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TECHNICAL  
R E P O R T

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The Bankruptcy Abuse  
Prevention and Consumer  
Protection Act of 2005

Evaluation of the Effects of Using  
IRS Expense Standards to  
Calculate a Debtor's Monthly  
Disposable Income

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## Executive Summary

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One of the main changes introduced by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) was the requirement that certain debtors filing for bankruptcy use IRS expense standards for certain expense categories rather than their current expenses to calculate their monthly disposable income (MDI). This change can affect both the options available to a debtor considering filing for bankruptcy and the amount the debtor must pay to creditors under a repayment plan.

In this RAND Corporation study, we assessed the effects of this change on debtors and the courts. We conducted the research in three steps: First, we reviewed the case law to identify relevant issues; second, we conducted interviews and focus groups with those involved in the bankruptcy process to understand background and context; and third, we examined samples of bankruptcy cases filed in eight judicial districts to estimate the effects of using the IRS standards to calculate a debtor's MDI.

### Effects on the Courts

BAPCPA took effect too recently for appellate courts to have had time to settle the many open questions. Because there is considerable lack of uniformity among judicial districts in application of the IRS standards in chapters 7 and 13 of the Bankruptcy Code, similarly situated debtors may have substantially different payment obligations depending on the jurisdiction in which they live.

Most judges report that each bankruptcy case now requires more of their time, but the effects seem to vary greatly depending on the district. The increase in workload is not attributable to any particular provision of the new law; therefore, what portion may be due to the IRS expense standards is not known.

### Results of Analysis of Bankruptcy Cases

#### Fraction of Chapter 7 Cases Using the IRS Standards

About 7 percent of the Chapter 7 debtors in our samples had above-median incomes, but their deductions, including those calculated using IRS standards, resulted in MDIs that met the Chapter 7 criteria. The percentage of debtors who filed for Chapter 7 even though their

incomes exceeded the applicable median varies considerably across the country. We have no data on the extent to which the IRS standards, as part of the means test, may have deterred debtors from filing under Chapter 7.

### **Fraction of Chapter 13 Cases Using the IRS Standards**

Slightly more than one-quarter of Chapter 13 debtors in our samples had above-median incomes and, consequently, were required to use the IRS expense standards to calculate their MDIs. Almost three-quarters of the debtors in our samples who filed under Chapter 13 had below-median incomes. These debtors presumably could have filed under Chapter 7 had they so chosen but opted for Chapter 13 filing instead.

There was substantial variation across judicial districts in the fraction of Chapter 13 filers whose incomes exceeded the median and, consequently, used the IRS expense standards in calculating their MDIs.

### **Effects of Using the IRS Standards in Calculating MDI**

In every sampled district, the average deductions allowed under the IRS standards are considerably higher than the average equivalent deductions based on reported current expenses. Higher deductions result in lower MDIs. MDI is reduced by an average of \$490 in all sampled districts combined when the IRS standards are used. In individual districts, the average reduction in MDI due to the use of the IRS standards ranges from \$311 in the Middle District of Florida to \$612 in the Northern District of Ohio. The IRS standards result in larger deductions, on average, and, therefore, lower MDIs across the country.

### **Effects of Specific IRS Standards**

Two of the IRS standards primarily account for this differential. The IRS standards for living expenses and for transportation ownership are generally favorable to debtors. In every sample district, these IRS standards allow debtors deductions that exceed their reported current expenses. Conversely, in every sample district, the IRS standards for nonmortgage housing expenses and for vehicle operation and public transportation allow debtors lower deductions than their reported current expenses. The IRS standard for mortgage or rental expenses generally favors owners, though the differences between the deduction that owners are allowed using the IRS standards and their current expenses in that category generally are not large. The effects on renters of using the IRS standards for mortgage or rental expenses are mixed. In five of the eight sample districts, using the IRS standards results in smaller deductions, on average, than does using current rental expenses. In the other three districts, the IRS standard rental allowance exceeded, on average, the debtors' current rental expenses.

### **Effects of Using the IRS Standards on Different Types of Debtors and in Different Districts**

Using IRS standards to calculate deductions benefits the average homeowner more than it does the average renter, but the difference is small, about \$65 per month. Among homeowners and among renters, the only other significant difference in the effects of the IRS standards on different types of debtors is for debtors with high current incomes. In general, higher-income debtors gain less using the IRS standards rather than their current expenses than do otherwise similar,

lower-income debtors. For homeowners, the average difference in deductions calculated using the IRS standards rather than current expenses is about \$70 lower for each additional \$1,000 in current monthly income. For renters, the average difference in deductions calculated using the IRS standards rather than current expenses is about \$175 lower for each additional \$1,000 in current monthly income. This effect is significant for homeowners and highly significant for renters. Debtors' assets, liabilities, and expenditures were not significantly related to the effects of using the IRS standards in calculating their deductions.

The results for the eight judicial districts examined suggest that, controlling for debtors' financial characteristics, there are some systematic differences among the districts in the effects of using the IRS standards instead of the corresponding current expenses to calculate a debtor's MDI. The district effect is more pronounced for homeowners than for renters.