

## **EVALUATION OF CONTRIBUTIONS FROM INCOME BY BANKRUPTS – SECOND INTERIM EVALUATION REPORT**

### **Section 1 - Purpose of the paper**

1. To provide details of the on-going evaluation work being undertaken in respect of the income payment agreement (IPA) provisions of the Enterprise Act 2002.

### **Section 2 – Background and Purpose of Evaluation**

2. On 1 April 2004, new insolvency legislation came into force contained in the Enterprise Act 2002. This new legislation introduced income payment agreements (IPAs) as an administrative alternative to court-based income payment orders (IPOs).

3. The objectives of the IPA provisions contained in the Enterprise Act 2002 are:

- To reduce the time by the Official Receiver and Court in dealing with IPO applications where a bankrupt has consented; and
- To improve returns to creditors

4. The principal aim of the evaluation is to provide a comprehensive assessment of whether, to what extent and how the provisions relating to IPAs meet these policy objectives. The evaluation also provides information and data that can be used to inform future policy decisions.

5. The Insolvency Service made a commitment to the Government to undertake an evaluation of the Enterprise Act 2002 within 3 years of commencement of the various provisions. The IPO provisions commenced on 1 April 2004 and therefore, the evaluation is due to be completed by 31 March 2007. This is the second interim report to summarise the evaluation work and findings to date<sup>1</sup>.

### **Section 3 – Approach**

6. The evaluation uses both quantitative and qualitative evaluation methods, including:
- Analysis of data on individual insolvency cases held on The Insolvency Service's internal Information Technology system
  - Sampling and review of files on individual insolvency cases to supplement information from other sources
  - Meetings with professionals within the insolvency sector to seek their views regarding the appropriateness and impact of insolvency legislation
  - Structured questionnaires and interviews with bankrupts, creditors, and other members of the public to obtain their views and experience of the impact of insolvency legislation and to obtain feedback on the wider issues associated with bankruptcy.

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<sup>1</sup> The first interim report dated March 2005 is available on The Insolvency Service's website ([www.insolvency.gov.uk](http://www.insolvency.gov.uk)).

7. In order to ascertain the impact of the Enterprise Act 2002 provisions, benchmark information was obtained regarding the operation and effect of the existing legislation, i.e. before the implementation of the Enterprise Act 2002 provisions.

8. A copy of the evaluation planning paper is contained at [appendix 1](#).

#### **Section 4 – Work Carried Out to Date**

9. To date, benchmarking information and information relating to the operation and effect of the Enterprise Act 2002, i.e. from 1 April 2004, has been, and continues to be collected.

#### **Objective 1: To reduce the time spent by the Official Receiver and Court in dealing with IPO applications where a bankrupt has consented**

10. This objective relates to the benefit to the court and Official Receiver in introducing IPAs. The evaluation looks at the level of IPO/As obtained by the Official Receiver, the time spent by the Official Receiver and the court in dealing with IPO/As, and the level of contested and varied IPO/As.

11. Full details of the evaluation information obtained in respect of this objective are contained at [appendix 2](#).

#### **Objective 2: To improve returns to creditors**

12. This objective relates to the benefit to creditors of the IPA provisions. The evaluation looks at the level and costs of IPO/As obtained, the number of payments involved, and the variations made to IPOs.

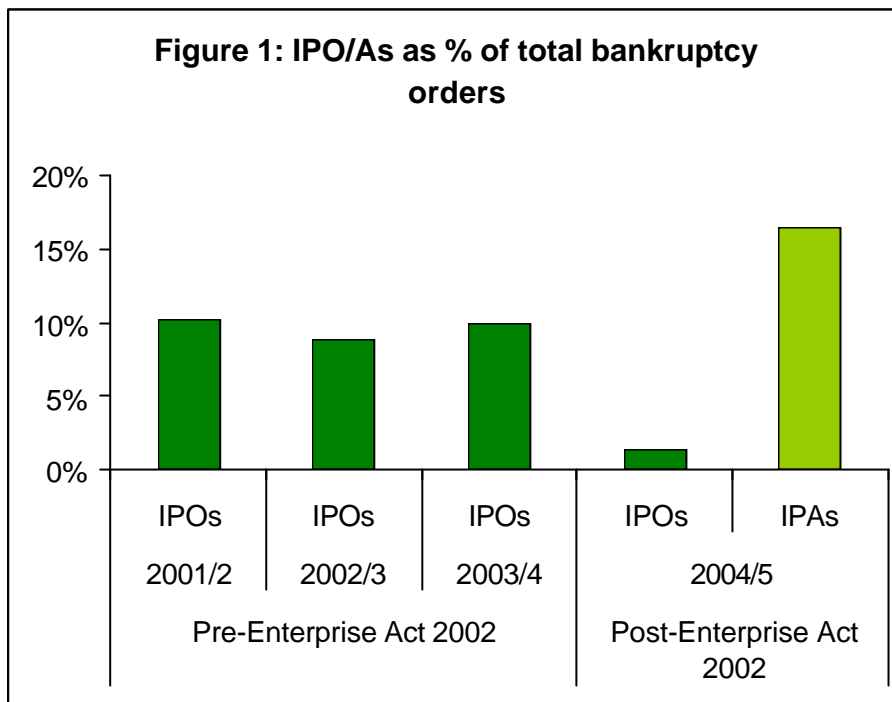
13. Full details of the evaluation information obtained in respect of this objective are contained at [appendix 3](#).

#### **Section 5 - Preliminary conclusions and recommendations**

16. From the evaluation information available, the following observations can be made:

#### **Objective 1: To reduce the time spent by the Official Receiver and Court in dealing with IPO applications where a bankrupt has consented**

- Since the implementation of the Enterprise Act 2002, the IPA provisions have been well used. The IPA regime has been used in over 90% of cases where contributions from bankrupts have been obtained.
- Prior to the Enterprise Act 2002, the level of IPOs in relation to the level of bankruptcy orders remained pretty consistent. Figures post-Enterprise Act 2002 indicate an increase in the overall level of IPO/As obtained by Official Receivers in relation to bankruptcy orders (see Figure 1).



- It is estimated that there is a saving of 30 minutes by Official Receivers as regards the administration of IPAs compared to IPOs. Therefore, in 2004/5, the Official Receiver saved over 3,000 hours of administration as a result of the introduction of the IPA regime<sup>2</sup>. This time saving is counteracted by the increase in IPO/As obtained in 2004/5. However, based on the level of IPOs prior to the Enterprise Act 2002, the Official Receiver has still saved in the region of 1,600 hours in 2004/5 as a result of the introduction of the IPA regime<sup>3</sup>.
- It is estimated that, prior to the Enterprise Act 2002, the Official Receiver spent around 50 hours per year dealing with formal uncontested variations of IPOs. This time should reduce as the court is not involved in the variation of IPAs.
- It is estimated that there is a saving of 15 minutes of court time as a result of IPAs being obtained instead of court-based IPOs. Therefore, in 2004/5, the Court saved over 1,500 hours of administration as a result of the introduction of the IPA regime, assuming that the court would have had to deal with all the IPAs obtained as IPO applications. However, based on the level of IPOs prior to the Enterprise Act 2002, the Court has still saved in the region of 800 hours in 2004/5 as a result of the introduction of the IPA regime.

<sup>2</sup> There were 6,617 IPAs in 2004/5. This is assuming all IPO/As obtained in 2004/5 would have been obtained regardless of the introduction of the IPA regime.

<sup>3</sup> Prior to the Enterprise Act 2002, on average, IPOs were obtained in 9.68% of bankruptcy cases. Post-Enterprise Act, there were 37,562 bankruptcy cases and the split between IPO and IPA cases is 1: 11 approximately. Therefore, ignoring the increase in the level of IPO/As obtained, we can assume that the Official Receiver would have obtained in the region of IPO/As in 2004/5 is 3,636, consisting of 331 IPOs and 3,305 IPAs.

- As regards uncontested variations of IPOs, the court will save time as the majority of IPOs will now be dealt with under the IPA regime and the court are not involved in uncontested IPA variations. However, prior to the Enterprise Act 2002, the court spent a minimal amount of time on these and therefore, the time saving is not significant.
- Prior to the Enterprise Act 2002, based on case sampling results to date, about 1.2% of IPO applications were contested. Since the implementation of the Enterprise Act 2002, the Official Receiver has only sought IPOs in cases where the bankrupt will not consent to an IPA. In 2004/5, IPOs were sought in 8% of all IPO/As obtained<sup>4</sup>. Therefore, it appears that the introduction of the IPA regime may have affected a bankrupt's willingness to make contributions from his/her income. However, this increase may be due to the material increase in IPO/As obtained in 2004/5<sup>5</sup>, the change in the type of cases where an IPA/O is sought (see below), or because the case sampling results to date are not representative.

**Objective 2: To improve returns to creditors**

- Prior to the Enterprise Act 2002, where an IPO was based on surplus monthly income rather than to cover a temporary situation such as seasonal overtime, it was The Service's policy to obtain orders until discharge unless there are specific reasons why this should not be done (such as non-co-operation of the bankrupt or suspension of discharge). This meant that IPOs in summary cases would only last for a maximum of 24 months. Additionally, it took between 2 and 4 months for the IPO to be obtained (and often longer where the bankrupt is not consenting to the IPO). This meant that an IPO may have lasted for less than 36 months (in non-summary cases) or 24 months (in summary cases) if a bankrupt did not pay voluntarily prior to obtaining the order of court.
- Based on case sampling results to date, prior to the Enterprise Act 2002, just over a half of IPOs obtained were agreed for 24 monthly payments or less, with less than 5% of IPOs being agreed for over 36 monthly payments.
- Post-Enterprise Act 2002, IPO/As should last for 36 months as an IPO/A is not tied-in to discharge and does not depend on when the agreement is made. Therefore, post-Enterprise Act 2002, we can expect that the number of payments agreed under an IPO/A should increase, and work is on-going to confirm this.
- Prior to the Enterprise Act 2002, based on case sampling results to date, only 25% of IPOs based on monthly surplus income were paid for the full duration of the IPO. Further, in 40% of cases, less than 25% of the payments due were actually collected. Work is on-going to confirm the collection rate on IPAs.
- Prior to the Enterprise Act 2002, it appears that IPOs were only varied to reduce, or cease, the payments due. It is not expected that the type of variations post-Enterprise Act 2002 will be different, and work is on-going to confirm this.

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<sup>4</sup> In 2004/5, there were around 546 IPOs and 6,741 total IPO/As.

<sup>5</sup> Assuming an exponential growth tending towards a plateau in contested IPOs compared to total IPO/As obtained.

- Prior to the Enterprise Act 2002, the majority of uncontested IPO applications/ variations were made by way of an application without notice. Applications with notice were only requested where the bankrupt contested the IPO application. Prior to January 2006, the court fees for payable for an application without notice and an application with notice were £25 and £50 respectively. No court fees are payable in connection with an IPA.
- However, it appears that the court fee was waived in around one third of cases. Therefore, in 2004/5, court fees in the region of £110,000 were saved as a result of the IPA provisions<sup>6</sup>, assuming that the court would have had to deal with all the IPAs obtained as IPO applications. However, based on the level of IPOs prior to the Enterprise Act 2002, around £55,000 has still been saved in 2004/5 as a result of the introduction of the IPA regime<sup>7</sup>.
- As regards uncontested variations of IPOs, court fees will no longer be payable as the majority of IPOs will now be dealt with under the IPA regime and the court are not involved in uncontested IPA variations. However, prior to the Enterprise Act 2002, the amount spent on court fees was minimal and therefore, the money saved is not significant.
- Prior to the Enterprise Act 2002, the travel and subsistence claims payable on IPO hearings were minimal. This appears to be because the vast majority of IPO applications were made without notice.
- Post-Enterprise Act 2002, the Official Receiver, as trustee, does not charge for remuneration on the realisation of assets, although the costs of agents used in the collection of monies due under IPO/As are charged. Currently, no fee is payable if no realisation is made; otherwise, the fee for the collection of IPO/As is fixed at 10% of the sum realised plus VAT. Further work is being undertaken to ascertain the level of remuneration charged by an insolvency practitioner for the collection of monies due under IPO/As.
- Prior to the Enterprise Act 2002, based on case sampling results to date, the Official Receiver was trustee in around 20% of cases. Since the Enterprise Act 2002, the Official Receiver was trustee in around 96% of cases in 2004/5. Therefore, if the Official Receiver charges less remuneration than an insolvency practitioner when in office, there are potential savings as regards trustee remuneration charged.

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<sup>6</sup> There were 6,617 IPAs in 2004/5. This is assuming all IPO/As obtained in 2004/5 would have been obtained regardless of the introduction of the IPA regime, and that court fees would have been waived in one third of cases.

<sup>7</sup> Prior to the Enterprise Act 2002, on average, IPOs were obtained in 9.68% of bankruptcy cases. Post-Enterprise Act, there were 37,562 bankruptcy cases and the split between IPO and IPA cases is 1: 11 approximately. Therefore, ignoring the increase in the level of IPO/As obtained, we can assume that the Official Receiver would have obtained in the region of IPO/As in 2004/5 is 3,636, consisting of 331 IPOs and 3,305 IPAs.

- As noted previously, the level of IPO/As obtained since the introduction of the IPA regime has materially increased. Because of the simplified process in obtaining an IPA, it was thought that it should be easier to recover payments from the self-employed and others whose income fluctuates, such as employees who receive an 'NT' tax coding ('tax holiday')<sup>8</sup>.
- Prior to the Enterprise Act 2002, based on the sampling results to date, IPOs based on income from self-employment were obtained in around 1% of cases, and IPOs based on an 'NT' tax coding were obtained in around 11% of cases. Post-Enterprise Act 2002, IPAs based on income from self-employment were obtained in around 29% of cases, and IPAs based on an 'NT' tax coding were obtained in around 50% of cases.
- Therefore, it appears that as result of the introduction of the IPA provisions, there has been an increase in the level of contributions from income by bankrupts whose income fluctuates.
- As regards IPO/As obtained based on an 'NT' tax coding, prior to the Enterprise Act, around 90% were based solely on the money available as a result of the 'NT' tax coding (the rest being based on monthly contributions and the money being available as a results of the 'NT' tax coding). Post-Enterprise Act 2002, around 60% of the IPAs based on an 'NT' tax coding were based solely on the money available as a result of the change in tax code. Therefore, it appears that the increase in the level of contributions from income by bankrupts based on an 'NT' tax coding is not solely due to obtaining IPAs which only last for the period of the 'NT' tax coding.

13. No changes to the evaluation planning paper are recommended at this time.

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<sup>8</sup> The Inland Revenue has been in the practice of claiming in the bankruptcy proceedings in respect of income tax due for the whole of the tax year in which the bankruptcy order is made less the amount of tax paid and deducted up to the date of the order. In consequence, a "nil tax" (or NT) code is applied to the bankrupt for the remainder of the tax year in which he was made bankrupt so that he does not pay any tax on his income for that period and is thus in receipt of extra money. Where this "nil tax" code is put into place, the extra funds made available to the bankrupt, following this revision of the tax coding, are included in calculating the amount he is able to pay under an IPA. The IPA is drafted so that when at the end of the tax year the Inland Revenue recommence tax deductions from the bankrupt's income, the amount payable can be reduced accordingly or the agreement may only run for the period in which the bankrupt is in effect tax exempt.