SO ORDERED.

SIGNED this 4th day of November, 2021.

LENA MANSORI JAMES
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
WINSTON-SALEM DIVISION

IN RE:	)	
	)	
Ronald Lee Morgan,	)	Chapter 7
	)	
Debtor.	)	Case No. 21-50455
	)	
	)	

ORDER
SUSTAINING TRUSTEE'S OBJECTION TO EXEMPTION

THIS MATTER came before the Court on the Objection to Debtor's Claim for Property Exemptions (Docket No. 8, the "Objection") filed by the chapter 7 trustee (the "Trustee"). The dispute at issue in the Objection is whether, and to what extent, the Debtor may exempt property held as a tenancy by entirety when the Internal Revenue Service (the "IRS") holds a valid tax lien against that property and is a priority and general unsecured claimant in the Debtor's bankruptcy case. Notwithstanding that the IRS tax lien is asserted only against the Debtor and not his non-filing spouse, the Court finds that, under the reasoning set forth in *United States v. Craft*, 535 U.S. 274, 288 (2002), the tax lien attached to the Debtor's entireties interest despite the protections afforded by North Carolina law against non-joint creditors. Therefore, under "applicable nonbankruptcy law," the tenancy by entirety interest held by the Debtor is not "exempt from process" by the IRS, nor

from the claims of joint-creditors of both the Debtor and his non-filing spouse. *See* 11 U.S.C. § 522(b)(3).[1] Accordingly, the Court will sustain the Trustee's Objection.

FACTUAL BACKGROUND AND PROCEDURAL HISTORY

The Debtor filed for relief under chapter 7 of the Bankruptcy Code on July 16, 2021. In Schedule A/B, the Debtor lists an ownership interest in real property located at 3301 Mayfield Court, Winston-Salem, North Carolina (the "Property"), which the Debtor owns with his non-filing spouse as tenants by the entirety. The Property has a scheduled value of $313,500 and is encumbered by a deed of trust loan held by Calibur Home Loans ("Calibur") with a scheduled balance of $329,000. The Debtor claimed the Property as exempt under 11 U.S.C. § 522(b)(3) and North Carolina law pertaining to property held as tenants by the entirety.

In Schedule E/F, the Debtor lists an $18,000 priority unsecured debt owed to the IRS. While the Calibur deed of trust is a liability of both the Debtor and his non-filing spouse, only the Debtor is liable for the IRS debt.[2] The only other joint creditor of the Debtor and his non-filing spouse is GM Financial, which is an oversecured creditor holding a lien on the Debtor's vehicle.

In the Objection, the Trustee argues that the Property was not exempt from process by the IRS prepetition and is thus not exempt in bankruptcy to the extent of the IRS debt (Docket No. 8, ¶¶ 9–11). The Trustee also objects to the exemption to the extent of any joint debts owed by the Debtor and his non-filing spouse. The Debtor filed a response to the Objection, asserting first, that the Debtor's interest in the Property "is not property of his bankruptcy estate[,]" and, second, that the Trustee does not have the right to "stand in the shoes" of the IRS and assert the tax collector's rights (Docket No. 14, ¶¶ 6, 13–15). In his reply, the Trustee argues the decisions relied upon by the Debtor are distinguishable from the instant case because the Trustee is not attempting to "stand in the shoes" of any creditor or

[1] All citations to statutory sections refer to Title 11 of the United States Code, unless otherwise indicated.

[2] The listed co-debtor for the IRS debt, Jane Hixon, is not the Debtor's non-filing spouse. Ms. Dixon is not listed as a co-debtor for any other scheduled debts in this case.

assert any creditor's rights under 11 U.S.C. § 544. The Trustee also rejects the premise that the Debtor's tenancy by the entireties interest is not property of the bankruptcy estate (Docket No. 16, ¶¶ 5, 9).

The Court held a hearing on August 31, 2021, at which Daniel Bruton appeared in his capacity as Trustee, Robert E. Price, Jr., appeared as the Assistant United States Bankruptcy Administrator (the "BA"), and Joshua Bennett appeared on behalf of the Debtor. The Trustee and the Debtor argued their respective positions as to the extent to which the Debtor's entireties interest in the Property is exempt under 11 U.S.C. § 522(b)(3). The Debtor also represented at the hearing that approximately $14,000 of the IRS debt dates from 2012 and 2013 and is treated as a dischargeable, general unsecured debt. The remaining $4,000 of the IRS debt represents more recent tax liability and is treated as a priority, non-dischargeable debt.

At the conclusion of the hearing, the Court requested briefing from the BA as to its position on the propriety of administering the Property. After receiving the BA's response (Docket No. 19), as well as the additional replies of the Debtor and the Trustee (Docket No. 20, 23), the Court took the matter under advisement.

DISCUSSION

The Trustee has the burden of proving the Debtor's entireties exemption is not properly claimed as it relates to the IRS debt or to joint-creditors of the Debtor and his non-filing spouse. Fed. R. Bankr. P. 4003(c). The key dispute at the heart of the Objection is whether, and to what extent, the Debtor may exempt property held as a tenancy by entirety when the IRS holds a valid tax lien against that property and is a priority and general unsecured claimant in the Debtor's bankruptcy case.

First, the Debtor questions whether his entireties interest is, or was ever, part of the bankruptcy estate (Docket No. 14, ¶ 6). The Debtor's filing of his bankruptcy petition created the estate, which is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). Section 541(a) "is broad" and "includes all kinds of property, tangible and intangible, causes of action, and all other forms of property." 5 COLLIER ON

BANKRUPTCY ¶ 541.03 (16th ed. 2021). The Fourth Circuit Court of Appeals, as well as this Court, have clearly held that the bankruptcy estate includes interests in entireties property even where only one spouse has filed. *See In re Cordova*, 73 F.3d 38, 40 (4th Cir. 1996); *Chippenham Hosp., Inc., v. Bondurant*, 716 F.2d 1057, 1058 (4th Cir. 1983); *In re Knapp*, 285 B.R. 176, 179 (Bankr. M.D.N.C. 2002).

As with all estate property, the Trustee is obligated under § 704(a)(1) to "collect and reduce to money the property of the estate[,]" and, to that end, has the general power "to use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1). Through its provisions on exemptions, however, the Bankruptcy Code "allows the debtor to prevent the distribution of certain property by claiming it as exempt." *Taylor v. Freeland & Kronz*, 503 U.S. 638, 642 (1992). In the absence of a timely objection, a debtor's claimed exemption will "withdraw from the estate certain interests in property, such as his car or home, up to certain values." *Schwab v. Reilly*, 560 U.S. 770, 791 (2010) (emphasis removed) (quoting *Rousey v. Jacoway*, 544 U.S. 320, 325 (2005)).

As North Carolina is an "opt out" state, the Debtor "has the following exemptions available to him: (1) North Carolina's list of exemptions, (2) federal non-bankruptcy exemptions, and (3) Section 522(b)(3)(B)'s entireties and joint tenancy exemption." *In re Payne*, No. 04-52124C-7W, 2004 WL 2757907, at *2 (Bankr. M.D.N.C. Nov. 15, 2004) (citing *In re Bunker*, 312 F.3d 145, 151 (4th Cir. 2002)). In attempting to exempt his entireties interest in the Property, the Debtor relies upon the third of these options, § 522(b)(3)(B), which allows for the exemption of:

> [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 or joint tenant *to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law* …

11 U.S.C. § 522(b)(3)(B) (emphasis added).

By the language of § 522(b)(3)(B), the Debtor may exempt his tenancy by entirety interest in the Property and prevent the Trustee from distributing it to satisfy creditors but may do so only "to the extent" that the Debtor's interest "is exempt from process under applicable nonbankruptcy law." The phrase "exempt

from process" appearing in § 522(b)(3) "is understood as meaning 'immune from process.'" *Zebley v. Sanner (In re Sanner)*, No. 04-31975, 2005 WL 6761125, at *2 (Bankr. W.D. Pa. Aug. 1, 2005) (quoting *Napotnik v. Equibank and Parkvale Savings Assoc.*, 679 F.2d 316, 319 (3d Cir. 1982)). Therefore, the Court looks to applicable nonbankruptcy law to determine the extent to which the Debtor's interest is "exempt" or "immune" from process.

Given the factual circumstances of the case, the applicable nonbankruptcy state law for purposes of § 522(b)(3)(B) is that of North Carolina. Within that context, this Court has consistently found that tenancy by entirety interests are exempt under North Carolina law from the claims of non-joint creditors. *See, e.g.*, *In re Knapp*, 285 B.R. at 179; *In re Surles*, No. 01-13070C-7G, 2003 WL 2006846, at *2 (Bankr. M.D.N.C. May 1, 2003). Under North Carolina law, "if one spouse files for bankruptcy, a trustee may sell property held as tenants by the entirety only if there are creditors in the case as to whom both spouses are indebted." *In re Knapp*, 285 B.R. at 179. The Trustee's Objection may be sustained, therefore, to the extent there are joint creditors of both the Debtor and his non-filing spouse. The Court observes, however, that the only joint-creditor in the case who could enforce its claim against the Property under North Carolina law is the secured mortgagee Calibur.

The Court's analysis does not end there, however, because "applicable nonbankruptcy law," a phrase found in numerous provisions in the Bankruptcy Code, also includes federal law. *See Patterson v. Shumate*, 504 U.S. 753, 758 (1992) ("Reading the term 'applicable nonbankruptcy law' in § 541(c)(2) to include federal as well as state law comports with other references in the Bankruptcy Code to sources of law."); *In re Moore*, 907 F.2d 1476, 1477 (4th Cir. 1990) (finding that "'[a]pplicable nonbankruptcy law' means precisely what it says: all laws, state and federal …"). In this case, there is applicable federal law— specifically, the United States Tax Code—that informs whether the Property is exempt or immune from process for purposes of § 522(b)(3)(B). Under federal tax law, "[i]f any person liable to pay any tax neglects or refuses to pay the same after demand, the amount … shall be a lien in favor of the United States upon *all property and rights to such*

property, whether real or personal, belonging to such person." 26 U.S.C. § 6321 (emphasis added). The tax lien imposed under 26 U.S.C. § 6321 "arises at the time that the tax assessment is made and continues until the liability is satisfied or becomes unenforceable by reason of lapse of time." *In re Estate of Young*, No. 1:09CV814, 2010 WL 1427584, at *4 (S.D. Miss. Apr. 8, 2010) (internal citation omitted). Moreover, in *United States v. Craft*, 535 U.S. 274 (2002), the Supreme Court concluded that a spouse's entireties interest was subject to attachment of a statutory tax lien under 26 U.S.C. § 6321 for the spouse's sole tax obligation. *Id.* at 276. Despite analogous Michigan law preventing non-joint creditors from executing on entireties property, *Craft* held that the federal tax lien nevertheless attached to the spouse's interest in the entireties property, reasoning that "exempt status under state law does not bind the federal tax collector." *Id.* at 288. Applicable federal tax law, as interpreted through *Craft*, thereby allows for statutory federal tax liens to attach to tenancy by entirety interests of a taxpayer for individual tax debt, regardless of state law limitations on debts held by non-joint creditors.

Consequently, the IRS debt for which the Debtor was liable prepetition is not immune or exempt from process under applicable nonbankruptcy law. When the Debtor failed to pay his taxes, the statutory tax lien under 26 U.S.C. § 6321 arose and attached to the Debtor's interest in the Property, and as he had not satisfied that liability prior to the bankruptcy filing, that lien remains in place. The Debtor's entireties interest is thus not exempt from process by the IRS. *See In re Sanner*, 2005 WL 6761125, at *3 n.2; *see also Conrad v. Schlossberg*, 555 B.R. 514, 520 (D. Md. 2016) (finding debtor's interest as tenant by the entirety is not exempt from process where the United States obtained a restitution judgment and lien under 18 U.S.C. § 3613).[3]

[3] The failure of the IRS to file a notice of federal tax lien "does not invalidate the section 6321 tax lien as to the taxpayer but merely affects the lien's priority as to other creditors." *In re Estate of Young*, 2010 WL 1427584, at *5. In fact, the absence of a notice of federal tax lien, like a judgment, does not factor into whether the Debtor's interest would be exempt from process under applicable nonbankruptcy law. *See Sumy v. Schlossberg*, 777 F.2d 921, 928 n.14 (4th Cir. 1985) (finding "the absence of a judgment or lien has no bearing on the hypothetical issue of whether the debtor's interest would be exempt from process under state law…"); *In re DiStefano*, 610 B.R. 419, 429–30

The Court is unpersuaded by the Debtor's argument that the Trustee has not shown he has the authority to "step into the shoes of the IRS and assert the IRS's rights" (Docket No. 23, ¶ 1). It is true that this Court and the Fourth Circuit Court of Appeals have rejected trustees' attempts to use § 544(a)(2) to stand in the shoes of a hypothetical federal tax lien creditor for purposes of reaching entireties property to benefit individual, non-joint creditors. *See Schlossberg v. Barney*, 380 F.3d 174 (4th Cir. 2004); *In re Knapp*, 285 B.R. at 183. The cases cited by the Debtor, however, are readily distinguishable from the context of this case. While *Knapp* and *Barney* considered a trustee's attempt under § 544 to step into the shoes of a *hypothetical* IRS creditor, in this case the IRS is an *actual* creditor with a tax lien that attached to the Debtor's entireties interest in the Property prior to the bankruptcy filing. And here, the Trustee objects to the claimed exemption only to the extent of the IRS debt, as the Property is not exempt from process under federal tax law. *Cf. Conrad*, 555 B.R. at 520 ("Here, unlike in *Barney*, where no tax lien was in place, the United States government is an actual creditor, not a hypothetical one."). Thus, the Trustee is not attempting to use his powers under § 544, but instead, simply seeks to preserve the possibility of administering the non-exempt portion of the Debtor's entireties interest in the Property as part of his duty to "collect and reduce to money the property of the estate[.]" 11 U.S.C. § 704(a).[4]

Accordingly, just as the Property is not exempt from process by joint creditors under state law, the Property is not exempt from process by the IRS under federal law, as interpreted by *Craft*. The Court therefore will sustain the Trustee's Objection and disallow the exemption, but only as to the IRS debt and any joint-

(Bankr. N.D.N.Y. 2019) (adopting the "majority view" that "a judgment is not necessary to render a [tenancy by the entirety] not exempt from process").

[4] As it is not presently before it, the Court makes no findings as to the propriety of selling the Property under 11 U.S.C. § 363(h), which allows the trustee to sell, subject to certain conditions, both the estate's interest in entireties property along with that of any co-owner. The Trustee would have the burden of establishing the required conditions of § 363(h) by a preponderance of evidence, *see Ivey v. Whitestone (In re Whitestone)*, No. 12-2049, 2013 WL 3776316, at *1 (Bankr. M.D.N.C. July 17, 2013), and he would "need to seek authority for such a sale by an adversary proceeding on notice to the co-owner." 3 COLLIER ON BANKRUPTCY ¶ 363.08 (16th ed. 2021) (citing Fed. R. Bankr. P. 7001(a)(3)).

creditors of both the Debtor and his non-filing spouse. The Debtor may still exempt his entireties interest in the Property, less the total amount of the IRS debt and all joint debts owed by the Debtor and his non-filing spouse. *In re Sanner*, 2005 WL 6761125, at *4; *In re Fishman*, 241 B.R. 568, 575 (Bankr. N.D. Ill. 1999); *In re Wenande*, 107 B.R. 770, 774 (Bankr. D. Wyo. 1989).[5]

CONCLUSION

Based upon the foregoing, THE COURT FINDS the Debtor's interest as a tenant by the entirety in the Property is not exempt from process under applicable nonbankruptcy law from the IRS tax lien owed solely by the Debtor or from the claims of joint-creditors of the Debtor and his non-filing spouse.

Accordingly, IT IS HEREBY ORDERED that the Trustee's Objection is SUSTAINED, and the Debtor's exemption is denied to the extent of the IRS tax lien and any debts held by joint-creditors of the Debtor and his non-filing spouse.

END OF DOCUMENT

[5] The effect of sustaining the Trustee's Objection to a claimed exemption taken under § 522(b)(3)(B) "is not the same in every instance" and "is not an all-or-nothing situation." *In re Sanner*, 2005 WL 6761125, at *4. For instance, if an objection to exemption is sustained where there are joint debts, "the property in question remains property of the estate *to that extent* and is subject to administration by the Trustee." *Id.* (emphasis added) (citing *Edmonston v. Murphy (In re Edmonston)*, 107 F.3d 74, 77 (1st Cir. 1997)).

PARTIES TO BE SERVED

Ronald Lee Morgan (Ch.7)

21-50455

Elizabeth Lawson
via cm/ecf

Joshua Bennett
via cm/ecf

Daniel C. Bruton, Trustee
via cm/ecf

William P. Miller, BA
via cm/ecf

Ronald Lee Morgan
3301 Mayfield Court
Winston-Salem, NC 27104