims"). Thus, if there are no claims excluded from exemption, the debtor's exemption in the property is allowed to the full extent available under state law. Conversely, if the joint claims have a value greater than the value of the exempt property, no exemption can be recognized. *Wenande*, 107 B.R. at 774:

> If the sum of the total claims held by creditors with claims against both debtors exceeds the debtors' equity in their entireties property, then none

of their entireties property may be exempted from the estate. If there were not a single creditor with a claim against both of the debtors, their entireties property would be totally exempt.

IV. The problems.

Although the treatment of TBE in bankruptcy, as set out above, is reasonably settled, several areas remain potential sources of difficulty.

A. The existence of the tenancy.

With the changes in the common law effected by the Married Women's Property Acts, tenancy by the entirety is never the only manner in which property can be held by married persons. State law determines the circumstances under which property is held in TBE, and may impose special requirements. *Compare, e.g., Travelers Indem. Co. v. Engel*, 81 F.3d 711, 712-13 (7th Cir.1996) (in order to create a TBE under Illinois law, the deed conveying the property must so provide and transferees must be expressly identified as husband and wife), *with Wetteroff v. Grand (In re Wetteroff)*, 453 F.2d 544, 546 (8th Cir.1972), cert. denied, 409 U.S. 934 (1972) (reading Missouri law to provide that "in any conveyance to a husband and wife, there is a rebuttable presumption that an entirety estate was created.").

B. The extent of the tenancy—liens perfected prior to its creation.

If property is subject to a lien before being transferred to a married couple as tenants by the entirety, the lien will remain effective, even though the lienholder may not have a joint claim against the couple. *See, e.g., United States v. Davenport*, 106 F.3d 1333, 1336 (7th Cir.1997) (transfer of property into tenancy by the entirety could not eliminate a tax lien that already attached to the husband's interest in the property); *Miller v. Conte*, 72 F.Supp.2d 952, 959 (N.D.Ind. 1999) (tax lien on funds used by debtor to purchase entireies property attached to the entireties property itself). In a situation like this, the lien holder may be able to procure a sale of the property. *Id.*

C. Joint claims.

As noted above, there is little question that bankruptcy trustees may administer a debtor's interest in TBE property, by selling both tenant's interest in the property pursuant to § 363(h), to the extent of any joint claims against the tenants. Nevertheless, in at least two areas, there remain problems in the treatment in bankruptcy of TBE property that is subject to joint claims.

1. The need for objection to exemption if joint claims are present.

Section 522(l) of the Bankruptcy Code requires a debtor to file a list of the property that the debtor claims as exempt and provides that unless a creditor or the trustee objects to the exemption, the property interest claimed will be exempt. The trustee and creditors have 30 days in which to file such an objection. Fed. R. Bankr. P. 4003(b). If the trustee or creditors fail to file an objection within this period, the debtor receives the benefit of the claimed exemption regardless of whether or not the debtor was legally entitled to claim the

exemption. *Taylor v. Freeland & Kronz*, 503 U.S. 638, 643-44, 112 S.Ct. 1644, 1648, 118 L.E.2d 280 (1992). Accordingly, if a debtor asserts that TBE property is fully exempt, even though there are joint claims present in the case, it may be that in the absence of a timely objection to the exemption claim, the debtor will be awarded a full exemption of the TBE property, despite the joint claims. *See In re Page*, 240 B.R. 548 (Bankr. W.D. Mich. 1999) (overruling untimely objection to claimed TBE exemption).

However, the Fourth Circuit has held that a failure to object in such circumstances does not prevent the trustee from administering the property to the extent of the joint claims. In *Williams v. Peyton (In re Williams)*, 104 F.3d 688 (4th Cir. 1997), a Chapter 7 trustee attempted to sell TBE property that the debtor had claimed as exempt under section 522(b)(2)(B) of the Bankruptcy Code because the property was held in tenancy by the entirety. The debtor asserted that the exemption claim, not having been objected to, prevented any sale of the property by the trustee. In sustaining the trustee's position, the Fourth Circuit pointed out that Section 522(b)(2)(B) allows an exemption for entirety property only to the extent the property is exempt from process under applicable nonbankruptcy law. Because under Virginia law, like that of most states, TBE property is not exempt from process as to joint claims against both tenants, the court found that there was a conflict between the statute and the extent of the exemption asserted by the debtor. The court resolved this conflict by limiting the exemption to the extent allowed by the statute. Courts have also limited the value of the debtor's exemption to that provided in the valid exemption statute cited when there is an ambiguity as to the intent of the debtor in claiming the exemption. *See, e.g., Hyman v. Plotkin (In re Hyman)*, 967 F.2d 1316, 1319 (9th Cir. 1992).

2. The effect of selling property subject to joint claims: who gets the proceeds?

a. Distribution of proceeds to the extent of joint claims.

Although the decisions dealing with entireties property generally recognize that joint claims should result in an exclusion from exemption to the extent of the joint claims, they disagree about what should be done with the property as to which the exemption is not recognized. Several suggest that the property excluded from exemption should be used to pay only the joint claims. *See, e.g., In re Monzon*, 214 B.R. 38, 46-48 (Bankr. S.D. Fla. 1997); *In re Ginn*, 186 B.R. 898, 903 (Bankr. D. Md. 1995); *In re Cochrane*, 178 B.R. 1011, 1021 (D. Minn. 1995) (applying Florida law). These decisions are supported by the argument that a creditor should not receive more in bankruptcy than that creditor would receive under the applicable nonbankruptcy law. *See, e.g., In re Cerreta*, 116 B.R. 402, 406 (Bankr. D. Vt. 1990) ("The filing of a bankruptcy case cannot increase a creditor's rights. If a creditor has no rights against the debtor under applicable nonbankruptcy law then state law should prevail unless there is an overriding Federal policy which ought to take precedence."). This argument, however, is questionable. The Bankruptcy Code frequently gives creditors rights to property that they would not have under applicable nonbankruptcy law. To cite two examples, (1) creditors in bankruptcy are able to share in preferential payments, recovered pursuant to § 547 of the Code, that could not be recovered under state law, and (2) creditors holding nonrecourse claims are able to assert "artificial" deficiency claims against a Chapter 11 estate pursuant to § 1111(b). The most noted example of bankruptcy's different treatment of claims is in the situation addressed

by the Supreme Court in *Moore v. Bay*, 284 U.S. 4, 52 S.Ct. 3 (1931)—creditors who would not be able to recover on a fraudulent conveyance under state law, because they extended credit after the transfer took place, were nevertheless allowed to share in a bankruptcy trustee's recovery. Indeed, the entire operation of the bankruptcy system can be seen as providing different rights to recovery than would exist under state law. Thus, the question is one of statutory construction—what does the Code require be done with the debtor's interest in TBE property that is nonexempt because of joint claims—and the better reading may be to employ nonexempt property in payment of all claims, in the priority established by the Code.

Under the Code, all estate property, pursuant to § 522, is either exempt or nonexempt. To the extent that property is *exempt*, it is removed from the estate and returned to the debtor; it cannot be used to pay debts through the bankruptcy case, and (with the exceptions enumerated in § 522(c)) cannot be reached by creditors through nonbankrutpcy collection actions. However, to the extent that the property is *nonexempt*, it is used in the bankruptcy case—either directly (in Chapter 7) or indirectly (in Chapters 11 and 13)—to pay claims against the estate, according to the priorities established by the Code.[5] In this way, the Code creates a division of responsibility—state law defines what property is exempt, but federal law determines priority of payments made from non-exempt property. Accordingly, since joint claims render TBE property nonexempt, that property would be subject to liquidation and distribution according to the priorities of the Code, rather than being used to make payments to joint creditors in excess of their assigned bankruptcy priorities. *See* Lawrence Kalevitch, *Some Thoughts on Entireties in Bankruptcy*, 60 Am. Bankr. L.J. 141, 147-49 (1986) (arguing in favor of distribution pursuant to Code priorities); *In re Wenande*, 107 B.R. 770, 774-5 (Bankr. D. Wyo. 1989)

[5]In Chapter 7 cases, the trustee has the duty, under § 704(1), to liquidate the property of the estate, and then, under § 726, to distribute the proceeds to creditors in a defined order of priority. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 383 (1977), S. Rep. No. 989, 95th Cong., 2d Sess. 96 (1978) ("[S]ection [726] is the general distribution section for liquidation cases. It dictates the order [of] distribution of property of the estate, which has usually been reduced to money by the trustee under the requirements of section 704(1)."). In Chapter 11 and 13 cases, creditors are paid pursuant to plans that must, pursuant to §§ 1129(a)(7) and 1325(a)(4), pay at least as much on account of claims as the creditors would have received had the estate been liquidated in Chapter 7.

(adopting this position); *In re Anderson*, 132 B.R. 657, 660 (Bankr. M.D. Fla. 1991).[6]

b. Distribution of proceeds in excess of joint claims. Once a sale of TBE property takes place, based on the fact there are joint claims to be paid, there is a potential for dispute regarding the proceeds in excess of the amount of the joint claims. One Florida bankruptcy court decision, *In re Planas*, 199 B.R. 211 (Bankr. S.D. Fla. 1996), *rev'd in part*, 1998 WL 757988 (S.D. Fla. Aug 21, 1998), has been read to hold that if there are joint creditors, TBE property is not "exempt from process," and so the debtor's entire interest in the property is subject to distribution to creditors. Steven B. Chaneles, Tenancy by the Entireties: Has the Bankruptcy Court Found a Chink in the Armor, 71-Feb. Fla.B.J. 22 (1997). The *Planas* decision plainly supports pro rata distribution of TBE property found not to be exempt, but it is less clear that it allows distribution of all TBE property interests of the debtor.

Apart from *Planas*, it might be argued that if state law limits TBE status to real estate or to a homestead, then a sale of TBE property, whether in bankruptcy or otherwise, terminates the tenancy, making the proceeds available to pay individual as well as joint claims. In this way, TBE property subject to joint claims would not be immune from any claims, since the right of the joint creditor to execute judgment on the property would allow individual claims to be satisfied from the proceeds. It may be that the proper resolution of this matter depends on whether state law extends TBE status to proceeds. Most states appear to provide for such an extension, at least where the sale of the TBE property is involuntary. See Michael A. DiSabatino, Proceeds or Derivatives of Real Property Held by Entirety as Themselves Held by Entirety, 22 A.L.R.3d 459 (1981).

D. Individual claims: Sale of contingent interests. As noted above, the law of some states allows creditors holding individual claims against a tenant by the entirety to execute on that tenant's rights in the property—rights to present use and survivorship. On this basis, it has been held that the trustee in bankruptcy may similarly administer such rights, and even sell the entire property so as to realize a greater value for the individual rights, pursuant to § 363(h). *See, e.g., In re Persky*, 893 F.2d 15, 19-20 (2d Cir. 1989); *Sapir v. Sartorius*, 230 B.R. 650, 654 (S.D.N.Y. 1999). As these decisions note, however, § 363(h) only allows a sale if (1) partition in kind of such property is impracticable; (2) sale of the

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[6]The decision principally cited in support of distribution only to holders of joint claims, *Butner v. United States,* 440 U.S. 48, 55, 99 S.Ct. 914, 918 (1979), states the following principle: "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." There is no violation of this principle by paying all creditors pro rata from the nonexempt portion of TBE property interests of a debtor. First, unsecured joint creditors do not have any interest in the property of the debtor; second, the debtor's interest is subject to joint claims, and so is not diminished by payment from TBE property to the extent of those claims. Finally, even if there were some impact on state property rights, this would be the result of a "federal interest" in equality of distribution under the Bankruptcy Code.

estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of the co-owners; and (3) the benefit to the estate from the sale of the property free from the co-owners' interests outweighs the detriment, if any, to the co-owners. The first two of these elements may be easily established in most TBE situations. However, the question of detriment to the nondebtor is an evidentiary one in which non-economic factors, such as the emotional attachment that the nondebtor may have to the home, are relevant.

E. Avoidance actions.

Because TBE offers the potential for unlimited exemption from claims affecting only an individual debtor, it is not surprising that debtors may transfer property from some other form of ownership into TBE as a way of avoiding payment. The extent to which such transfers may be avoidable has also generated significant questions.

1. Applicable law. *In re Gutpelet*, 137 F.3d 748 (3rd Cir. 1998), is one of several cases applying § 548(a) of the Bankruptcy Code to allow a trustee to challenge a transfer of the debtor's property into TBE. The principles relevant here are the same that generally apply when a debtor makes a transfer that has the effect of creating exempt property from property that would otherwise be nonexempt. *See* John M. Norwood, An Historical Analysis of Pre-Bankruptcy Conversion Cases on a Circuit-By-Circuit Basis, 103 Com.L.J. 154 (1998).

However, if the transfer in question took place more than one year before the bankruptcy filing, § 548 is inapplicable, and a trustee would have to proceed under § 544, which incorporates state fraudulent transfer law, with a longer reach-back period. The difficulty here is that states may well have special rules regarding avoidance of transfers into TBE, which would be applicable under § 544. *See, e.g., In re Stacy,* 227 B.R. 272, 275 (Bankr. N.D. Ill. 1998) (special Illinois statute governed fraudulent conveyance of property into entirety).

2. Need for adversary proceeding. *Havoco of America, Ltd. v. Hill*, 197 F.3d 1135 (11th Cir. 1999), reasonably holds that, in order to avoid a debtor's transfer of property into TBE, a trustee must serve the nondebtor spouse with an adversary complaint, rather than simply filing an objection to the exemption. The court notes that this result is required both by Fed. R. Bankr. P. 7001 and by due process.

3. Need for objection to exemption. *Havoco*, as noted above, holds that an adversary proceeding is *necessary* in order to assert that a debtor has fraudulently transferred property into TBE. However, it might be argued that such an adversary is not sufficient, and that an objection to exemption is also necessary. This argument would be based on the doctrine of *Taylor v. Freeland § Kronz*, discussed above at IV.A.1. If a debtor claims as exempt all of the debtor's homestead interest, and there is no objection, the debtor could assert that, regardless of the form in which the property is held, the debtor is entitled to an exemption under § 522(l). Such an argument should not succeed. Section 550(a) of the Code provides (with exceptions not applicable here) that any transfer avoided by the trustee under §§ 544 and 548 may be "recover[ed] for the benefit of the estate" from the transferee.