

REPAYMENT TO THE D&S PLAN TRYING TO SOLVE THE TAX PROBLEM

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This article relates only to pilots receiving LTD benefits from the D&S Plan

The final benefit determination by the Pension Benefit Guaranty Corporation (PBGC) has revealed that a number of pilots were underpaid by the PBGC in previous years; therefore, the PBGC will make a lump sum payment of the aggregate underpayment to date and increase the amount of future benefit payments. Because Delta retirement benefits reduce LTD benefits on a dollar for dollar basis, the adjustment by the PBGC necessitates repayment of amounts that were “overpaid” from the D&S Plan.

There is a potential taxation problem that should be discussed with your tax professional. Without giving tax advice, this article will discuss issues relating to the taxation problem.

PROBLEM:

1. In past years, LTD pilots were overpaid by the D&S Plan and paid federal and state taxes (where state taxes were applicable) on that income.
2. Make-up payments from the PBGC are taxed as income for the year in which they are received even though an equivalent amount has to be repaid the D&S Plan.
3. IRS Publication 15 indicates that the repayment of overpayments received in previous years cannot legally be deducted from this year’s W-2 income. Additionally, filing amended tax returns for previous years is not the appropriate remedy to recover previous excess tax payments.

The following is an excerpt from IRS Publication:

“The wages paid in error in the prior year remain taxable to the employee for that year. This is because the employee received and had use of those funds during that year. The employee is not entitled to file an amended return (Form 1040X) to recover the income tax on these wages. Instead, the employee is entitled to a deduction (or credit in some cases) for the repaid wages on his or her income tax return for the year of repayment.”

IRS Publication 525, pages 36-37, details the manner in which the repayment can be reported. You may want to have your income tax professional refer to that section.

If the repayment is less than \$3,000 in a given year, the individual may have difficulty recovering all of the excess taxes that were paid previously. According to IRS Pub 525, repayments of less than \$3,000 are entered under a section of Schedule A (itemized deductions) that is subjected to an offset in the amount of 2% of adjusted gross income.

If the repayment amount in a given year exceeds \$3,000, IRS Pub 525 indicates that there are two options for recovering the taxes paid on overpayments received in previous years.

1. The \$3,000+ amount of repayment can be entered on Schedule A, line 28 (which is not subject to offset by 2% of adjusted gross income). In the event that overall itemized deductions are limited as a result of taxpayer's adjusted gross income, the previous overpayment of taxes possibly will not be fully recovered under this option.
2. The alternative procedure outlined in IRS publication 525 may be cumbersome if the overpayments were received over several tax years. The amount of overpayment for a given year can be deducted from taxable income of that given year and a revised tax liability calculated for that year. The differential between the taxes that were paid for that year and the revised tax liability for that year becomes a tax credit for the year in which repayment is made. The same process is used to determine tax credits relating to each year that overpayments were received. This process may require recalculating tax liabilities for years 2006 through 2010.

It certainly would be easier if Delta could reduce D&S Plan taxable income for the year in which repayment is made by the amount of such repayment. Apparently, the IRS will not allow such a process.

This article is not giving tax advice as is not to be relied upon as such. Some of the information in the article may be useful in understanding problems relating to overpayment from the D&S Plan; however, your professional tax advisors should assist you in making decisions relating to filing your tax returns.