United States Department of Agriculture
Farmers Home Administration
Washington D.C. 20250

FmHA AN No. 2108 (1951)

June 28, 1990

SUBJECT: Income Tax Liability Resulting from Debt Write-Down

TO: State Directors, District Directors and County Supervisors

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide some general guidance on how to consider a borrower's submission of estimated tax liability in the calculation of debt write-down. A recent audit by the Office of Inspector General (OIG) reported that Farmers Home Administration's (FmHA) field offices were not uniformly considering the effects of income tax liability resulting from debt write-down in the processing of debt restructuring offers. In one case, an accountant's estimation of $32,000 tax liability on a write-down of $33,000 was accepted and used in determining the feasibility of a borrower's farm plan. The intended outcome is to prevent the inclusion of unreasonable estimates of tax liability resulting from write-down in the borrower's farm plan and the DALR$ program.

COMPARISON WITH PREVIOUS AN:

There is no previous AN on this subject.

IMPLEMENTATION RESPONSIBILITIES:

FARMERS HOME ADMINISTRATION'S PERSONNEL SHOULD NOT GIVE TAX ADVICE TO BORROWERS. SINCE MOST FmHA PERSONNEL HAVE LIMITED KNOWLEDGE OF TAX LAWS, BORROWERS SHOULD BE REFERRED TO PROFESSIONAL TAX CONSULTANTS FOR ADVICE.

As stated in Exhibit F of Subpart S of Part 1951, debt write-down may result in added Federal income tax liability to the borrower. The Internal Revenue Service treats forgiven debt as taxable income under certain conditions. A borrower offered write-down on Exhibit F, therefore, may submit an estimate of Federal income tax attributable to debt write-down, so the County

EXPIRATION DATE: May 31, 1991

FILING INSTRUCTIONS:
Preceding FmHA
Instruction 1951-S

Supervisor can more accurately determine the feasibility of the borrower's farm plan. Documentation supporting the tax estimate must accompany the estimate. The County Supervisor may accept the estimate only if the following conditions are met:

1. No estimate will be accepted which exceeds 33 percent for individuals, or 34 percent for corporations, of the principal debt written down. These percentages represent the maximum tax rates.

2. No estimate will be accepted which includes tax on interest debt written down.

3. Consideration of the tax estimate will not delay FmHA's 60-day response time to the borrower.

If the estimate is accepted, the County Supervisor will change the borrower's farm plan accordingly and rerun DALR$ to determine if additional write-down is necessary or whether net recovery buyout should be offered instead. If the estimate is not accepted, the borrower still may accept FmHA's offer of write-down within the 45 days as specified on Exhibit F.

The tax consequences of write-down and their effect on the feasibility of farm plans and 1951-S servicing are complicated matters which we will be addressing in a proposed rule in the near future. If you have any questions, please contact Johnny Toles, Farmer Programs Loan Servicing and Property Management Division at FTS 475-4014.

for

LA VERNE AUSMAN
Administrator

Sent by Time Delay Option to States at 1:00 pm on 7/2/90; to Districts at 3:00 pm on 7/2/90; and Counties at 9:00 am on 7/3/90 by ASD.