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The Role of Exemptions in a Bankruptcy

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The Bankruptcy Code (11 U.S.C. §101 et seq.) provides a means by which an individual can obtain a fresh start by discharging certain debts. At the time of the filing of the bankruptcy petition, the individual, known as a "Debtor," must turn over all assets to a trustee for liquidation for the benefit of the creditors.

However, the Bankruptcy Code gives the Debtor the right to exempt certain assets from being turned over to a trustee. This article reviews the rights of an individual to retain certain assets even when filing a bankruptcy petition.

Illinois opted out of a portion of the federal exemption statute for use in bankruptcy matters. 735 ILCS 5/12-1201. Instead, the exemptions contained in the Code of Civil Procedure apply to Illinois Debtors.

- The Bankruptcy Code provision that recognizes a Debtor's right in Illinois to assert a state law created exemption for tenancy by the entirety is found under 765 ILCS 1005/1c of the Illinois Code of Civil Procedure. That statute recognizes a tenancy by the entirety form of ownership of a residence in which the joint tenants with right of survivorship are a husband and wife. It protects the Debtor's interest if a creditor has a claim only against one of the parties and could not have levied upon the interest of the other party. The homestead limitation of $15,000 per Debtor is not applicable for entireties property claimed as exempt.

- Exemptions provided by state law that are available for individuals in Illinois are set forth in the Illinois Code of Civil Procedure primarily at 735 ILCS 5/12-901 through 1006. These exemptions are limited and not as expansive as those of some other states. A Debtor can claim as exempt a certain amount of equity in his or her home, a certain value in an automobile, household goods and furnishings, jewelry, wearing apparel, tools of their trade, health aids, and selected future benefits such as social security and ERISA qualified pension funds and a portion of a recovery from a personal injury matter.

- Additionally, there is statutory authority under Illinois law that protects other assets from being reached by creditors or trustees, assuming that there has been no violation of the provisions of the Bankruptcy Code that permit the trustee to avoid such transfers such as fraudulent conveyances: 110 ILCS 979/45(g) exempts prepaid tuition trust funds; 235 ILCS 5/6-1 exempts pre-need cemetery sales funds; 820 ILCS 305/21 workers' compensation benefits; and 820 ILCS 310/21 workers' occupational disease compensation.

However, there are many other exemptions provided in the federal statutes that protect certain property owned by a Debtor, even if the Debtor's home state opted out of the federal exemption scheme.

The additional exemptions are available under subsections (f), (g), and (h) of §522 of the Bankruptcy Code. Also, §522(b)(3)(B) permits the Debtor to exempt an interest held as a tenant by the entirety where permitted under non-bankruptcy law.

- §522(f) of the Bankruptcy Code provides for the ability to avoid a judgment lien on real estate if the lien impairs the Debtor's exemption. For example, if a Debtor owned a residence worth $200,000 and a mortgage lien existed on the property valued at $190,000, then a judgment lien of $50,000 could be wiped off the title to the real estate.

- §522(g) of the Bankruptcy Code permits the Debtor to avoid liens on property recovered by the trustee. The trustee has certain avoidance powers that permit the recovery of property from a transferee. This section permits the Debtor to exempt property that the trustee recovers as long as the property was transferred from the Debtor involuntarily and as long as the Debtor could have otherwise exempted the property had it not been transferred.

- §522(h) of the Bankruptcy Code permits the Debtor to avoid certain transfers that a trustee would be permitted to avoid if the trustee elects not to pursue the avoidance action. As a result of this provision the Debtor may avoid certain statutory liens, recover preference and fraudulent transfer payments, avoid post-petition transfers, and may avoid liens for fines, penalties, and forfeitures.

Under Bankruptcy Rule 4003 a party in interest, including a trustee, may file an objection to an exemption asserted by the Debtor only within 30 days after the meeting of creditors is concluded or within 30 days after any amendment to the list of exemptions is filed, whichever is later.

Although the court may extend the time to object or a trustee can file an objection to a claimed exemption prior to one year after the closing of the case if the Debtor fraudulently asserted the claimed exemption, the better practice is to file an objection to the exemptions within the 30 days provided by the rule.

Filing a bankruptcy does not automatically mean that a Debtor loses control over the Debtor's assets. Knowledge of the exemption statutes discussed above can help a Debtor recover from a financial crisis with a fresh start.

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