

## 2007 Tax Questions Related to Bankruptcy Settlement Claims and Attorney's Fees

We have frequently been asked various versions of the following two questions, but since DP3 trustees are not qualified or permitted by our charter to give tax advice, we asked our CPA to offer his opinion. These tax issues are between you and your personal accountant or tax advisor, so we will be unable to offer further explanation or answer your individual questions about these issues.

**Please note: Dollar amounts used in this example are for illustration purposes only. Your individual stock basis and claim value may differ. Consult your own tax advisor about these issues when filing your personal tax return.**

**Q1.** As you know, Delta credited each retired pilot and issued a W2 for the gross dollar value of his or her claims for lost non-qualified pension benefits and lost medical benefits. Delta then withheld 25% federal and 6% state (GA) taxes of the gross claim award before issuing 225 shares of New Delta stock per \$10,000 of net claim. The stock was then deposited into each pilot's Fidelity account and worked out to a value of \$19.56/share. **The question is: if the pilot then sells his stock, is the stock basis the gross value of his underlying claim, i.e. the gross amount as reported on the W2 or the net value deposited into his account?** Example, 300K gross claim award, 93K withheld for state and fed tax, 207K converted to 10,588 shares @ \$19.56/share. The pilot next day sells his 10,588 shares for 18.00/share netting \$190,588 cash. Is his short-term loss \$109,411 based on the gross 300K basis or \$16,442 based on the actual stock deposited into his Fidelity account?

**A1.** The value of the Delta stock on the day it was included as income in your W-2 will be considered your basis in the stock. When this stock is sold, you will recognize capital gain on the difference between what you sold it for and your basis. In order to pay the payroll taxes, Delta had to sell a portion of your stock and remit the proceeds to the taxing authority. When this transaction occurred, you were deemed to have sold enough shares to cover this tax payment. There was no gain or loss on this sale because the basis in the stock was the same as the sales price.

The remaining shares that were transferred to you will have a basis of \$19.56/share as you list in your example. When you sell these, you will recognize a capital gain or loss between the total basis of the remaining shares and the gross proceeds from these shares. In your example, you are only entitled to a loss of \$16,442 because that is the amount related to the shares which were transferred to you. The shares that were sold to pay taxes did not produce any gain or loss when sold because they were sold at the same price as your basis.

**Q2.** In short recap, the attorneys received 10% of the Administrative claim which was paid in cash and 8% of the pre pension plan termination claim. No attorney's fees were awarded for the post termination claim. The question is: **can the pilot deduct his share of the attorney's fees awarded by the court?** Example: after court awarded attorney fees, a pilot received \$4,500 cash for the Administrative claim, and a stock award equal to \$46,000 for the pre-termination claim. Absent attorneys fees he would have received \$5,000 cash and \$50,000 in stock. Is the difference deductible?

**A2.** The reduction of the pilot's claim that relates to attorneys fees will not be deductible by the pilots. The pilots only received the claim net of attorney's fees, so they never paid taxes on the gross amount. This actually works out better for the pilots because the fees have essentially already been deducted in that the pilots are only paying taxes on what they actually received.