

THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

TIMOTHY C. PIGFORD, *et al.*,)
)
 Plaintiffs,)
)
 v.)
)
 TOM VILSACK, Secretary,)
 United States Department of)
 Agriculture,)
)
 Defendant.)

Civil Action No.
97-1978 (PLF)

CECIL BREWINGTON, *et al.*,)
)
 Plaintiffs,)
)
 v.)
)
 TOM VILSACK, Secretary,)
 United States Department)
 of Agriculture,)
)
 Defendant.)

Civil Action No.
98-1693 (PLF)

MONITOR'S SECOND REPORT ON DEBT RELIEF IMPLEMENTATION

On April 21, 2009, the Court directed the Monitor to continue to work with the parties to review, correct, and verify the debt relief implemented by the United States Department of Agriculture (USDA) for all prevailing claimants who may be entitled to debt relief. The Court further directed the Monitor to report to the Court on or before June 30, 2009, regarding the parties' progress with respect to debt relief implementation, including: (1) the steps taken to implement a system to manage the tax consequences of debt relief; and (2) the preparation of a complete list of class members whose cases must be reviewed in order to ensure that debt relief

has been fully implemented. The Monitor submits this report to comply with the Court's April 21, 2009 Order.

I. BACKGROUND

Prior Monitor reports described the debt relief USDA must provide to claimants who prevail in Track A or Track B credit claims. Prior reports also described the review process the parties instituted to ensure that debt relief is properly implemented for all claimants who are entitled to *Pigford* debt relief.¹

A. Substantive Debt Relief Review

The debt relief review process begins with a substantive review of the debt relief each prevailing claimant is entitled to receive. In determining the appropriate debt relief, USDA applies the substantive rules set forth in (1) the Consent Decree;² (2) a Stipulation and Order filed on February 7, 2001;³ (3) an Opinion and Order issued by the Court on February 22, 2008;⁴ and (4) the agreements of the parties which are memorialized in Monitor Update No. 10, Debt Relief for Prevailing Class Members, as revised on July 11, 2008.⁵ If USDA identifies any

¹ See, for example, the Monitor's Report on Debt Relief Implementation, filed March 31, 2009, and available on the Monitor's web site at: http://www.pigfordmonitor.org/reports/rpt20090331_dr_impl.pdf. For more general information on debt relief, see pages 12-13 and 40-47 of the Monitor's Report Regarding Implementation of the Consent Decree for the Period of January 1, 2008, through December 31, 2008, filed June 17, 2009, and available on the Monitor's web site at: http://www.pigfordmonitor.org/reports/Rpt20090617_2008.pdf.

² The debt relief provisions are contained in paragraphs 9(a)(iii)(A) and 10(g)(ii) of the Consent Decree. The Consent Decree is available on the Monitor's web site at: <http://www.pigfordmonitor.org/orders/19990414consent.pdf>.

³ Paragraph 2 of the February 7, 2001 Stipulation and Order pertains to the debt relief USDA must provide to prevailing claimants. The February 7, 2001 Stipulation and Order is available on the Monitor's web site at: <http://www.pigfordmonitor.org/orders/20010207order.pdf>.

⁴ The Court's Opinion considers the debt relief USDA is required to implement for certain claimants who have had their loans restructured or who have resolved their loans through a write-down and a shared appreciation agreement. The Court's Opinion is available on the Monitor's web site at: http://www.pigfordmonitor.org/orders/20080221_op.pdf.

⁵ Monitor Update No. 10 is available on the Monitor's web site at: <http://www.pigfordmonitor.org/updates/update10.pdf>. The parties' decision to memorialize the

corrections needed to fully implement debt relief (such as the forgiveness of additional loans or the refund of payments made or offsets taken on loans subject to *Pigford* debt relief), USDA generally will initiate the implementation of those corrections.⁶

Once USDA has completed its substantive review and has implemented any additional debt relief that it identifies as required, USDA forwards the loan records for each claim to be reviewed by Class Counsel and the Monitor. Class Counsel and the Monitor review each claimant's loan history and any other documents necessary for verification of the debt relief provided. If questions arise regarding the appropriate debt relief, USDA, Class Counsel, and the Monitor confer about those questions, either in writing or in regularly scheduled telephone conversations. Once any questions are resolved regarding the appropriate debt relief and the necessary records have been received for verification of USDA's implementation of that relief, the Monitor prepares a summary of the debt relief USDA has implemented. The Monitor provides the summary to USDA and to Class Counsel, and Class Counsel shares the information in the summary with each individual claimant whose debt relief has been reviewed.

B. Tax Implications of Debt Relief

In addition to providing *Pigford* debt relief based upon the substantive rules governing debt relief, USDA has the obligation to send claimants Internal Revenue Service (IRS) Forms

agreements in the July 11, 2008 revised Monitor Update No. 10 is described on page 2 of the Update and on pages 6-7 of the Monitor's Fifth Progress Report on Amended Decisions and Debt Relief Implementation, filed July 11, 2008, and available on the Monitor's web site at: http://www.pigfordmonitor.org/reports/rpt20080711_amenddec.pdf.

⁶ An exception to this general rule occurs in what the parties refer to as "switch" cases. In certain switch cases, when USDA discovers that the agency has mistakenly provided debt relief that was not due a claimant and has failed to provide the debt relief that was due to that claimant, USDA has agreed to provide the claimant's records to Class Counsel and to consult with Class Counsel before taking any corrective action. USDA has further agreed that the agency will not implement the correct debt relief or reverse the mistakenly provided debt relief unless the claimant (through counsel) has agreed to the change. See Monitor Update No. 10, Debt Relief for Prevailing Class Members (rev. July 11, 2008) (regarding correcting mistakes in debt relief).

1099-C reflecting the amount of debt relief provided. For Track A claimants, the Government also has the obligation to deposit funds in a tax account established with the IRS. The tax deposit for debt relief is twenty-five percent of the amount of principal loan forgiveness. Prevailing Track A claimants receive an additional IRS Form 1099-C from the Facilitator for the amount of any tax deposit made on their behalf.

C. Application of Substantive Debt Relief Rules and Tax Law

One challenge in the debt relief implementation work is found in the application of two sets of laws—the substantive law of the case in *Pigford* and tax law. In each claimant’s case, first USDA must apply the substantive rules of debt relief to determine loan forgiveness and refunds, and then USDA must apply tax law to determine the proper timing of taxable events for the issuance of required tax notices. The sources of the substantive debt relief rules are noted above.⁷ The sources of USDA’s obligation to issue IRS Forms 1099-C for discharge of indebtedness are set forth in the Internal Revenue Code,⁸ federal Income Tax regulations,⁹ Internal Revenue Service bulletins,¹⁰ and cases that interpret these provisions.¹¹

The application of the two sets of rules can become particularly challenging when the timing of a transaction is understood one way under *Pigford* debt relief rules and another way for

⁷ As noted above, the substantive rules regarding debt relief are set forth in the Consent Decree, the February 7, 2001 Stipulation and Order, the Court’s February 22, 2008 Opinion and Order, and the agreements of the parties set forth in Monitor Update No. 10, Debt Relief for Prevailing Class Members, as revised on July 11, 2008.

⁸ See IRC §§ 61(a)(12) (defining discharge of indebtedness as income for federal income tax purposes), 6050P (regarding reporting requirements for discharges of indebtedness).

⁹ See Treas. Reg. § 1.6060P-1 (setting forth information-reporting requirements for discharges of indebtedness).

¹⁰ See Rev. Proc. 2008-30, 2008-23 I.R.B. 1056 (providing that, in general, filers should submit corrections for returns filed within the last three calendar years).

¹¹ See *United States v. Kirby Lumber Co.*, 284 U.S. 1 (1931) (regarding the determination of when income is realized for federal income tax purposes); *Cozzi v. Commissioner*, 88 T.C. 435 (1987) (regarding the determination of when a debt has been discharged for federal income tax purposes).

the purpose of federal income tax reporting. For example, the “effective date” for implementation of a claimant’s debt relief may, for the purpose of calculating claimant eligibility for *Pigford* debt relief, be the date of the initial prevailing Adjudicator or Arbitrator decision. Meanwhile, the reporting date of the claimant’s debt relief for federal income tax purposes may be 120 days after the Adjudicator or Arbitrator decision.¹² The parties are working together carefully to make sure that the correct rules are applied in the resolution of substantive debt relief and in the reporting of that relief for federal income tax purposes.

During the past several months, the parties and the Monitor have made progress on both the substantive review of debt relief provided by USDA in individual cases and the creation of a system for managing the tax implications of that debt relief. The parties and the Monitor have also made progress on identifying the list of claimants whose loan records should be reviewed to ensure the appropriate substantive debt relief has been provided. The Monitor summarizes the actions taken in each of these areas below.

II. PROGRESS ON SUBSTANTIVE DEBT RELIEF REVIEW

As of June 15, 2009, USDA had forwarded loan records for review by Class Counsel and the Monitor to verify the substantive debt relief provided in approximately 900 claims. As of June 29, 2009, the Monitor had completed the review process for 650 of those 900 claims and had prepared a summary of the debt relief USDA implemented in each of the 650 claims.

USDA’s implementation of the substantive debt relief review process has demonstrated the value of an individualized review of debt relief. As of June 25, 2009, USDA reports that the agency has implemented additional debt relief for approximately twenty-three claimants as a

¹² A Stipulation and Order filed July 14, 2000, establishes a 120-day deadline for filing petitions for Monitor review from a Track A decision by the Adjudicator or a Track B decision by the Arbitrator. Stipulation and Order, ¶ 5 (D.D.C. July 14, 2000).

result of the debt relief review process.¹³ USDA further reports that the agency has identified another seventy-four claimants who will receive additional debt relief as part of the debt relief review process. USDA has also provided additional debt relief for claimants whose cases were reviewed by the parties as a result of the Monitor's investigation of amended Adjudicator decisions¹⁴ and at the request of an individual claimant or Class Counsel.¹⁵

USDA has indicated that the agency's internal debt relief review process is ongoing, and USDA plans to route loan records for review by Class Counsel and the Monitor at the rate of approximately 100 claims each month.¹⁶ USDA has placed a priority on claimants who have delinquent USDA farm program loans, and the parties have established a process that is working well for applying the substantive rules of debt relief to ensure that each claimant has received the

¹³ The Monitor has received records confirming that, as of June 25, 2009, USDA wrote off an additional \$438,344.26 in principal debt and an additional \$212,667.38 in interest for the twenty-three claimants identified by USDA whose additional *Pigford* debt relief was initiated by the debt relief review process. The additional confirmed loan forgiveness provided by USDA for these twenty-three claimants totals \$651,011.64. The Monitor has not yet received confirmation of the refunds USDA has provided to all of these claimants.

¹⁴ The debt relief review process originated as a result of the parties' review of the loan records of claimants who had received amended Adjudicator decisions. As part of the Monitor's investigation of amended Adjudicator decisions, the Monitor and the parties reviewed the debt relief claimants had received. As a result of this review, five claimants who received amended Adjudicator decisions received additional debt relief. USDA wrote off an additional \$322,390.28 in principal debt and an additional \$60,522.33 in interest for these five claimants. The additional confirmed loan forgiveness provided by USDA for these five claimants totals \$382,912.61.

USDA also refunded \$29,479 for voluntary payments made after the prevailing Adjudicator decision and \$146,869.93 for offsets taken on or after January 1, 1999, that had been applied to loans qualifying for *Pigford* debt relief. The confirmed refunds of voluntary payments and offsets provided by USDA for these five claimants totals \$176,348.93.

¹⁵ Since January of 2008, USDA has provided additional debt relief to six claimants whose debt relief was reviewed as a result of claimants who contacted Class Counsel or the Monitor with questions about their debt relief. As of June 25, 2009, USDA wrote off an additional \$147,802.59 in principal debt and an additional \$59,367.24 in interest for six claimants whose loan records were reviewed at the request of Class Counsel or because the claimants had contacted the Monitor. The additional confirmed loan forgiveness provided by USDA for these six claimants totals \$207,169.83. The Monitor has not yet received confirmation of the refunds USDA has provided to all of these claimants.

¹⁶ USDA has indicated, however, that the agency reserves the right to modify, change, or delay the rate of claims each month.

appropriate debt relief. At the pace projected by USDA, the Monitor anticipates that the debt relief review process for individual claimants will be ongoing throughout 2009 and will continue into 2010.

III. PROGRESS ON MANAGING THE TAX CONSEQUENCES OF DEBT RELIEF

To understand the tax rules that apply to USDA's obligation to issue IRS Forms 1099-C, the parties and the Monitor have consulted with representatives from the IRS Office of Chief Counsel and the IRS Taxpayer Advocate Service. The parties and the Monitor provided general information regarding *Pigford* debt relief to the IRS Office of Chief Counsel and the IRS Taxpayer Advocate Service, and followed up with specific examples of the types of issues that arise in individual claims. The IRS provided the parties and the Monitor with a memorandum that provides guidance on a number of matters.¹⁷ The parties and the Monitor then met in person with representatives from the IRS Office of Chief Counsel and the Taxpayer Advocate Service to obtain clarification about the IRS guidance, focusing on questions regarding USDA's obligation to issue Forms 1099-C for debt relief and the effective date(s) for tax purposes of the debt relief each claimant has received or will receive as USDA's debt relief review process continues.

The discussions with the IRS representatives were helpful to the parties and to the Monitor in clarifying the tax implications of debt relief. The Monitor has shared the guidance received from the IRS Office of Chief Counsel with the Facilitator (who issues the IRS Forms 1099 for cash relief and tax relief). The parties have discussed the IRS guidance and the necessity of issuing corrected IRS Forms 1099 for some claimants.

¹⁷ The Monitor has been informed that the IRS Office of Chief Counsel will publish written guidance on the tax issues presented in this case in a document that will be publicly available. When the IRS guidance document is publicly available, the Monitor will file it with the Court.

The IRS guidance on USDA's reporting obligations for federal income tax purposes does not in any way change or affect any claimant's substantive debt relief rights. However, the IRS guidance clarifies details regarding USDA's obligation to issue IRS Forms 1099-C for federal income tax purposes. The Monitor expects that, once a claimant's substantive debt relief has been implemented, USDA will fulfill its reporting obligation by issuing the necessary IRS Form(s) 1099-C, listing for each case the effective date for federal income tax purposes that best complies with the IRS guidance.

USDA is now working to apply the IRS guidance to determine the appropriate effective dates to use in the IRS Forms 1099-C that must be issued in a group of individual pending debt relief cases. The Monitor expects that significant progress will be made as USDA completes its review of these cases and the parties come to better understand how the IRS guidance should be implemented.

IV. PROGRESS ON LIST OF CLAIMANTS ENTITLED TO DEBT RELIEF REVIEW

As of the end of 2008, according to the Facilitator, approximately 15,156 Track A claimants had prevailed in credit claims before the Adjudicator and had received payment of their \$50,000 cash relief.¹⁸ Approximately twenty-one Track B claimants had prevailed before the Arbitrator and had received payment of a damage award.¹⁹ Under the Consent Decree, each of these prevailing claimants is eligible for consideration for debt relief of certain outstanding

¹⁸ See page 15, footnote 37 of the Monitor's Report Regarding Implementation of the Consent Decree for the Period of January 1, 2008, through December 31, 2008, filed June 17, 2009, and available on the Monitor's web site at: http://www.pigfordmonitor.org/reports/Rpt20090617_2008.pdf.

¹⁹ As of the end of 2008, an additional 71 Track B claimants had settled their claims. See pages 9-10 of the Monitor's Report Regarding Implementation of the Consent Decree for the Period of January 1, 2008, through December 31, 2008, filed June 17, 2009, and available on the Monitor's web site at: http://www.pigfordmonitor.org/reports/Rpt20090617_2008.pdf.

farm program loans.²⁰ The potential eligible universe for debt relief, therefore, includes more than 15,000 claimants.

As of the end of 2008, according to USDA, a total of 363 prevailing claimants (344 Track A claimants and nineteen Track B claimants) had received debt relief in the form of loan forgiveness for one or more USDA farm program loans.²¹ There are a number of reasons why a prevailing claimant who is eligible for consideration for debt relief may not, in fact, receive any loan forgiveness as part of their relief. To receive debt relief, a claimant must have loans that are eligible for *Pigford* debt relief. Some prevailing Track A and Track B claimants may not have obtained a farm program loan from USDA during the relevant time period.²² Other claimants may have obtained farm program loans during the relevant time period that were fully resolved prior to the date the claimant received a final decision in the claims process.²³ Still other claimants may have received farm program loans under a different loan program than the loan program identified in the prevailing claim.²⁴

²⁰ See Consent Decree, paragraphs 9(a)(iii)(A) and 10(g)(ii).

²¹ See page 13 of the Monitor's Report Regarding Implementation of the Consent Decree for the Period of January 1, 2008, through December 31, 2008, filed June 17, 2009, and available on the Monitor's web site at: http://www.pigfordmonitor.org/reports/Rpt20090617_2008.pdf. Many of the Track B claimants who received debt relief (12 of the 19 Track B claimants who received debt relief as of the end of 2008) received their relief as part of a settlement of their Track B claim.

²² For example, a claimant who prevailed on a 1995 loan denial claim may not have received a USDA farm program loan between the date of the prevailing claim (1995) and the end of the class period (December 31, 1996). Any loans the claimant may have received before 1995 or after December 31, 1996 would generally not qualify for debt relief.

²³ For example, a claimant who prevailed in 2004 on a 1983 Operating Loan claim would be eligible for *Pigford* debt relief for all outstanding Operating Loans that were incurred from 1983 to the end of the class period (December 31, 1996). The claimant could have received annual Operating Loans every year from 1983 to 1996, but could also have repaid those loans before the Adjudicator's decision in 2004. Voluntary payments made prior to the initial prevailing Adjudicator decision do not qualify for refund.

²⁴ For example, a claimant who prevailed on an Operating Loan claim generally would not qualify for *Pigford* debt relief for an outstanding Farm Ownership Loan.

The parties have agreed that the debt relief review process should be undertaken for all prevailing claimants who had outstanding farm program loan debt during the class period. The identification of those prevailing class members is complicated for a number of reasons. Loans that qualify for *Pigford* debt relief may be recorded under the name of a spouse, a co-borrower, or a farming entity. In addition, USDA's borrower database has been "purged" to remove records of certain loans that had been fully resolved prior to 1993. USDA retains microfiche records of all loans, but those records are more time-consuming and difficult to access. USDA has reviewed the list of prevailing Track A claimants provided by the Facilitator to identify claimants whose current loan records or whose claim records contain evidence of outstanding farm program loans during the class period. USDA is reviewing its microfiche loan records for claimants whose claim records contained evidence of outstanding farm program loans to determine if the archived records contain evidence of loans that should be reviewed as part of the debt relief implementation process.

The Monitor has also conducted a review of Monitor Track A petition files for evidence of prevailing claimants who received farm program loans. The Monitor identified class members in addition to those identified by USDA, and USDA has undertaken a review of those claims. In addition, the parties have agreed to review the loan records for each prevailing Track B claim. These efforts have identified a list of approximately 2,400 Track A and Track B claimants. The parties have agreed that all claimants on this list will receive a review of their loan files for debt relief purposes. The Monitor will continue to work with the parties to identify all prevailing claimants whose loan files should be reviewed in order to ensure that appropriate debt relief has been provided.

V. CONCLUSION

Progress has been made in the substantive review of individual debt relief files and in the parties' understanding of the tax implications of debt relief. Implementation efforts are important to ensuring that claimants have received the substantive debt relief to which they are entitled.

The Monitor recommends that the Court order the Monitor: (1) to continue in the Monitor's role in the debt relief review process; (2) to continue to work with the parties to help resolve tax issues that arise in individual debt relief cases; and (3) to provide a report to the Court on or before August 28, 2009, regarding these continued efforts and, in particular, on USDA's progress in implementing a system for managing the tax consequences of debt relief.

Dated: June 30, 2009.

Respectfully submitted,

s/Randi Ilyse Roth

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