

Trustee Talk

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Tenancy-by-the-Entirety Exemption and What It Means to Be Exempt from the Process



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Generally, the most important question for any homeowner contemplating filing for chapter 7 is whether he/she can keep his/her home. In the case of a homeowner whose home is worth significantly more than the combined amount of all security interests on the property, the would-be debtor's focus is principally on utilizing either the state or Bankruptcy Code's exemptions to protect the equity in the property from the reach of unsecured or judgment creditors or a bankruptcy trustee. While the Code's federal homestead exemption is relatively straightforward, as it allows a debtor to exempt up to \$24,925 in home equity under § 522(d)(1) and (d)(5),¹ the same cannot be said for a debtor's ability to exempt real property owned with his/her spouse using a tenancy-by-the-entirety exemption under applicable state law as provided under § 522(b)(3)(B).²

Pursuant to § 522(b)(3)(B), a debtor may exempt "[a]ny 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." A debtor's ability to use this exemption, to the extent it is available under applicable state law, is generally dependent on a given bankruptcy court's interpretation of what it means for entireties property to be "exempt from process" as stated in § 522(b)(3)(B).

To this point, bankruptcy courts in New Jersey and Pennsylvania, despite the many similarities in their respective states' tenancy-by-the-entirety jurisprudence, have significantly diverged on what it means for entireties property to be "exempt from process." At a baseline level, courts in both jurisdictions follow the Third Circuit's guidance that being "exempt from process" means "immune from process," or unable to be reached by a debtor's credi-

tors.³ However, this elementary definition is where the similarities end, as bankruptcy courts applying state law within each state have come up with differing interpretations regarding the level of protection that must be afforded in order for a debtor's real property to be truly immune from the reach of his creditors. To better understand these contrary interpretations, a brief overview of tenancy-by-the-entirety law in each state is warranted.

Tenancy-by-the-Entirety Law in Pennsylvania and New Jersey: A Comparison

Under Pennsylvania's common law, a married couple may own real property as tenants by the entirety. Neither spouse may destroy the tenancy or alienate any portion of it for his/her own exclusive benefit without the consent of the other.⁴

In addition, property that is owned by the entirety is not owned by either spouse in their individual capacity, but instead owned by the marital unit itself.⁵ Property owned as a tenancy by the entirety is also characterized by the spouses' right of survivorship — namely, upon the death of one spouse, the surviving spouse becomes the sole owner of the entireties property.⁶

What's more, in Pennsylvania, a creditor of only one spouse cannot execute or levy on property owned by both spouses as tenants by the entirety because the marital unit is not the obligor.⁷ Conversely, however, creditors may reach entireties property to satisfy the joint debts of the spouses.⁸ In other words, if a husband and wife own property jointly as tenants by the entirety but are also jointly liable on a given debt, a judgment creditor attempting to collect on the joint debt may execute upon such property.

In the context of creditor collections actions, this is far from the only limitation of Pennsylvania's

¹ Section 522(d)(1) allows a debtor to exempt up to \$25,150 in value real property or personal property that the debtor uses as a residence. Section 522(d)(5) allows a debtor to exempt his interest in any property not to exceed \$1,325 in value plus up to \$12,575 of any unused amount of the exemption provided by § 522(d)(1).

² A majority of states have opted out of the federal exemption scheme pursuant to § 522(b)(2). Accordingly, in these states, the ability of debtors to exempt the equity in their real property is entirely dependent on state law. Moreover, state exemption statutes vary widely in their generosity. For example, debtors in Florida may exempt an unlimited amount of equity in their homes under Fla. Stat. Ann. § 222.01-02, while debtors in Virginia may only exempt \$25,000 in equity under Va. Code Ann. § 34-4. Debtors in states with a more limited homestead exemption such as Virginia often use a tenancy-by-the-entirety exemption to protect equity in their homes that would otherwise exceed their state's homestead exemption limit.

³ See *Napotnik v. Equibank & Parkvale Sav. Ass'n*, 679 F.2d 316, 319 (3d Cir. 1982).

⁴ See *Blummer v. Metro. Life Ins. Co.*, 362 Pa. 7, 66 A.2d 245 (1949); *United States Nat'l Bank v. Penrod*, 354 Pa. 170, 47 A.2d 249 (1946).

⁵ See *Lindenfelser v. Lindenfelser*, 396 Pa. 530, 534 (1959); *In re Estate of Bullotta*, 798 A.2d 771, 774 (Pa. Super. 2002).

⁶ *In re Holmes Estate*, 414 Pa. 403, 200 A.2d 745 (1964).

⁷ See *Klebach v. Mellon Bank NA*, 388 Pa. Super. 203, 565 (1989); *Reliance Ins. Co. v. Schoofield Constr. Co.*, 14 Pa. D. & C. 4th 490, 494 (Pa. Com. Pl. 1992).

⁸ *Consumers Time Credit Inc. v. Remark Corp.*, 248 F. Supp. 158, 162 (E.D. Pa. 1965).

entirety asset-protection scheme. Indeed, the creditors of only one spouse may still put a lien on entireties property, although such a lien is unenforceable until the tenancy by the entirety is severed, such as when the nondebtor spouse dies before the debtor or the couple divorces.⁹ Moreover, when one spouse conveys his/her individual property to a tenancy by the entirety for the purpose of defrauding his/her creditors, those creditors may still execute on the transferred property to satisfy the debt owed.¹⁰

Similar to Pennsylvania, in New Jersey “a tenancy by the entirety is a form of joint property ownership available only to spouses that is created ‘when property is held by a husband and wife with each becoming seized and possessed of the entire estate.’”¹¹ Each co-tenant also enjoys the right of survivorship.¹²

However, in contrast to Pennsylvania law, New Jersey’s former common law version of tenancy-by-the-entirety ownership allowed either spouse the right to alienate his/her separate interest in the subject property, including their right of survivorship.¹³ Thus, a creditor had the right to execute and levy on a debtor spouse’s separate interest in the property. In such a situation, the creditor at an execution sale became a tenant in common with the remaining nondebtor spouse for the joint lives of the husband and wife.¹⁴ In other words, at common law, a tenancy by the entirety could be unilaterally destroyed by either spouse and was susceptible to the collection actions of the creditors of only one spouse.

In 1988, the New Jersey legislature fundamentally changed its tenancy-by-the-entirety law by enacting §§ 46:3-17.2—46:3-17.4 of the New Jersey Statute Annotated (the “Entireties Act”).¹⁵ The most important provision of the Entireties Act is in § 46:3-17.4, which provides that “[n]either spouse may sever, alienate, or otherwise affect their interest in the tenancy by entirety during the marriage or upon separation without the written consent of both spouses.”¹⁶ In short, this language greatly expanded the protections afforded to entireties property by no longer allowing a single spouse to unilaterally alienate their interest in such property, and by prohibiting a single spouse’s unsecured creditors from obtaining the forced partition of real property that the debtor and his/her nondebtor spouse own together as tenants by the entirety.¹⁷

Based on the plain language of this provision, it is prudent to question what remedies remain, if any, for a creditor of only one spouse to proceed against entireties property in New Jersey. Indeed, if the involuntary partition of entireties property is now prohibited, which in essence blocks the execution and sale of a property to satisfy a judgment

creditor’s debt, the only practical alternative would be for the creditor to assert a lien against the property in hopes of being paid once the couple attempts to sell it. Much like the Pennsylvania entirety law, however, such a lien can no longer be enforced or foreclosed upon through a forced sale. Finally, while the Entireties Act greatly expanded the protections afforded to entireties property in New Jersey, as in Pennsylvania, it does not preclude a creditor from executing against the property when the title was deeded as a fraudulent conveyance by one spouse to the other in entirety form so that the conveying spouse can avoid his/her known debts.¹⁸

In sum, the current states of tenancy-by-the-entirety laws in Pennsylvania and New Jersey are quite similar. Both states have broad asset-protection schemes where one spouse is prohibited from alienating entireties property without the express permission of the other. Further, in both states creditors of only one spouse cannot force a partition and subsequent sale of entireties property. Both states also have almost identical limitations to their respective asset-protection schemes — namely, creditors in both states can still place liens on entireties property and execute against entireties property when such property was deeded as part of a fraudulent conveyance.

Notwithstanding these broad similarities, as previously stated bankruptcy courts within Pennsylvania and New Jersey have come to different conclusions in determining whether the above-referenced exemption laws are “exempt from process” under § 522(b)(3)(B) and therefore should be allowed as permissible exemptions under the Bankruptcy Code.

Bankruptcy Court Interpretations of What Exactly Is Exempt from Process

The issue of whether Pennsylvania’s common law tenancy-by-the-entirety scheme is “exempt from process” was settled by the Third Circuit in *Napotnik v. Equibank & Parkvale Sav. Ass’n*.¹⁹ In that case, the Third Circuit expressly ruled that a tenancy-by-the-entirety exemption claimed under Pennsylvania law was “exempt from process” because “creditors of either spouse cannot acquire by judgment an enforceable lien on entirety property, or title therein by sale or execution.”²⁰ The Third Circuit further stated that this aspect of Pennsylvania’s entirety common law was the “chief distinguishing characteristic of an estate by the entirety” and therefore “exempts it from the ordinary legal process to which all other estates are subject.”²¹

In contrast to Pennsylvania’s relatively straightforward and somewhat generous rule allowing a tenancy-by-the-entirety exemption under § 522(b)(3)(B) as provided by the Third Circuit, there is no Third Circuit precedent interpreting New Jersey’s exemption statute. Moreover, bankruptcy courts in New Jersey have applied a much more stringent

9 *Beihl v. Martin*, 236 Pa. 519, 525 (1912); *In re DelCorso*, 382 B.R. 240, 251-52 (Bankr. E.D. Pa. 2007).

10 *Patterson v. Hopkins*, 247 Pa. Super. 163, 171 (1977) (citing cases).

11 *N.T.B. v. D.D.B.*, 442 N.J. Super. 205, 218 (App. Div. 2015) (quoting *Capital Fin. Co. of Del. Valley Inc. v. Asterbadi*, 389 N.J. Super. 219, 227 (Ch. Div. 2006)).

12 *Id.*

13 *King v. Greene*, 30 N.J. 395, 412 (1959).

14 *Id.* Notwithstanding the foregoing, if the nondebtor spouse outlived the debtor spouse, the creditor’s survivorship interest obtained from the debtor spouse would be destroyed. *Id.*

15 Notably, the New Jersey legislature made the changes within the Entireties Act effective only for property interests acquired on or after the effective date of the legislation on April 4, 1988. Property interests acquired prior to this date are still governed by New Jersey common law. See *Freda v. Commercial Tr. Co.*, 118 N.J. 36, 40 (1990); *Vander Weert v. Vander Weert*, 304 N.J. Super. 339, 700 (A.D. 1997).

16 N.J.S.A. 46:3-17.4.

17 *Jimenez v. Jimenez*, 454 N.J. Super. 432, 433-34 (App. Div. 2018). *Jimenez* is the seminal case by the New Jersey Superior Court Appellate Division that concluded and established that forced partition was no longer a permissible remedy under the Entireties Act.

18 *Id.* at 439.

19 679 F.2d 316 (3d Cir. 1982).

20 *Id.* at 319.

21 *Id.* The court in *Napotnik* further recognized a limited exception to this rule when a creditor has a judgment against both spouses and the spouses hold property as tenants by the entirety. Thus, in this one particular instance the entirety property in question would be subject to process and a § 522(b)(3)(B) exemption would be disallowed. *Id.* at 320.

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standard to determine whether the New Jersey exemption statute is subject to process. Indeed, two recent bankruptcy cases illustrate that courts in New Jersey are much more hesitant to allow a tenancy-by-the-entirety exemption.

First, on an appeal from the bankruptcy court, the district court in *In re Tarquinio* affirmed the bankruptcy court and ruled that New Jersey has long recognized that a lien may attach to the interest of one spouse in property held by the entirety, and as such, New Jersey law does not exempt property held as tenants by the entirety.²² Second, the bankruptcy court in an oral decision in *In re Yuriy Gorochko*²³ ruled that notwithstanding the appellate division's holding in the New Jersey Superior Court decision in *Jimenez v. Jimenez*, entirety property was still subject to process because in the event of a fraudulent conveyance, such property was still subject to execution under New Jersey state law, and a marital residence in New Jersey, notwithstanding any state law-based exemption, was still subject to a forced sale based on federal tax law to satisfy an Internal Revenue Service (IRS) lien.²⁴

Based on the aforementioned reasons, it is clear that bankruptcy courts in New Jersey that have considered this issue are denying debtors a tenancy-by-the-entirety exemption in marital property if there is any possible scenario where the property is not 100 percent shielded from the reach of the debtor's creditors.²⁵ Put simply, this is the exact opposite approach that was taken by the Third Circuit in *Napotnik* interpreting Pennsylvania's tenancy-by-the-entirety exemption scheme. Moreover, as previously discussed, both New Jersey and Pennsylvania laws have an exception in their protections for property that is fraudulently conveyed. Both states also allow liens to be placed on entireties property, despite creditors not being able to actively foreclose upon them. Notwithstanding, it seems that only New Jersey courts take issue with these provisions in order to justify disallowing a tenancy-by-the-entirety exemption under § 522(b)(3)(B).

It is also notable that the holding in *In re Gorochko* seems to cut against precedent established by the Third Circuit in *In re Brannon*.²⁶ In *Brannon*, the Third Circuit explicitly distinguished the IRS's ability to place a lien on all property of a delinquent taxpayer in spite of a valid Pennsylvania tenancy-by-the-entirety exemption from the role of a bankruptcy trustee who has no such authority and is bound by state property law rather than federal tax statute.²⁷ As such, the *Brannon* court ruled that the IRS's unique powers to lien property and thereafter force a sale under federal tax law should not preclude the use of the debtor's § 522(b)(3)(B) exemption by being subject to process.²⁸ Indeed, a ruling to the contrary, as was the case in *In re Gorochko*, would have the effect of entirely dismantling the Bankruptcy Code's tenancy-by-the-entirety exemption no matter what state's exemption law was at issue, because federal tax law preempts all state-based exemption laws under the supremacy clause.²⁹

Looking to the Future

The contradictory opinions between Pennsylvania and New Jersey courts regarding what makes entireties property subject to process might be best resolved at the appellate level, since both jurisdictions are within the Third Circuit. In the future, the losing party to a motion to disallow a tenancy-by-the-entirety exemption might find that the best way to address this stark split in authority is to bring a direct appeal to the Third Circuit Court of Appeals under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005's direct-appeal provision as provided by 28 U.S.C. § 158(d). An application for such an appeal would likely be granted, as a debtor's ability to save his/her home from the reach of creditors is an issue of public importance. Moreover, additional guidance from the Third Circuit would ensure a uniform circuit-wide rule that would finally resolve what constitutes being "exempt from process" under § 522(b)(3)(B). **abi**

22 *Tarquinio v. Tarquinio* (*In re Tarquinio*), No. 17-cv-01917, 2017 WL 5707538 at *6 (D.N.J. Nov. 27, 2017). *Tarquinio* was decided before the New Jersey Superior Court Appellate Division's 2018 holding in *Jimenez*. As stated herein, the *Jimenez* court clarified that forced partition of entirety property was expressly prohibited under the Entireties Act.

23 *In re Gorochko*, No. 19-10480-KCF, D.E. 15 (Bankr. D.N.J. 2019). A recording of the bankruptcy court's oral decision in this case is available at the above-referenced case and docket number via PACER.

24 *Id.*

25 Interestingly, two other bankruptcy courts outside of New Jersey that have applied New Jersey tenancy-by-the-entirety law have found that the Entireties Act provides a state law exemption that is exempt from process and therefore allowable under § 522(b)(3)(B). See *In re Wanish*, 555 B.R. 496, 499-500 (Bankr. E.D. Pa. 2016); *In re Montemoino*, 491 B.R. 580, 588 (Bankr. M.D. Fla. 2012).

26 *In re Brannon*, 476 F.3d 170, 177 (3d Cir. 2007) (citing *Schlossberg v. Barney*, 380 F.3d 174 (4th Cir. 2004); *In re Sinnreich*, 391 F.3d 1295 (11th Cir. 2004)).

27 26 U.S.C. § 6321 allows the IRS to place a federal tax lien on the property interests of a delinquent taxpayer. 26 U.S.C. § 7403(c) authorizes the federal government to conduct a forced sale of the property subject to a federal tax lien.

28 *Id.*

29 See *United States v. Cardaci*, 856 F.3d 267, 273 (3d Cir. 2017) (citing *U.S. v. Rodgers*, 461 U.S. 677, 701 (1983)).

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