

DATE: 05-08-91

CITATION: VAOPGCPREC 54-91
Vet. Aff. Op. Gen. Couns. Prec. 54-91

TEXT:

Reporting Waived Loan Guaranty Debts to the Internal Revenue Service

QUESTION PRESENTED:

Should VA report waived loan guaranty debts to the Internal Revenue Service (IRS)?

DISCUSSION:

1. When VA pays a claim under a home loan guaranty, the Secretary becomes subrogated to the rights of the loan holder to the extent of amounts paid under the guaranty. 38 U.S.C. § 1832(a)(1). By regulation, VA has also provided that any amount paid by VA on behalf of a veteran under a guaranty becomes a debt owing to the Government by the veteran. 38 C.F.R. § 36.4323(e).

2. The statute further provides that VA "shall ... waive payment of an indebtedness" of a veteran or spouse arising under the VA loan guaranty program if the Secretary "determines that collection of such indebtedness would be against equity and good conscience." 38 U.S.C. § 3102(b). Waiver is precluded, however, if there is an indication of fraud, misrepresentation, or bad faith. 38 U.S.C. § 3102(c).

3. The discharge of a debt is generally considered to be taxable income to the debtor under section 61(a)(12) of the Internal Revenue Code. There are, however, certain exceptions specified in other sections of the tax code, the IRS regulations, and various administrative rulings and court decisions. This office is aware of one IRS ruling which held that VA's waiver of a loan guaranty debt was "in the nature of a relief payment made for the promotion of the general welfare and the amount waived is not includible in the veteran's gross income for federal income tax purposes." IRS Letter Ruling 8839026 (September 30, 1988). That ruling states, however, " t his ruling is addressed only to the taxpayer who requested it.... I t may not be used or cited as precedent." 26 U.S.C. § 6110(j)(3).

4. Determinations as to whether or not the waiver of a particular debt

constitutes taxable income must be made by IRS, and not this office. We, thus, do not consider it appropriate for us to provide an opinion as to whether or not such a waiver is, in fact, a taxable event.

5. Office of Management and Budget (OMB) Circular A-129 (revised November 25, 1988), page 41, provides that "Agencies shall report to IRS any written-off debt not discharged through bankruptcy...." In your memo, you inquired whether or not this provision is "legally mandatory." In the strictest sense, it is not. Neither the Internal Revenue Code nor the IRS regulations mandate such reporting. The only requirement for such reporting that our research found was OMB Circular A-129. That circular is not a regulation published in the Federal Register, and does not have the force and effect of law. Nevertheless, the courts have recognized that agencies do not always speak through formal regulations. Agencies often issue guidelines, manuals, and various other directives which are entitled to great weight, and can be binding on persons who have actual notice of them.

6. Therefore, while OMB Circular A-129 may not have the force and effect of law, it does represent "an internal executive branch directive." Department of the Treasury v. Federal Labor Relations Authority, --- U.S. ---, 110 S.Ct. 1623, 1626 (1990). Department officials and employees are generally bound to follow these policy pronouncements in the absence of a contrary law or other compelling reason.

7. The reporting of a waiver to IRS by VA does not constitute a determination that either the waiver must be reported to IRS by the taxpayer, or that the waiver is taxable income. In this regard, we understand that, in the past, VA advised veterans that waivers are taxable and must be reported to IRS. This office strongly urges that VA revise all appropriate forms and letters, and instead advise veterans that the waiver may result in taxable income. Veterans should be advised to consult a tax professional regarding their situation. The ultimate decision as to the taxability of a debt waiver will be made by IRS or the courts on a case-by-case basis.

8. In view of the foregoing, it is the opinion of this office that VA should comply with OMB Circular A-129, and report all loan guaranty debt write-offs, unless VA reasonably believes there was not a valid and enforceable debt to write off.

8. We understand that, in many instances, when veterans contact VA and challenge the validity of loan guaranty debts, such letters are considered to be requests for waiver. VA often does not directly respond to the challenge, but rather waives the debt. This procedure may complicate the issue of reporting waivers to IRS.

9. An argument could be made that, since 38 U.S.C. § 3102(b) provides that VA "shall" waive debts whose collection is deemed to be against equity and good conscience, the debt was never enforceable, and thus the waiver should not be reported. We do not concur with that reasoning. Equitable considerations such as equity and good conscience do not go to the underlying legal validity of the debt. Rather, they provide the veteran a form of administrative relief from an otherwise valid legal debt.

10. The following are examples of loan debt write-offs this office believes should not be reported to IRS:

a. Cases where VA is unable to establish a debt because the veteran was not given the constitutionally mandated notice of the foreclosure proceeding. See: DVB Circular 20-86-14 which discusses United States v. Whitney, 602 F.Supp. 722 (W.D.N.Y.1985).

b. Cases arising in states where, under court rulings, VA is precluded by State law from enforcing its indemnity regulation. At present, this only applies to nonjudicial foreclosures in Washington State and Alaska. Recent court decisions have applied these principles to Idaho, Minnesota, and Wisconsin. Appeals are pending in those states. We understand that, in those jurisdictions, waiver requests are on hold pending the final outcome of the class actions.

11. Because of the uncertainty, consideration may be given to having the Secretary request an opinion from the IRS regarding the taxability of VA loan guaranty debt waivers. This office has discussed this matter informally with the Office of the Chief Counsel of IRS. We were told that VA may request such an opinion. This office would be pleased to draft an appropriate request to IRS.

HELD:

VA should comply with OMB Circular A-129 and report loan guaranty debt write-offs to IRS. Absent more specific guidance from IRS, VA should report all such write-offs unless VA reasonably believes there was not a valid and enforceable debt to write off. VA may want to consider requesting further guidance from IRS.

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