

Executive Note

The Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008 SSI/2008/81

This instrument will if approved be made in exercise of the powers conferred by sections 5A(5) and 39A(4) of the Bankruptcy (Scotland) Act 1985 (“the 1985 Act”), as introduced by sections 15(2) and 19(2) of the Bankruptcy and Diligence etc. (Scotland) Act 2007 (“the 2007 Act”). The instrument is subject to affirmative resolution procedure.

Policy Objectives

This instrument is primarily concerned with a new route into bankruptcy. It provides prescribed rules for determining applications for an award of bankruptcy by debtors with low income and low assets (“LILA”). This is intended as an alternative to a application on grounds of apparent insolvency under current rules.

Purpose of the Low Income Low Asset Scheme

The purpose of the LILA scheme is to provide debt relief for a class of debtors who have substantial debts but are unable to petition for their own bankruptcy because they are not “apparently insolvent” as defined by section 7 of the 1985 Act. This is because creditors have established that the debtor has minimal funds and assets and is not in a position to repay any of their debts. In these circumstances, many creditors are unwilling to “throw good money after bad” and pay for court action to pursue a debt with little prospect of recovering their costs and less of obtaining repayment. Yet without court action against them for debt, a debtor cannot establish apparent insolvency and is not entitled to petition for their own bankruptcy. In these circumstances the debtor is trapped with no prospect of repaying their debts and no prospect of debt relief. The scheme is intended to address this social problem. Citizens Advice Scotland have estimated that there may be as many as 5,000 debtors who urgently need the relief offered by the scheme.

LILA in the context of bankruptcy reform

Section 14 of the 2007 Act amends the 1985 Act so that the current procedure for a debtor’s petition to court for an award of bankruptcy will be replaced by an application to the Accountant in Bankruptcy who will make an award bankruptcy if the application is properly made. Rules for the administration of the application process will be set out in a separate set of regulations, made by negative procedure. This will include the administration rules for applications under the LILA scheme.

Section 14(2) of the 2007 Act inserts section 2(1C) into the 1985 Act. This provides that when an award is made under the LILA scheme, the Accountant in Bankruptcy will be deemed to be appointed as the debtor’s trustee in all cases. However, this will not prevent creditors from seeking the appointment of a private trustee under the process for calling a statutory meeting if they consider it appropriate to do so.

Evidence of low income and low assets will be provided in a signed declaration made by the debtor in order to keep the process simple and non-intrusive. A random sample of cases will

be checked to prevent abuse of the scheme. The LILA scheme will provide a gateway into bankruptcy but awards, once made, will be subject to the same rules as other bankruptcies.

The definition of low income

Regulation 2 defines “low income” as gross weekly income of less than $40 \times$ the national minimum wage. This is currently equivalent to earnings of £220.80 per week. The regulation also provides that any debtor in receipt of specified social security benefits and tax credits will be treated as meeting the low income rule. This is because these benefits are income based and already means-tested for income.

The regulation also provides that any other social security benefits or tax credits will not be taken into account for the purposes of calculating income.

The regulation also provides that only the debtor’s personal income is taken into account. This is intended to ensure that the income rule does not prevent access to the scheme because of income received by another member of the debtor’s family.

The regulation also provides a rule for calculating the average income of debtors whose earnings vary from week to week. The income rule is based on the average of actual income over a twelve week period immediately preceding the date of application.

The definition of low income for the purpose of entry to the LILA scheme will not prevent a debtor who can afford to do so from making a contribution out of their earnings to their estate.

The definition of low assets

Regulation 3 defines “low assets” as no individual asset worth more than £1,000 and the total value of all the assets owned by the debtor do not exceed £10,000. The original intention as expressed in the 2007 Act was to set an assets threshold of £1,000. We have increased this in order to apply the £1,000 threshold to assets individually but with a higher overall threshold for assets collectively. This is intended to minimise the need for debtors to calculate the total value of ordinary household items which would not usually interest a trustee in sequestration.

Section 33 of the 1985 Act contains a cross-reference to the rules on exempt assets for the purposes of attachment under the Debt Arrangement and Attachment (Scotland) Act 2007. These exempt assets do not vest in a bankrupt debtor’s trustee. Exempt assets include things like household appliances, medical equipment and children’s toys. Some exempt assets are limited to a maximum value of £1,000. An example of a limited exempt asset is the debtor’s car. It is the intention of the regulation that none of these assets should be taken into consideration for the purposes of determining the value of a debtor’s assets.

The regulation also provides that the debtor cannot own any land. This will exclude homeowners from the LILA scheme. This is because we consider that dealing with property will substantially increase the administration costs of the scheme which would require either a higher application fee or funding from the public purse.

The definition of low assets for the purpose of entry to the LILA scheme will not restrict a trustee's right to realise any asset which would be realisable under the provisions of the 1985 Act.

Consultation

A public consultation on the LILA scheme ran from 2 April 2007 to 26 June 2007. A report on the consultation was published on [confirm date] and is available on-line at [confirm address]. There has also been extensive engagement with the key stakeholders, including Money Advice Scotland, Citizens Advice Scotland, and the Institute of Chartered Accountants of Scotland. The Scottish Executive has also set up a programme board to help oversee implementation of the 2007 Act. The key stakeholders are represented on that board, and have agreed that the changes made by the above instrument are needed.

In general, stakeholders are supportive of the scheme and agree that a new route into bankruptcy is required.

The debtor's family home and gratuitous alienation

Apart from LILA, the set of regulations also includes a regulation amending the effect of section 39A of the 1985 Act as introduced by section 19(2) of the 2007 Act. The new section 39A provides that a debtor's family home will be returned to the debtor three years after the date of sequestration unless the trustee has not taken specified action in relation to that home. Regulation 4 will modify this provision in any case where the trustee has been unable to take specified action within the three year period only because the debtor had transferred title to the home to a third party at less than its true value. It sometimes happens, for example, that a debtor will sometimes "give" an asset to a family member shortly before an award of bankruptcy in order to avoid the sale of that asset to repay their creditors. This type of transaction is described as a "gratuitous alienation". Section 34 of the 1985 Act enables the trustee to challenge a gratuitous alienation and to restore the alienated property to the debtor's estate for the benefit of their creditors. The regulation is intended to prevent a property returned to the estate in these circumstances from passing automatically from the trustee to the debtor solely because of the lapse of three years.

Section 72 of the 1985 Act as amended by section 35 of the 2007 Act provides that the power to make regulations modifying section 39A of the 1985 Act is by affirmative procedure. This regulation has been included with the set of regulations required for the LILA scheme in order to reduce the number of separate instruments put before Parliament.

Financial Effect

The LILA scheme will require public funding of £186,000 to set-up. This has been allocated from existing funds held by the Justice and Communities Directorate and Finance Group within the Scottish Government. These are sunk costs committed to development and recruitment prior to commencement in April 2008.

The ongoing administration costs of the LILA scheme will be covered by an application fee of £100.

Equality Impact Assessment

Under guidance issued by the Scottish Government an equality impact assessment has been carried out on the Scheme. We have engaged with the relevant equality groups and there is no evidence to show that this policy will either positively or negatively impact on any particular group. The scheme will continue to be monitored and evaluated to ensure that no adverse affect or unintentional discrimination arises in the future.

Accountant in Bankruptcy
February 2007