

# Monitor Update:

## Federal Income Tax and Debt Relief

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**This is not a USDA publication.**

## Federal Income Tax and Debt Relief

### A. Introduction

This Monitor Update discusses briefly the intersection between *Pigford* debt relief and federal income tax rules.<sup>1</sup>

This intersection occurs because the *Pigford* Consent Decree grants prevailing claimants forgiveness of some USDA loans, and also requires the government to make payments to the Internal Revenue Service (IRS) on behalf of those claimants. *Pigford* claimants are subject to federal income tax rules. According to those rules, *Pigford* debt relief may result in taxable income for the claimant.

This Update focuses on a handful of topics.

- First, it describes the most basic rules for *Pigford* debt forgiveness and for federal income tax that affect claimants receiving *Pigford* debt forgiveness.
- Second, it discusses how the interaction between *Pigford* debt forgiveness and federal income tax rules should work.
- Third, it explains why the timing of debt forgiveness is both complicated and important for claimant income taxes.
- Fourth, it describes the purpose of the IRS Form 1099-C that many claimants will receive in the mail.
- Finally, and perhaps most important, it directs claimants to additional resources that can be of help to them.

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<sup>1</sup> Information in this Update is drawn primarily from the Consent Decree and other *Pigford* documents, especially *Pigford* court orders and other Monitor Updates, and an official memorandum from the Office of Chief Counsel at the IRS. All of these documents are available at the Monitor website. The *Pigford* Consent Decree is available at <http://www.pigfordmonitor.org/orders/19990414consent.pdf>; a February 7, 2001, Stipulation and Order, at <http://www.pigfordmonitor.org/orders/20010207order.pdf>; Monitor Update No. 10, "Debt Relief for Prevailing Class Members" (July 10, 2008), at <http://www.pigfordmonitor.org/updates/>; and Memorandum, Office of Chief Counsel, Internal Revenue Service, to Special Counsel to the National Taxpayer Advocate, *Pigford v. Schafer: Debt Relief Issues* (March 12, 2009), at [http://www.irs.gov/pub/lanoa/pmta2009\\_151.pdf](http://www.irs.gov/pub/lanoa/pmta2009_151.pdf).

Understanding the intersection between *Pigford* debt relief and federal income taxes is essential if a claimant's federal income taxes are to be filed correctly.

## **B. Get Expert Income Tax Help**

The topics covered in this Update are complicated. Therefore, claimants facing the issues described in the Update should consult with a federal income tax expert.

In addition, help for claimants on tax issues is available from the National Taxpayer Advocate and from Class Counsel. Contact information for both is available at the end of this Update.

## **C. Pigford Debt Relief in Brief**

The *Pigford* Consent Decree provides for debt relief for some prevailing claimants. For the purpose of this Update, two aspects of debt relief are central: the forgiveness of some USDA loans and, for Track A claimants, payment(s) to the IRS on behalf of the claimant.

### **1. Forgiveness of Claimant Debt**

As part of debt relief, the *Pigford* Consent Decree provides for the forgiveness of some USDA claimant debt. Not all prevailing claimants receive debt forgiveness, and in some cases prevailing claimants receive forgiveness for only a part of their USDA debt.

The *Pigford* debt relief process—the sorting out of which claimant debts are to be forgiven, and which are not to be forgiven—has now stretched out over several years. Some claimants received debt forgiveness as early as 1999, and others are receiving debt forgiveness as this Update is written, in 2009. In addition, some claimants have received debt forgiveness on more than one occasion.

### **2. USDA Tax Payments to the IRS**

The *Pigford* Consent Decree requires USDA to make payments to the IRS on behalf of Track A claimants who receive debt forgiveness. The payment to the IRS is equal to 25 percent of the principal debt forgiven by USDA.

The IRS treats the payment as if it were made by the claimant toward his or her federal income tax.

### **3. For More Information on Debt Relief: See Monitor Update No. 10**

The above explanation only touches on the most basic aspects of *Pigford* debt relief. For detail about how debt relief works, see Monitor Update No. 10, "Debt Relief for Prevailing Class Members."<sup>2</sup>

See, as well, the contact information at the end of this Update for further assistance regarding *Pigford* debt relief.

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<sup>2</sup> Available at <http://www.pigfordmonitor.org/updates/>.

## **D. Federal Income Tax Law in Brief**

*Pigford* debt forgiveness can affect the federal income tax a claimant may owe.

### **1. Debt Forgiveness Can Mean “Debt Cancellation” Income**

The IRS sees *Pigford* debt forgiveness as a form of what federal income tax law calls “debt cancellation.”<sup>3</sup> The IRS considers debt cancellation a form of income, much like the salary from a job, or proceeds from the sale of crops, are considered income.

The extent to which *Pigford* debt forgiveness turns out to be taxable income can vary greatly from person to person. For example, *Pigford* debt forgiveness will almost always include both principal and interest. Because *Pigford* debts were made for farming purposes, it is possible that only forgiveness of the principal part of the debt is considered income by the IRS.

There are other complicated rules regarding how debt cancellation affects taxes owed by a claimant. For example, some or all of the cancelled debt may be excluded from income if the debt was incurred for the claimant’s farming business or if the claimant is financially insolvent.

### **2. IRS Form 1099-C and *Pigford* Debt Forgiveness**

Federal income tax law requires USDA to use what is known as IRS Form 1099-C to report the amount of *Pigford* debt forgiveness if the forgiveness is for \$600 or more. The purpose of IRS Form 1099-C is to let the *Pigford* claimant and the IRS know exactly what debts are forgiven and in what tax year the forgiveness took place. Both of these pieces of information—how much debt is forgiven, and in what year—are essential if the claimant is to file his or her federal income taxes correctly.

IRS Form 1099-C reports the total amount of debt cancelled—both principal and interest. It also gives the date of debt cancellation for tax reporting purposes. It is sent to both the claimant and the IRS.

### **3. Consult an Income Tax Expert**

Although the IRS says that debt cancellation—including *Pigford* debt forgiveness—can be taxable income, figuring out how debt cancellation affects a person’s taxes can be very complicated.

To make sure federal income tax filings are correct, and to deal with the IRS, the agency that administers tax law, claimants should consult a tax expert.

In addition to a tax expert, claimants may want to contact the National Taxpayer Advocate or Class Counsel. Contact information for both is at the end of this Update.

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<sup>3</sup> IRS Form 1099-C refers to “Cancellation of Debt.” IRS rules also sometimes call debt forgiveness “discharge of indebtedness.” See, for example, IRS Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment) (revised March 2009).

## **E. *Pigford* Debt Relief and Federal Income Taxes—How It Should Work in Theory**

Several basic steps that should occur every time a *Pigford* claimant is eligible for debt forgiveness are described below.

### **1. *Pigford* Debt Identified and Forgiven**

The Consent Decree and other *Pigford* documents set out how *Pigford* debt relief works.

Some prevailing *Pigford* claimants with outstanding USDA farm loan debt will have at least part of that debt forgiven. The rules governing *Pigford* debt forgiveness are described generally in Monitor Update No. 10, "Debt Relief for Prevailing Class Members."<sup>4</sup>

### **2. USDA Makes Payments to the IRS**

The Consent Decree orders USDA to make payments to the IRS on behalf of Track A claimants who receive debt relief. The payments are equal to 25 percent of the principal forgiven under *Pigford* debt relief.

For example:

Suppose debt relief for a Track A claimant is \$5,000. One thousand dollars of this total is interest that had accumulated over time, and \$4,000 is the remaining principal on a loan. USDA forgives the entire \$5,000. Since 25 percent of \$4,000 is \$1,000, USDA contributes \$1,000 to the IRS on behalf of the claimant to be applied to any taxes the claimant might owe.

Track B claimants are not entitled to a tax payment for debt relief.

### **3. USDA Sends IRS Form 1099-C to *Pigford* Claimants and the IRS**

After the debt to be forgiven is identified, USDA sends claimants an IRS Form 1099-C. The same form is sent to the IRS. This is the way both the claimant and the IRS learn how much claimant debt was forgiven and when the forgiveness—for income tax purposes—took place. It is therefore an important tax document.

The year after USDA makes a payment to the IRS on behalf of a claimant receiving debt forgiveness, an additional IRS Form 1099-C is sent to the claimant and the IRS to report the tax payment. The IRS considers the tax payment income.

### **4. Claimants File Federal Income Taxes**

Using IRS Form 1099-C and other documents, the claimant files his or her federal income tax forms. The extent to which *Pigford* debt forgiveness turns out to affect the federal income taxes of a claimant varies greatly from person to person and circumstance to circumstance. Even in the simplest case, farm taxes and debt cancellation tax law is complicated. As noted above, therefore, *Pigford* claimants should consult an expert on federal income taxes.

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<sup>4</sup> Available at <http://www.pigfordmonitor.org/updates/>.

## **F. Timing of Debt Relief—a Central Problem for Federal Income Tax**

For *Pigford* claimants, the timing of debt forgiveness is both important and complicated.

### **1. Timing of Debt Forgiveness “Realization”**

From the viewpoint of the IRS, an important question for *Pigford* debt forgiveness is when the cancellation of *Pigford* debt is “realized.” Realization of debt forgiveness essentially means that the claimant’s right to debt forgiveness is final and cannot be taken away.

One might think that it would be easy to identify the year in which *Pigford* debt forgiveness for a particular claimant is realized. Unfortunately, settling on a date on which *Pigford* debt forgiveness is realized is more difficult than it may seem at first.

### **2. When *Pigford* Debt Forgiveness Is Realized for Income Tax Purposes**

The question to be answered for each *Pigford* claimant who receives debt forgiveness is: when is *Pigford* debt cancellation realized for federal income tax purposes? The IRS has provided legal guidance on how to answer this question.

In general, the date when *Pigford* debt forgiveness is realized can be based on one of four possible events:

- a. the date of a final decision on the claimant’s individual case;
- b. the date of a specific order issued by the Court;
- c. the date of an agreement on a general rule regarding how *Pigford* debt relief works; or
- d. the date of an agreement in an individual claimant’s case.

A claimant’s right to debt forgiveness is made final by one of these dates, which means that debt forgiveness is realized on that date.

It is also the case that a claimant can have a number of different realization dates because part of the forgiveness was realized on a certain date, and another part of the forgiveness was realized on a different date.

Each of the four realization possibilities is discussed briefly below.

#### ***a. Adjudicator or Arbitrator Decision Is Final***

For many *Pigford* claimants, the realization of debt cancellation occurs when a decision by the Adjudicator or Arbitrator that resulted in debt forgiveness becomes final.

The question of when a *Pigford* decision becomes final is itself sometimes challenging to answer. In general, if the claimant prevails with the Adjudicator or Arbitrator, and no petition to the Monitor is filed, the IRS concludes that the decision is final, and the debt cancellation is realized 120 days after the decision is issued.

For example:

Suppose the Track A decision by the Adjudicator approving the claim is issued on October 1, 2007. The 120-day period for USDA to file a petition to the Monitor

expires on January 29, 2008. USDA does not file a petition. The decision is final on January 29, 2008, and the debt cancellation income is realized in 2008.

In many cases, however, a petition is filed by either the claimant or the government with the Monitor in an effort to have the decision changed. The finality of an Adjudicator or Arbitrator decision therefore depends on whether a petition to the Monitor is filed.

For example, when the claimant prevails on an Adjudicator or Arbitrator decision, a petition to the Monitor is filed, and the Monitor denies the petition, the decision is final and debt cancellation is realized when the Monitor issues a decision.

If the claimant receives a decision from the Adjudicator or Arbitrator, a petition to the Monitor is filed, and the Monitor grants the petition, the Adjudicator or Arbitrator will issue a decision on reexamination. In such a case, the decision is final, and the debt cancellation is realized when the Adjudicator or Arbitrator issues a reexamination decision.

#### ***b. Pigford Court Order Regarding Debt Forgiveness***

A number of court orders issued by the Judge in the *Pigford* case address debt forgiveness. As a result, for some claimants, the IRS considers the date of a *Pigford* court order as the date a claimant realizes cancellation of indebtedness income.

In general, *Pigford* rules say that debt relief is provided for loans that were directly affected by discrimination. A Stipulation and Order issued by the Court on February 7, 2001, clarifies debt relief further. The February 7, 2001, Stipulation and Order stated that if the claimant received loans through the same loan program after the loan that was directly affected by discrimination, those loans are also eligible for debt forgiveness. Forgiveness of these loans is sometimes called "forward sweep" debt forgiveness.<sup>5</sup> The IRS has concluded that, for federal income tax purposes, forward sweep debt relief resulted from the February 7, 2001, Stipulation and Order. As a result, for many claimants, forward sweep debt relief is realized in 2001.

So, for example:

Suppose a claimant prevailed on a claim concerning the denial of a 1981 Operating Loan and that the Adjudicator issued a decision on January 10, 2000. Suppose also that the claimant has an outstanding Operating Loan that originated in 1985. As a result of "forward sweep," the claimant is entitled to debt forgiveness of the 1985 Operating Loan. The date on which the claimant realized cancellation of indebtedness income is February 7, 2001.

#### ***c. Agreement on a General Rule Regarding Debt Forgiveness***

After the *Pigford* Consent Decree was signed, lawyers for the class and the government ironed out some agreements as to how *Pigford* debt forgiveness should work. These agreements could be said to have filled in some of the gaps of the Consent Decree as far

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<sup>5</sup> For details, see Update No. 10 at <http://www.pigfordmonitor.org/updates/>.

as debt forgiveness is concerned. They apply to the whole class in general, and not just to a certain claimant. The IRS considers the date of this type of agreement as the date some claimants realize cancellation of indebtedness income.

For example, a revised version of Monitor Update No. 10, "Debt Relief for Prevailing Class Members," was released on July 11, 2008.<sup>6</sup> It set forth a number of general agreements reached by the lawyers for the class and the government as to how debt forgiveness should work, and discusses which claimant loans should be forgiven in certain situations.

According to the IRS, claimants who receive debt forgiveness based on some of the rules agreed to and described in Monitor Update No. 10 realize a cancellation of indebtedness in 2008, the year the agreement was reached and the revised Update was issued.

#### ***d. Agreement on a Case-by-Case Basis***

In still other cases, lawyers for the class and the government do not at first agree on the debt forgiveness that a particular claimant should receive. If there is a disagreement on how *Pigford* debt relief rules should be applied to an individual claimant, but lawyers for the class and the government later reach agreement on the debt relief that should be provided to that claimant, the IRS considers the date of the agreement as the date the claimant realizes a cancellation of indebtedness income.

### **3. IRS Form 1099-C Should Tell Claimants When Forgiveness Realized**

The above sections discuss in some detail when *Pigford* debt forgiveness is realized for income tax purposes. As noted above, the date on which *Pigford* debt forgiveness is realized is important when a *Pigford* claimant files his or her taxes. An IRS Form 1099-C sent to the claimant by USDA should take into account all of the factors described above, and should give the claimant the correct date for when his or her debt forgiveness is realized.

Claimants who believe their IRS Form 1099-C is in error should talk with an income tax expert and should consider contacting Class Counsel. Contact information for Class Counsel is at the end of this Update.

### **4. Administrative Delay—No Effect on Realization Date**

In some cases, the claimant's decision is final, and under the rules that apply for *Pigford* the claimant should receive debt forgiveness. Instead of getting debt forgiveness right away, however, there is a delay in the implementation of the debt forgiveness. If the reason debt

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<sup>6</sup> Available at <http://www.pigfordmonitor.org/updates/>.

forgiveness is not implemented right away is what the IRS calls “administrative delay,” the delay in implementation does not change the date of realization.

For example, debt cancellation realization often takes place when an Adjudicator decision that triggered debt forgiveness is final. If after an Adjudicator’s decision some form of administrative delay slows the actual cancellation of the claimant’s debt, this delay does not affect the year in which a claimant realizes cancellation of indebtedness income. The date of realization is still the date when the Adjudicator decision was final.

### **G. IRS Form 1099-C Information Returns**

If debt is forgiven under *Pigford*, federal tax law requires USDA to send to the claimant an IRS Form 1099-C if the debt forgiven is \$600 or more.

#### **1. IRS Form 1099-C and the Year Debt Cancellation Is Realized**

The purpose of an IRS Form 1099-C, as noted above, is to let the *Pigford* claimant and the IRS know exactly what debt is forgiven, and in what year the debt cancellation is realized. With this information a claimant can properly file his or her federal income tax return.

#### **2. IRS Form 1099-C and a New Round of Debt Cancellation**

Beginning in 2008, USDA, Class Counsel, and the Monitor started reviewing the loan records and debt forgiveness provided to prevailing *Pigford* claimants. As a result of this review, some claimants may receive additional debt cancellation or may receive debt cancellation for the first time. If, as a result of the review, USDA cancels claimant debt, USDA must send the claimant and the IRS an IRS Form 1099-C.

#### **3. Correcting an Already-Issued IRS Form 1099-C**

In some cases, a claimant may receive additional debt relief on a loan for which the claimant already received an IRS Form 1099-C. If the additional debt relief makes an earlier IRS Form 1099-C incorrect, USDA may correct the previously issued IRS Form 1099-C rather than issue a new IRS Form 1099-C. USDA will only issue corrected IRS Forms 1099-C if the previously issued form was filed within the last three calendar years.

Legal guidance issued by the IRS suggests that USDA incorrectly identified the tax year in some previously issued IRS Forms 1099-C.<sup>7</sup> According to the IRS legal guidance, a corrected IRS Form 1099-C with the correct tax year should be issued if the previously issued form was filed within the last three calendar years.

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<sup>7</sup> See Memorandum, Office of Chief Counsel, Internal Revenue Service, to Special Counsel to the National Taxpayer Advocate, *Pigford v. Schafer*: Debt Relief Issues (March 12, 2009), available at [http://www.irs.gov/pub/lanoa/pmta2009\\_151.pdf](http://www.irs.gov/pub/lanoa/pmta2009_151.pdf).



## **H. For More Information**

Claimants interested in more information on the interaction between *Pigford* debt relief and federal income tax should ask for additional help. The following resources are available.

### **1. Income Tax Experts**

As noted above, *Pigford* claimants with debt relief should consult a tax expert. Tax experts may include, for example, certified public accountants (CPAs) who assist people with their taxes.

### **2. Class Counsel**

Claimants in *Pigford* are represented by Class Counsel. Class Counsel can be contacted at 1-866-492-6200.

### **3. National Taxpayer Advocate**

The Taxpayer Advocate Service is an independent organization within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should. Each state, the District of Columbia, and Puerto Rico has at least one Local Taxpayer Advocate, who is independent of the local IRS office and reports directly to the National Taxpayer Advocate. If a claimant has difficulties resolving a tax issue with the IRS, the claimant should contact the Taxpayer Advocate Service at 1-877-777-4778 or TTY/TTD 1-800-829-4059. Their website is <http://www.irs.gov/advocate/>. Either the claimant or the claimant's tax adviser should feel free to contact the Taxpayer Advocate Service.

### **4. Monitor**

The Monitor's office is unable to provide tax advice to claimants. For questions about *Pigford* debt relief or other matters related to *Pigford*, feel free to contact the Monitor's office at 1-877-924-7483.