



## CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

May 10, 1999

### **S. 625**

### **Bankruptcy Reform Act of 1999**

*As ordered reported by the Senate Committee on the Judiciary on April 27, 1999*

#### **SUMMARY**

S. 625 would make many changes and additions to the laws relating to bankruptcy, including establishing a system of means-testing for determining eligibility for relief under chapter 7 of the U.S. bankruptcy code. CBO estimates that implementing S. 625 would cost \$218 million over the 2000-2004 period—\$207 million in discretionary spending, subject to appropriation of the necessary funds, and \$11 million in mandatory spending. CBO also estimates that enacting this bill would increase receipts by about \$2 million over the next five years. Because the bill would affect direct spending and receipts, pay-as-you-go procedures would apply. Provisions in title VII also would affect receipts, but the Joint Committee on Taxation (JCT) has not completed an estimate of such changes at this time.

S. 625 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). Overall, CBO expects that enacting this bill would benefit state and local governments by enhancing their ability to collect outstanding obligations in bankruptcy cases. S. 625 would impose new private-sector mandates, as defined in UMRA, on bankruptcy attorneys, creditors, and credit and charge-card companies. CBO estimates that the costs of these mandates would exceed the \$100 million (in 1996 dollars) threshold established in UMRA.

#### **DESCRIPTION OF THE BILL'S MAJOR PROVISIONS**

In addition to establishing means-testing for determining eligibility for chapter 7 bankruptcy relief, S. 625 would:

- Require the Executive Office for the United States Trustees (U.S. Trustees) to establish a test program to educate debtors on financial management;

- Require the Administrative Office of the United States Courts (AOUSC) to receive and maintain tax returns for all chapter 7 and chapter 13 debtors; and
- Require that at least one out of every 250 bankruptcy cases under chapter 13 or chapter 7 be audited;
- Require the AOUSC and the U.S. Trustees to collect and publish certain statistics on bankruptcy cases; and
- Authorize 18 new temporary judgeships and extend five existing judgeships in 19 federal districts.

Other provisions would make various changes affecting the bankruptcy provisions for municipalities and the treatment of tax liabilities in bankruptcy cases.

## **ESTIMATED COST TO THE FEDERAL GOVERNMENT**

As shown in the following table, CBO estimates that implementing S. 625 would cost the courts, the AOUSC, and the U.S. Trustees \$12 million in fiscal year 2000 and \$207 million over the 2000-2004 period, subject to appropriation of the necessary funds. In addition, we estimate that mandatory spending for the salaries and benefits of bankruptcy judges would increase by less than \$500,000 in 2000 and \$11 million over the 2000-2004 period. Enacting the means-testing provisions in title I would result in a net increase in revenues of about \$2 million over the next five years. The costs of this legislation fall within budget function 750 (administration of justice).

## **BASIS OF ESTIMATE**

For purposes of this estimate, CBO assumes that S. 625 will be enacted by October 1, 1999, and that all estimated authorization amounts will be appropriated for each fiscal year.

## **Spending Subject to Appropriation**

Most of the estimated increases in discretionary spending would be required to fund the additional workload that would be imposed on the U.S. Trustees, which are currently funded through the bankruptcy-related fees collected by the courts. Without additional statutory authority, those fees cannot be increased to cover any expenditures that would occur under the bill. Because the legislation does not provide for such increases in fees, any additional costs would be subject to the availability of appropriated funds.

	By Fiscal Year, in Millions of Dollars				
	2000	2001	2002	2003	2004

**CHANGES IN SPENDING SUBJECT TO APPROPRIATION**

Means-Testing (Section 102)					
Estimated Authorization Level	5	10	9	9	8
Estimated Outlays	5	10	9	9	8
Debtor Financial Management Training (Section 104)					
Estimated Authorization Level	2	0	0	0	0
Estimated Outlays	1	1	0	0	0
Credit Counseling Certification (Section 105)					
Estimated Authorization Level	4	3	3	4	4
Estimated Outlays	2	4	3	4	4
Maintenance of Tax Returns (Section 315)					
Estimated Authorization Level	3	6	7	9	9
Estimated Outlays	3	6	7	9	9
U.S. Trustee Site Visits (Section 430)					
Estimated Authorization Level	3	2	2	2	3
Estimated Outlays	1	4	2	2	3
Audit Procedures (Section 601)					
Estimated Authorization Level	0	3	8	10	10
Estimated Outlays	0	3	8	10	10
Compiling and Publishing Data (Sections 602-603)					
Estimated Authorization Level	0	5	9	8	8
Estimated Outlays	0	5	9	8	8
Additional Judgeships—Support Costs (Section 1228)					
Estimated Authorization Level	a	6	11	11	12
Estimated Outlays	<u>a</u>	<u>6</u>	<u>11</u>	<u>11</u>	<u>12</u>
Total Discretionary Changes					
Estimated Authorization Level	17	35	49	53	54
Estimated Outlays	12	39	49	53	54

**CHANGES IN DIRECT SPENDING**

Additional Judgeships (Section 1228)					
Estimated Budget Authority	a	2	3	3	3
Estimated Outlays	a	2	3	3	3

**CHANGES IN REVENUES<sup>b</sup>**

Changes in Filing Fees (Section 102)					
Estimated Revenues	0	0	a	1	1

a. Less than \$500,000.

b. The Joint Committee on Taxation has not yet completed its review of tax provisions in title VII.

**Means-Testing (Section 102).** This section would establish a system of means-testing for determining a debtor's eligibility for relief under chapter 7. Under the means test, if the debtor is expected to have income (after certain expenses) to pay at least \$15,000 or 25 percent of general outstanding unsecured claims over five years, the debtor would be presumed ineligible for chapter 7 relief. A debtor who could not demonstrate "special circumstances," which would cause expected disposable income to fall below the threshold, could file under other chapters of the bankruptcy code. The U.S. Trustees would be responsible for conducting the initial review of a debtor's income and expenses, filing the majority of motions for dismissal or conversion, and taking part in additional litigation that is expected to occur as the courts and debtors debate allowable expenses and other related issues.

Although CBO cannot predict the amount of such litigation, we expect that the amount of litigation could be significant during the first few years, as parties test the new law's standards. In subsequent years, litigation could begin to subside as precedents are established. Based on information from the U.S. Trustees, CBO estimates that the U.S. Trustees would require about 85 additional attorneys, paralegals, and analysts to address the increased workload. As a result, CBO estimates that appropriations of \$41 million would be required over the next five years.

**Debtor Financial Management Test Training Program (Section 104).** This section would require the U.S. Trustees to establish a test training program in three judicial districts to educate debtors on financial management. Based on information from the U.S. Trustees, CBO estimates that about 45,000 debtors would participate in the program, which we expect would be carried out over fiscal years 2000 and 2001. At a projected cost of about \$40 per debtor, CBO estimates that the U.S. Trustees would require an appropriation of about \$2 million in fiscal year 2000 to administer the program.

**Credit Counseling Certification (Section 105).** This section would require the U.S. Trustees to certify, on an annual basis, that certain credit counseling services could provide adequate services to potential debtors. Based on information from the U.S. Trustees, CBO estimates that the U.S. Trustees would require additional attorneys and analysts to handle the additional workload associated with certification. CBO estimates that enacting this provision would require appropriations of \$18 million over the next five years.

**Maintenance of Tax Returns (Section 315).** This section would require the AOUSC to receive and retain tax returns for the three most recent years preceding the commencement of the bankruptcy case for all chapter 7 and chapter 13 debtors (about 8 million debtors over the 2000-2004 period). CBO estimates that appropriations of \$34 million over the next five years would be required to store and provide access to over 20 million tax returns.

**U.S. Trustee Site Visits in Chapter 11 Cases (Section 430).** This section would expand the responsibilities of the U.S. Trustees in small business bankruptcy cases to include site visits to inspect the debtor's premises, review records, and verify that the debtor has filed tax returns. Based on information from the U.S. Trustees, CBO estimates that implementing section 430 would require about 20 additional analysts to conduct over 2,300 site visits each year. CBO estimates that the U.S. Trustees would require appropriations of about \$12 million over the next five years for the salaries, benefits, and travel expenses associated with these additional personnel.

**Audit Procedures (Section 601).** Beginning 18 months after enactment, S. 625 would require that at least one out of every 250 bankruptcy cases under chapter 7 and chapter 13, plus other selected cases under those chapters, be audited by qualified persons, as determined by the Attorney General. Based on information from the U.S. Trustees, CBO estimates that about 1.3 million cases would be subject to audits in fiscal year 2001, increasing to about 1.8 million in fiscal year 2004. CBO assumes that about 0.8 percent of all cases would be audited and that each audit would cost about \$500 (in 2000 dollars). CBO also expects that the U.S. Trustees would need about 10 additional analysts and attorneys to support the follow-up work associated with the audits. Thus, we estimate that implementing this provision would require appropriations of \$3 million in fiscal year 2001 and \$31 million over the 2000-2004 period.

**Compiling and Publishing of Data on Bankruptcy (Sections 602-603).** S. 625 would require the AOUSC to collect data on chapter 7, chapter 11, and chapter 13 cases and the U.S. Trustees to make such information available to the public. CBO estimates that appropriations of about \$30 million would be required over the 2000-2004 period to meet these requirements. Of the total estimated cost, about \$24 million would be required for additional legal clerks, analysts, and data base support. The remainder would be incurred by the U.S. Trustees for compiling data and providing Internet access to records pertaining to bankruptcy cases.

**Additional Judgeships—Support Costs (Section 1228).** This provision would extend five temporary bankruptcy judgeships and authorize 18 new temporary bankruptcy judgeships for 19 federal judicial districts. Based on information from the AOUSC, CBO assumes that one-half of the 18 new positions would be filled by the beginning of fiscal year 2001 and the other half would be filled by the start of fiscal year 2002. Also, we anticipate that all five temporary judgeships would be filled by fiscal year 2002. We expect that discretionary expenditures associated with each judgeship would average about \$450,000 (in 2000 dollars), after initial costs of about \$50,000. Therefore, CBO estimates that the administrative support of additional bankruptcy judges would require an appropriation of less than \$500,000 in

fiscal year 2000 and about \$40 million over the 2000-2004 period. (Salaries and benefits for the judges are classified as direct spending, and those costs are described below.)

## **Direct Spending and Revenues**

**Additional Judgeships (Section 1228).** CBO estimates that enacting the means-testing provision (section 102) would impose some additional workload on the courts. Section 1228 would authorize 18 new temporary bankruptcy judgeships and extend five existing temporary judgeships. Based on information from the AOUSC and other bankruptcy experts, CBO expects that the increase in the number of bankruptcy judges would be sufficient to meet the increased workload. Assuming that the salary and benefits of a bankruptcy judge would average about \$150,000 a year, CBO estimates that the mandatory costs associated with the salaries and benefits of these additional judgeships would be less than \$500,000 in fiscal year 2000 and about \$11 million over the 2000-2004 period.

**Changes in Filing Fees (Section 102).** The means-testing provision also could affect the government's income from bankruptcy filing fees because it would cause changes in the number and type of bankruptcy filings. CBO projects that about 5 to 10 percent of all chapter 7 debtors (about 50,000 to 100,000 cases each year) could be subject to the means test proposed under this bill. CBO expects that those debtors who are not successful in proving "special circumstance" will either convert their cases to chapter 13 cases or withdraw their petitions for bankruptcy relief. Under either of these options, CBO estimates that there would be no significant effect on the federal budget because there is no fee for converting a case from chapter 7 to chapter 13, and filing fees are not refunded to debtors who withdraw their petitions for bankruptcy relief. Over the long term, CBO estimates that the federal government could collect additional revenues as more debtors file directly under chapter 13. (The government collects an additional \$45 for each case filed under chapter 13 instead of chapter 7.) This increase could be partly offset by those debtors who might refrain from filing for any type of bankruptcy relief. On balance, CBO estimates that the means-testing provision would increase revenues by about \$1 million a year beginning in 2003.

**Tax Provisions (Title VII).** The provisions in title VII of the bill are currently under review by the Joint Committee on Taxation, and estimates of their effects on revenues will be provided when they are completed.

## PAY-AS-YOU-GO CONSIDERATIONS

The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. Because this bill would affect both, pay-as-you-go procedures would apply. The net changes in outlays and governmental receipts are shown in the following table. (JCT is reviewing title VII and has not yet completed an estimate of its effects on receipts.) For the purposes of enforcing pay-as-you-go procedures, only the effects in the current year, the budget year, and the succeeding four years are counted.

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	By Fiscal Year, in Millions of Dollars											
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	
Changes in outlays		0	0	2	3	3	3	3	3	3	2	2
Changes in receipts <sup>a</sup>		0	0	0	0	1	1	1	1	1	1	1

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a. Estimated impact of means-testing. JCT has not completed an estimate of changes in receipts for title VII.

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## ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

S. 625 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). Overall, CBO expects that enacting this bill would benefit state and local governments by enhancing their ability to collect outstanding obligations in bankruptcy cases. The changes to bankruptcy law in the bill would affect state and local governments primarily as creditors and holders of claims for taxes or child support. In addition, it would change the applicability of some state statutes that govern which of a debtor's assets are protected from creditors in a bankruptcy proceeding.

In 1996, a survey of the 50 states conducted by the Federation of Tax Administrators and the States' Association of Bankruptcy Attorneys, indicated that more than 360,000 taxpayers in bankruptcy owed claims to states totaling about \$4 billion. Of these claims, states reported collecting only about \$234 million. While CBO cannot predict how much more money might be collected, it is likely that states and local governments would collect a greater share of future claims than they would have under current law.

## **Exemptions**

Although bankruptcy is regulated according to federal statute, states are allowed to provide debtors with certain exemptions for property, insurance, and other items that are different from those allowed under the federal bankruptcy code. (Exempt property remains in possession of the debtor and is not available to pay off creditors). In some states debtors can choose the federal or state exemption; other states require a debtor to use only the state exemptions. This bill would restrict homestead exemptions, create a new exemption for certain retirement funds, and define which household goods would be eligible for exemption. These standards would apply regardless of the state policy on exemptions. The new restrictions on homestead exemptions would make more money available to creditors in some cases, while the exemptions on retirement savings generally would make less money available.

## **Domestic Support Obligations**

The bill would significantly enhance a state's ability to collect domestic support obligations, including child support. Domestic support obligations owed to state or local governments would be given priority over all other claims, except those same obligations owed to individuals. The bill also would require that filers under chapters 11 and 13 pay in full all domestic support obligations owed to government agencies or individuals, in order to receive a discharge of outstanding debts. In addition, the automatic stay that is triggered by filing for bankruptcy would not apply to domestic support obligations. Last, the bill would require bankruptcy trustees to notify individuals with domestic support claims of their right to use the services of a state child support enforcement agency and notify the agency that they have done so. The last known address of the debtor would be a part of the notification.

## **Utility Service**

The bill would enhance the ability of a utility provider, including state and local utilities, to collect debts by clarifying the definition of adequate assurance of payment. Currently, a utility must continue to provide service to a business that files for bankruptcy if adequate assurance that payment will be provided is received. The bill would clarify that adequate assurance means a cash deposit, or other verifiable forms of payment, rather than a verbal assurance.



## **Tax Payment Plans**

The bill would require that payment plans for tax liabilities be limited to six years and that payment amounts be regular and proportionate to payments for other obligations. Under current law, taxing authorities sometimes face payment plans that include a series of small payments over time followed by a large balloon payment near the end of the planned payment stream. At that point, the debtors often fail to complete their claims. This provision would require that taxes be paid at a rate proportionate to those of other debts. It also would establish interest rates to be applied to outstanding tax liabilities. Under current law, interest charges on outstanding tax liabilities are determined at the discretion of the bankruptcy judge.

## **Time Limits on Tax Collection**

Under some circumstances, a tax claim can qualify for priority status, and thus a state and local government would be more likely to collect the debt. However, this status is granted only if a tax is assessed within a specific period of time from the date of the filing for bankruptcy. If that filing is subsequently dismissed and a new filing is made, the tax claim may lose its priority status. The bill would allow more time to pass in some circumstances, thus increasing the likelihood that state or local tax claims would maintain their priority status.

## **Taxes and Administrative Expenses**

Under current law, certain expenses can be paid out of funds that would otherwise be available to pay tax liens on property. The bill would restrict the use of funds for administrative expenses to a limited number of circumstances, thereby making it more likely that funds would remain available to cover tax obligations.

## **Tax Return Filing and Government Notification**

A number of provisions in the bill would require debtors to have filed tax returns, and in some cases to be current in their tax payments, before a bankruptcy case may continue. Also, debtors would be required to provide notice to state authorities in a specific manner when they pursue relief under bankruptcy law. These provisions would help states identify potential claims in bankruptcy cases where they may be owed delinquent taxes.

## **Priority of Payments**

In some circumstances, debtors have borrowed money or incurred some new obligation that is dischargeable (able to be written off at the end of bankruptcy) to pay for an obligation would not be dischargeable. This bill would give the new debt the same priority as the underlying debt. If the underlying debt had a priority higher than that of state or local tax liabilities, state and local governments could lose access to some funds. However, it is possible that the underlying debt could be for a tax claim, in which case the taxing authority would face no loss. Because it is unclear what types of nondischargeable debts are covered by new debt and the degree to which this new provision would discourage such activity, CBO can estimate neither the direction nor the magnitude of the provision's impact on states and localities.

## **Single Asset Cases**

One provision of the bill would allow expedited bankruptcy proceeding in certain single asset cases (usually involving a large office building). State and local governments could benefit to the extent that real property is returned to the tax rolls earlier.

## **Municipal Bankruptcy**

The bill would clarify regulations governing municipal bankruptcy actions and allow municipalities that have filed for bankruptcy to liquidate certain financial contracts.

## **ESTIMATED IMPACT ON THE PRIVATE SECTOR**

S. 625 would impose new private-sector mandates on bankruptcy attorneys, creditors, and preparers of bankruptcy petitions. Bankruptcy attorneys would be required to make reasonable inquiries to confirm that the information in documents they submit to courts or bankruptcy trustees is well grounded in fact. Creditors would be required to make disclosures in reaffirmation agreements with debtors, to refrain from certain communications with debtors, and to provide notices to the court and to debtors. Preparers of bankruptcy petitions would be required to make disclosures to debtors and may face additional costs due to regulation of fees. CBO estimates that the costs of these mandates would exceed the \$100 million (in 1996 dollars) threshold established in UMRA.

Sections 102 and 319 would make bankruptcy attorneys liable for misleading statements and inaccuracies in schedules and documents submitted to courts or trustees. To avoid sanctions and potential civil penalties, attorneys would need to verify the information given to them by their clients regarding the list of creditors, assets and liabilities, and income and expenditures. Based on 1,286,000 projected filings under chapter 7 and chapter 13 and an estimated increase in attorneys' costs of \$150 to \$500 per case, CBO estimates that the costs to attorneys of complying with this requirement would be between \$190 million and \$640 million in fiscal year 2000. With the rise in projected filings over the next five years, annual costs would be \$280 million to \$940 million for fiscal year 2004. CBO expects bankruptcy attorneys to pass some of the cost on to debtors, reducing the pool of funds available to creditors.

S. 625 would regulate communications between creditors and debtors. Section 203 would require any creditor with an unsecured consumer debt seeking a reaffirmation agreement with the debtor to notify the debtor of his right to a hearing to determine whether the agreement is an undue hardship, is in the debtor's best interest, or is the result of an illegal threat by the creditor. Section 204 would prohibit creditors seeking reaffirmation agreements from threatening to file motions to determine dischargeability or to dismiss and from threatening to repossess collateral protected by the automatic stay created by filing for bankruptcy. The bill would also require creditors to specify to the court and to the debtor the person designated to receive notices. The requirements in section 204 would diminish creditors' ability to obtain reaffirmation agreements and recover debts, but CBO cannot estimate the costs of these requirements because of a lack of data on reaffirmation agreements. The costs of the other requirements would be small.

CBO cannot estimate the total costs to nonattorney preparers of bankruptcy petitions. Section 221 would require preparers of petitions to provide debtors with written notice that they are not attorneys and cannot provide legal advice. Section 221 also would authorize the Supreme Court and the Judicial Conference of the United States to set limits on the fees charged by preparers of bankruptcy petitions but does not suggest an appropriate limit. As a result, CBO cannot estimate the costs of limiting fees.

## **PREVIOUS CBO ESTIMATE**

On May 5, 1999, CBO transmitted a cost estimate for H.R. 833, as reported by the House Committee on the Judiciary on April 28, 1999. Both H.R. 833 and S. 625 would authorize additional bankruptcy judges; thus, enacting either bill would affect direct spending. S. 625, unlike H.R. 833, however, would not waive chapter 7 filing fees for certain debtors. As a

result, enacting S. 625 would result in a net increase in revenues of about \$2 million over the next five years. Differences in discretionary spending estimates between S. 625 and H.R. 833 reflect differences in the provisions of the two bills. The major differences in discretionary provisions between the two bills involve the debtor financial management test program and the audit requirement. Under S. 625, the U.S. Trustees must administer a test program in three judicial districts, while under H.R. 833, they must administer the program in six judicial districts. With regard to the audit requirement, S. 625, unlike H.R. 833, does not require that an independent certified public accountant conduct the audits.

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