# Analysis of Proposed Legislation to Allow Rollover of Distributions Received by Air Line Employees in Respect of Bankruptcy Claims, Notes or Fixed Obligations

## Available Data and Empirical Research

**Report prepared for the
Air Line Pilots Association, International**

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# I. OVERVIEW

The aftermath of the events of September 11, 2001 created overwhelming economic hardship for many domestic airlines. As a result, 19 domestic airlines filed for bankruptcy to relieve the pressure of their debts and other obligations.[1]

In the process of emerging from bankruptcy protection, five major airlines terminated or (hard) froze their employees' defined benefit pension plans. The defined benefit plan terminations effectively eliminated many employees' accrued benefits and both the plan terminations and freezes eroded employees' future financial security. In addition, this loss of retirement security followed long periods of contract negotiations where airline management extracted significant wage and benefit concessions from their employees. These concessions were thought to be a means of preventing the bankruptcy filing. However, in most cases, these concessions did not prevent the bankruptcy, but merely reduced wages and benefits prior to the filing.

In 2001, Congressional relief focused exclusively on commercial airline carriers offering loan packages and other economic relief. In 2004, the Congress provided partial funding relief for defined benefit plans sponsored by commercial passenger airline carriers. In 2006, the Congress provided additional assistance to those commercial passenger airline carriers that will continue their defined benefit plans.

However, past Congressional actions will never restore the lost retirement benefits for those airline workers whose defined benefit plans were terminated or frozen. This is an important point to emphasize. The actions already taken by the Congress to provide economic relief to the airlines and to reduce their future pension contributions for the continuing plans do not restore benefits to those airline workers that lost pension benefits in plans which were terminated or frozen.

The proposed legislation addresses this inequity by providing an additional retirement savings option to those airline workers whose defined benefit plans were terminated or frozen in bankruptcy proceedings. These airline workers would benefit to the extent that they would individually choose to rollover certain bankruptcy payments received into a traditional or Roth individual retirement account.

The intent of the proposed legislative change is to provide this retirement savings opportunity only to those airline employees for whom the bankruptcies imposed an economic burden through the substantial loss of retirement benefits. Finally, this opportunity would be available only to those airline employees receiving the

[1] The results of this research indicated that there were 21 bankruptcy filings during the period after September 11, 2001, and before January 1, 2007. However, there were only 19 airlines, as US Airways and Independence Air filed bankruptcy twice during this period.

bankruptcy payments from airlines filing bankruptcy after September 11, 2001, and prior to January 1, 2007.

The proposed changes provide targeted relief only to those employees who lost retirement benefits and received payments in respect of bankruptcy claims, notes, or fixed obligations of the carrier. The legislative relief is not only limited in scope (with respect to eligible employees and eligible amounts), but it is also a closed benefit (ceases to be available for bankruptcies filed after December 31, 2006).

The purpose of this document is to define carefully the empirical and background information that supports this legislative change. The document details the process by which eligible airline employees and eligible amounts are identified. In addition to providing supporting empirical information, the document provides background information of independent empirical research to help predict the likely behavioral response of eligible airline employees to this proposal.

This information will make possible a more accurate revenue analysis of the provision. Defining clearly the eligible airline employees and eligible amounts makes an accurate assessment of the budgetary impact both possible and straightforward.

# II. LEGISLATIVE CHANGES

***Airline Employee Rollover Provision*** **–** The proposed legislation would allow rollover of distributions received by airline employees in respect of bankruptcy claims, notes, or fixed obligations. The eligible rollover amount would not be includible in gross income for the taxable year in which it was received by the airline employee to the extent that amounts are transferred to a traditional IRA, but would be includible in gross income to the extent that amounts are transferred to a Roth IRA (see below).

For purposes of the proposal, a qualified airline employee is defined as an employee or former employee of a commercial passenger airline carrier who participated in a qualified defined benefit plan that has been terminated or that is frozen and subject to accrual restrictions as provided in section 402(b)(2) and (3) of the Pension Protection Act of 2006. The eligible rollover amount is defined as a distribution of money or other property to a qualified airline employee in respect of a bankruptcy claim, note or fixed obligation of the carrier.

Under the proposal, amounts received in respect of a bankruptcy claim, note, or fixed obligation from a commercial passenger airline carrier are eligible amounts if they are paid to a qualified airline employee under the approval of an order of a Federal bankruptcy court in a case filed after September 11, 2001, and before January 1, 2007. Such claim, note or fixed obligation shall not be based on the airline carrier's future earnings or profits.

The eligible rollover amounts received by the employee are subject to employment taxes even if rolled over to an IRA. These amounts shall be included in the definition of "wages" under section 3121(a) of the Internal Revenue Code, unless otherwise exempt.

A qualified airline employee may elect to transfer any portion of an eligible rollover amount to a Roth IRA without regard to his or her AGI. Any such transfer to a Roth IRA shall be treated as a qualified rollover contribution. To the extent transferred to a Roth IRA, the eligible rollover amount shall, at the election of the qualified airline employee, be includible in gross income entirely in the year of payment or 50 percent in the year succeeding the year of payment and 50 percent in the second year succeeding the year of payment. The transfer of an eligible rollover amount must be made within 180 days after the later of receipt of payment or date of enactment.

Commercial passenger airline carriers shall report to the Secretary of the Treasury the eligible rollover amounts paid to each qualified airline employee for each year, and shall provide an individual report to each qualified airline employee. Such reports shall be due within 90 days after the later of date of payment or date of enactment.

# III. SUPPORTING DATA AND EMPIRICAL RESEARCH

Identifying those airlines that filed for bankruptcy during the period (cases filed after September 11, 2001, and before January 1, 2007) and their eligible employees requires several steps. These steps are meant to ensure that the legislation targets relief to those airline employees meeting very specific criteria.

To verify the scope of the legislation, the research considered all domestic airlines and conducted a detailed process of elimination. This process created a finite list of those airlines making payments in consideration for bankruptcy settlements that would specifically qualify for this proposed legislative change.

## A. Eligible Airlines

***Determining the Universe of Eligible Airlines*** – The first step in the elimination process began by identifying the approximate 141 domestic airlines in operations in the US (Table A-1 displays the list of domestic airlines).

After identifying the universe of domestic airlines, the second step in the elimination process was to identify those airlines that filed bankruptcy during the applicable period. The results of this research indicated that there were 21 bankruptcy filings during the period after September 11, 2001, and before January 1, 2007. However, there were only 19 airlines, as US Airways and Independence Air filed bankruptcy twice during this period. (Table A-2 displays those filing for bankruptcy after September 11, 2001, and before January 1, 2007.)

## B. Eligible Airline Employees

***Determining the Universe of Eligible Airline Employees*** – The third step in the elimination process was to identify those employees of airlines (that filed bankruptcy within the applicable period) that are eligible as a result of receiving distributions in respect of bankruptcy claims, notes or fixed obligations. The legislation defines an eligible employee as an employee of one of the eligible airlines who participated in a qualified defined benefit plan that has been terminated or that has been frozen and is subject to accrual restrictions as provided in Section 402(b)(2) and (3) of the Pension Protection Act of 2006.

This analysis indicates that only five airlines that filed for bankruptcy maintained defined benefit plans that were later terminated or frozen.[2] (Table A-3 displays those airlines filing for bankruptcy after September 11, 2001, and before January 1, 2007 with defined benefit plans that were later terminated or frozen.)

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[2] Hawaiian Airlines filed for bankruptcy during this time period and maintained a defined benefit plan. However, the defined benefit plan was not terminated, nor was the plan frozen.

## C. Eligible Payments

***Notes, Claims, or Fixed Obligation Payments*** – The final step in the process was to identify the payments made to employees of the bankrupt airlines that maintained a defined benefit plan. The results of this analysis indicated that only four of the five previously identified airlines made payments to their employees.[3]

Table 1 displays the total payments made to employees that would be eligible for the rollover treatment. The employee groups shown in Table 1 include pilots as well as other airline employees.

Delta, United and Northwest made payments to various employee groups. Delta made payments to pilots represented by ALPA as well as front-line employees and managers. United Airlines made payments to employees represented by ALPA, the Transport Workers Union (TWU), Professional Airline Flight Control Association (PAFCA), International Association of Machinists (IAM), Association of Flight Attendants (AFA), and Aircraft Mechanics Fraternal Association (AMFA), and also to the non-union Salaried and Management (SAM) workers. Northwest Airlines made payments to employees represented by ALPA, IAM, AFA, Airline Transport Service Association (ATSA), TWU, and the National Airline Mechanics Association (NAMA).

US Airways agreed to make bankruptcy payments to pilots represented by ALPA, and there were no payments made to other employee groups. However, these payments are scheduled to be made in 2010 and 2011.

According to the Pension Benefit Guaranty Corporation press releases, defined benefit plans were terminated for the employees of US Airways (flight attendants, machinists, and pilots), United Airlines (ground employees, flight attendants, management and administrative and public contact employees, and pilots), Delta Air Lines (pilots), and Aloha Airlines (machinists, pilots and non-represented employees). Bankruptcy documents for Delta Air Lines, Northwest Airlines and United Airlines provide information about payments made in consideration of these terminated or frozen plans. Other available data sources, including the unions that represent each group, are the source for the remaining information.

Several points are worth noting about the amounts shown in Table 1. First, the total amounts as initially determined ($14,889 million) included bankruptcy claim amounts that were ultimately settled and paid at less than their face value. Two employee groups, pilots represented by ALPA for Delta and Northwest recovered amounts that were materially higher than all other employee groups. In these two instances, the employee groups hired a representative that arranged to pre-sell their claim amounts prior to the bankruptcy settlement. This allowed the Delta

[3] This information was made available through a variety of sources including sources at the ALPA R&I Department, Airline Annual Reports, newspaper reporting, and bankruptcy documents.

and Northwest ALPA employees to recover a market value in amounts far greater than other employee groups.

The overall market value ($5,416 million) of the amounts after bankruptcy settlement for all employee groups was less than half (37 percent) of their total face value.[4] The recovery percent falls to approximately 17 percent after removing these higher recovery amounts from the calculation.[5]

Second, the employees did not receive the entire market value of their settlements in the form of cash or stock. In most cases, when permissible, a portion of these amounts were paid as employer contributions up to the 415(c) limits on behalf of the employees to their 401(k) or other qualified defined contribution plans ($1,604 million).

The total amount already distributed and to be distributed to airline employees (excluding amounts contributed to qualified plans) is $3,812 million. This is the maximum amount eligible for rollover treatment. However, as discussed in section F, the actual amounts contributed under the proposal are likely to be considerably lower.

This $3,812 million includes amounts distributed as both stock and cash. It is noted that both traditional and Roth IRAs may receive rollover contributions in the form of stock or cash.

Two important timing issues should be noted. First, distributions to employees of United Airlines occurred in 2006. These amounts would have been included in taxable income on the employees' 2006 tax returns filed in 2007.

Second, US Airways fixed obligations are scheduled for distribution in 2010 and 2011. It is assumed that these amounts are likely to be contributed to the employees' 401(k) plans, rather than distributed directly to the employees, consistent with the practices of the other airline employee groups. Furthermore, these future payments are contingent upon the airline being able to make these payments in 2010 and 2011. US Airways filed for bankruptcy protection twice since September 11, 2001 – once on August 11, 2002 and again on September 12, 2004. The ability of US Airways to make these payments will depend heavily on its financial health in 2010 and 2011.

It is important to note that the employees of US Airways, United, Aloha, and Delta lost an estimated $6.9 billion in benefits as a result of the termination of their qualified defined benefit plans. Table 2 summarizes the benefits employees lost due to these terminations ($6.9 billion) in retirement benefits.

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[4] In most cases, the market values shown were the actual amounts obtained by the groups. However, in cases where this information was unavailable, the estimated market values relied on the actual amounts recovered by other employee groups for the same airline.

[5] This percentage excludes payments not yet received (US Airways) and excludes payments to certain ALPA groups.

| Table #1 Distributions Received by Airline Employees in Respect of Bankruptcy Claims, Notes or Fixed Obligations [amounts in millions] | | | | | |
|---|---|---|---|---|---|
| **Note, Claim, or Fixed Obligation** | | | | **Amount paid to employees** | |
| | **Year of Distribution** | **Face Value** | **Market Value** | **Contribution to 401(k)** | **Cash and Stock**[6] |
| **Delta** | | | | | |
| ALPA Claim | 2007 | $2,100 | $ 1,230 | $380[7] | $850 |
| ALPA Notes/Fixed Obligations | 2007 | $ 650 | $650 | $282[8] | $368[9] |
| Non-pilot Fixed Obligations | 2007 | $616 | $616 | $18 | $598 |
| Pilot Retirees' Claim | 2007 | $802 | $389 | n/a | $389 |
| **United** | | | | | |
| ALPA Claim | 2006 | $3,100 | $556 | $298 | $258 |
| ALPA Notes | 2006 | $550 | $537 | $201 | $336 |
| TWU Claim | 2006 | $2 | $0 | $0 | $0 |
| PAFCA Claim | 2006 | $15 | $2 | $0 | $2 |
| IAM Claim | 2006 | $1,487 | $173 | $0 | $173 |
| AFA Claim | 2006 | $1,033 | $99 | $0 | $99 |
| AMFA Claim | 2006 | $1,064 | $121 | $0 | $121 |
| SAM Claim | 2006 | $1,097 | $138 | $0 | $138 |
| Pilot Retirees' Claim[10] | 2006 | $497 | $60 | $0 | $60 |
| Non-pilot Retirees' Claim[11] | 2006 | $551 | $44 | $0 | $44 |
| **Northwest** | | | | | |
| ALPA Claim | 2007 | $888 | $639 | $355 | $284 |
| IAM Claim | 2007 | $181 | $36 | $0 | $36 |
| AFA Claim | 2007 | $182 | $55 | $0 | $55 |
| ATSA Claim | 2007 | $2 | $0.5 | $0 | $0.5 |
| TWU Claim | 2007 | $1.5 | $0 | $0 | $0 |
| NAMA Claim | 2007 | $0.1 | $0 | $0 | $0 |
| **US Airways**[12] | | | | | |
| ALPA Fixed Obligations | 2010 | $35 | $35 | $35 | $0 |
| | 2011 | $35 | $35 | $35 | $0 |
| **Totals** | | **$14,889** | **$5,416** | **$1,604** | **$3,812**[13] |

[6] Under present law, stock distributions are subject to income tax, just as cash. They are included in taxable income at the current stock price. Further, amounts received as company stock may be contributed to both Traditional and Roth IRAs.
[7] Of the $380 million contributed to the 401(k) plan, $121 million was contributed for plan year 2006 and $259 million was contributed for plan year 2007.
[8] The $282 million will be contributed to the 401(k) plan for plan year 2008.
[9] $14 million of this amount has yet to be allocated. It is possible that it will be either contributed to the tax-deferred 401(k) plan for 2008 or distributed as taxable amounts in 2008.
[10] Payments made to the pilot retiree claims were for their retiree benefit losses under Section 1114 and nonqualified pension plan losses.
[11] This category includes TWU, PAFCA, IAM, AFA, AMFA, and SAM United Airlines employee groups.
[12] Given the relatively smaller distribution amount and the behavior of the other airlines, it is reasonable to assume that US Airways will contribute these amounts to the retirement plan on behalf of the employees.

| Table #2 Summary of Airline Defined Benefit Plan Terminations and Lost Benefits; Lost Benefits as a Percentage of Total Termination Liability<br>Source: ALPA R&I Department Data | | |
|---|---|---|
| | **Value of Lost Benefits** | **Lost Benefits as Percentage of Total Termination Liability** |
| **Delta Air Lines** | | |
| Pilot Plan | $2.1 b | 44% |
| **United Airlines** | | |
| Pilot Plan | $1.5 b | 26% |
| Ground Employee, Flight Attendant, Mgt Admin & Public Contract Plans | $1.1 b | 15% |
| **US Airways** | | |
| Pilot Plan | $1.9 b | 51% |
| Non-Pilot Plans (three plans) | $0.2 b | 5% |
| **Aloha Airlines** | | |
| Pilot Plan | $0.1b | 23% |
| **Total Loss in Benefits** | **$6.9 b** | |

## D. Demographic and Income Analysis

***Demographic and Income Statistics*** – There are two factors that influence the tax rates that would be imposed on these distributions. The first factor is the current income level of the airline employee. The second factor is the size of the distribution. As the distribution amount increases, the individual would face a higher marginal tax rate.

The five graphs that follow show the income levels of pilot and non-pilot employees receiving such distributions, or "bankruptcy settlement payments." The income levels for pilots generally will exceed those of other airline employees. The income for the other employee groups (non-pilot) is estimated to be approximately 60 to 70 percent of the income distribution for the pilots.[14] (See Graph 5)

[13] This is the maximum amount eligible under the proposed legislation. The actual amounts contributed under the proposal are likely to be considerably lower. (Please refer to Section F for a discussion of the behavioral responses.)

[14] These percentages are the author's calculations that rely on wage and salary data from the Internal Revenue Service Statistics of Income, 2006 US Statistical Abstract, and the respective union websites.

For pilot employees receiving bankruptcy settlement payments, the graphs display a high concentration of individuals with incomes between $75,000 and $150,000.[15] However, this reflects an important workforce characteristic – the many years of service these employees devoted to their respective airline. In many cases, these employees accepted positions following military service and remained with their employers throughout their private-sector careers. These salaries represent employees in the later part of their work history.

Also, it is important to note that for many pilot employees, these incomes represent a decrease compared to prior years' incomes. Each of the four airlines negotiated multiple significant wage concessions from their employees. Wage concessions were typically negotiated with the labor unions as a means of preventing bankruptcy. However, in each case, the wage concessions merely preceded the bankruptcy filing.

For example in 2004, Delta Air Lines obtained wage and benefit concessions of $1.0 billion per year from its pilots prior to filing bankruptcy.[16] Delta Air Lines returned to negotiations with the pilots to seek an additional $305 million per year in wage concessions in 2006. Overall, employee groups accepted pay and benefit reductions totaling nearly 40 percent of their compensation.[17]

In 2005, United Airlines obtained wage concessions of $1.4 billion annually from its pilots and other union employees. United Airlines estimated that $361 million each year would result from wage concessions on behalf of the pilots. This followed a previous wage concession in 2004 of $250 million per year (approximately 24 percent of pay) on behalf of the pilots.

Prior to filing bankruptcy in 2005, Northwest Airlines obtained annual wage and benefit concessions totaling nearly $1 billion per year from its union employees (estimated $300 million per year was from wage concessions with their pilots' union), in addition to two temporary wage cuts prior to filing bankruptcy.[18]

Similarly in 2004, US Airways negotiated wage cuts of approximately $500 million from its pilots and other union employees, prior to its second bankruptcy filing. These wage cuts represented on average a 21 percent reduction in current wages. In 2005, US Airways negotiated an additional $1 billion per year in wage and benefit concessions from its union employees.

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[15] The income levels shown in Graphs 1 through 4 are for pilots. The income levels for non-pilots are much lower, as shown in Graph 5.

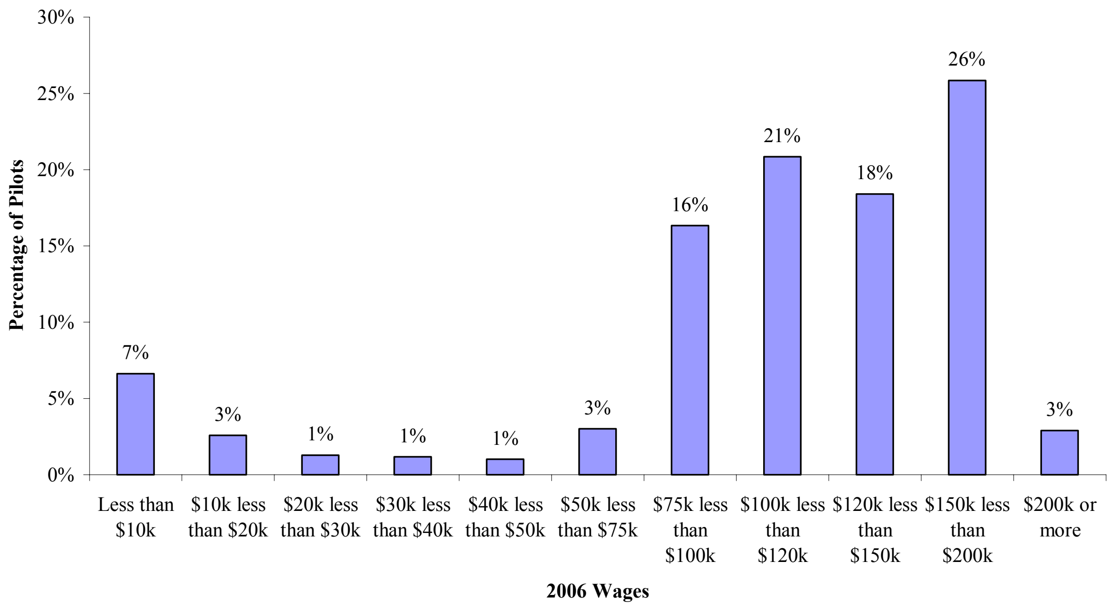
[16] Delta had been negotiating with pilots over concessions worth an additional $305 million a year as part of its attempt to slash $1.9 billion a year in operating costs. The pilots gave up $1 billion a year in concessions in late 2004 to help avoid the bankruptcy filing. See USA Today, April 14, 2006, http://www.usatoday.com/travel/flights/2006-04-14-delta-pilots_x.htm.

[17] According to a report by National Public Radio, by 2006, the Delta Pilots had received wage concessions that represented about one third of their pay. Further wage concessions were estimated to reduce their pay by approximately 40 percent. See http://www.npr.org/templates/story/story.php?storyId=5016437.

[18] See http://minnesota.publicradio.org/collections/special/ongoing/nwa/index.php?page=13.

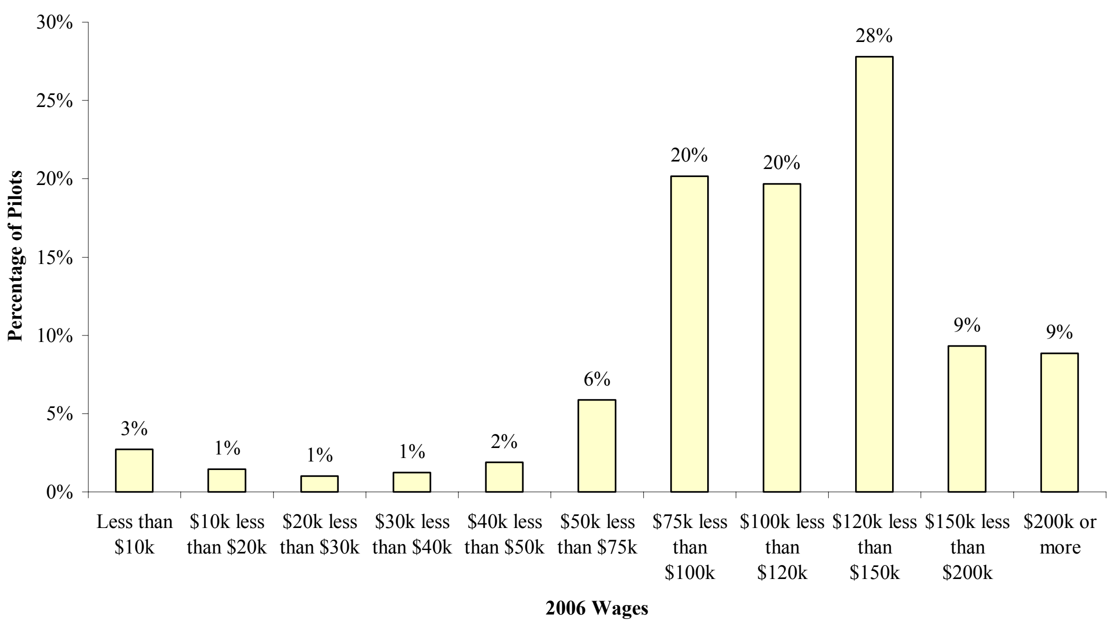
## Graph #1 Classification by 2006 Wages of Pilots Receiving Bankruptcy Settlement Payments - Delta Air Lines

**Source: Author's calculation from membership data provided by ALPA**



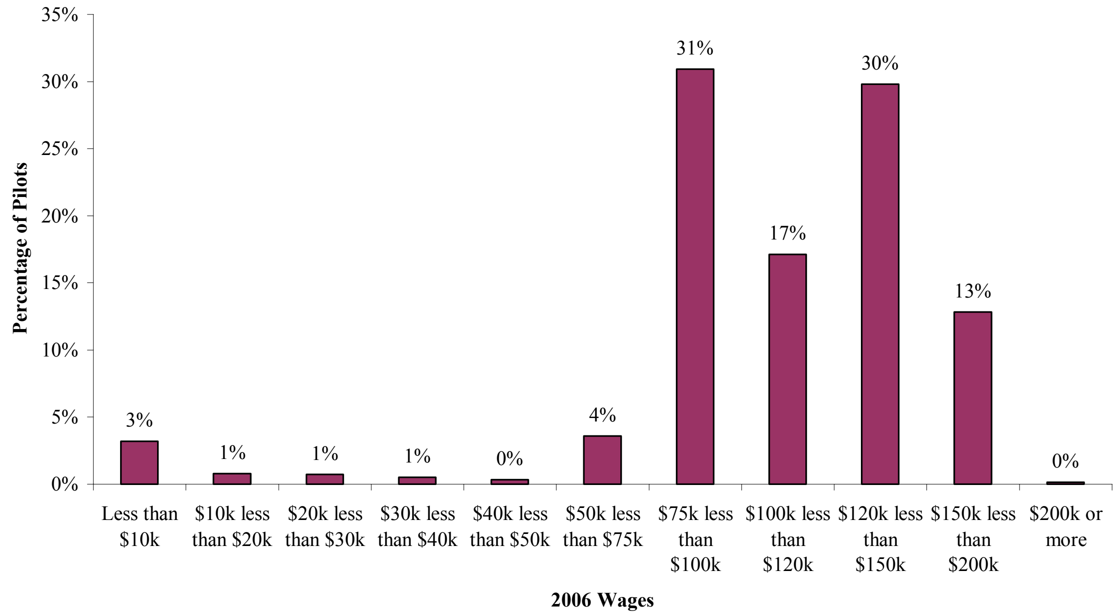

## Graph #2 Classification by 2006 Wages of Pilots Receiving Bankruptcy Settlement Payments - United Airlines

**Source: Author's calculation from membership data provided by ALPA**



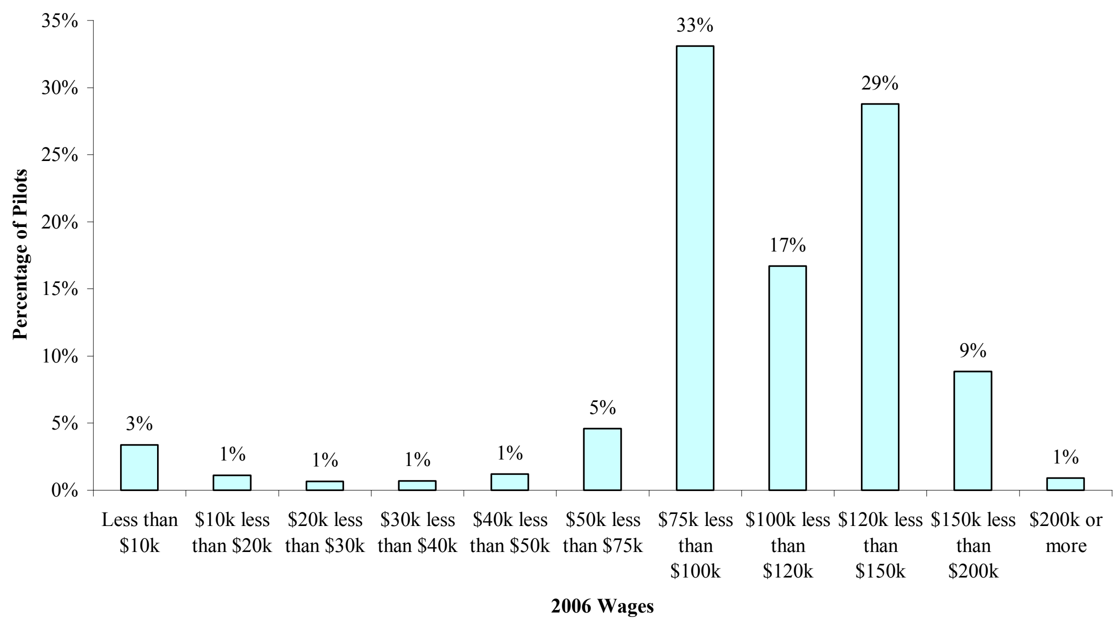
**Graph #3 Classification by 2006 Wages of Pilots Receiving Bankruptcy Settlement Payments - Northwest Airlines**

**Source: Author's calculation from membership data provided by ALPA**



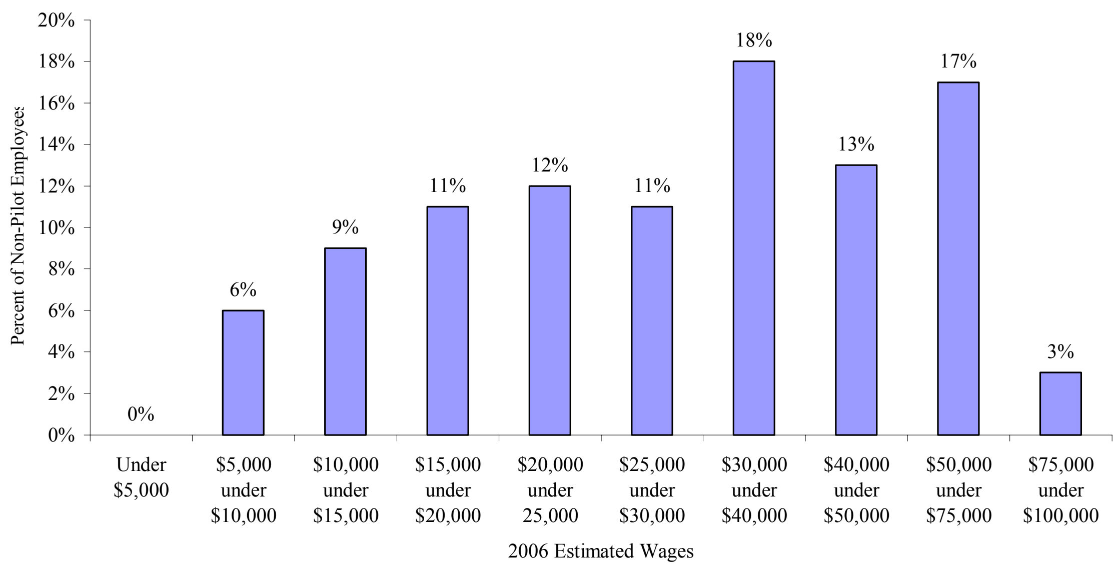

**Graph #4 Classification by 2006 Wages of Pilots Receiving Bankruptcy Settlement Payments - US Airways**

**Source: Author's calculation from membership data provided by ALPA**



## Graph #5 Classification by 2006 Estimated Wages of Non-Pilot Employees

**Source: Author's estimates based on wage and salary data from the IRS-SOI, US Statistical Abstract, and employee group websites**




## E. Analysis of Bankruptcy Settlement Payments by Size

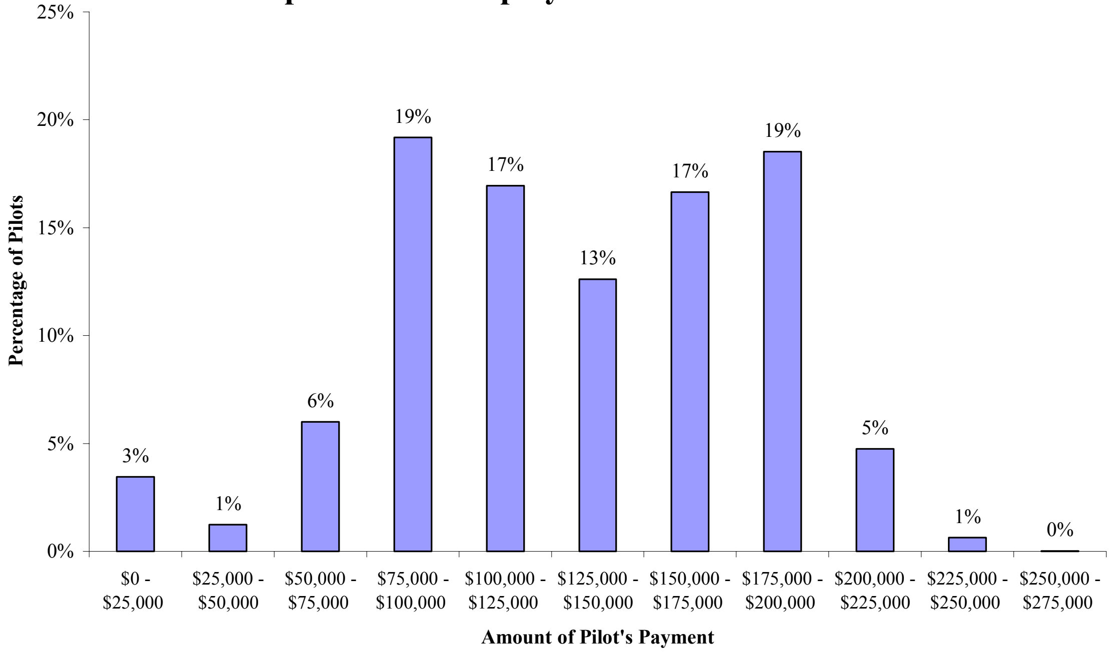
Disaggregate data provided by ALPA show a clearer picture of the size range of the bankruptcy settlement payments made directly to individual pilots (i.e. not contributed to a qualified retirement plan). The following three sets of graphs provide an indication of the breakdown of such payments by amount.

The formulas used to allocate the distribution amounts among pilots varied somewhat from airline to airline. However, generally, the allocations were based on four factors. Three of the four factors reflect payments in consideration of the pilots' work history – years of service, seniority, and pay grade. The final factor was a per capita payment made to all eligible pilots.

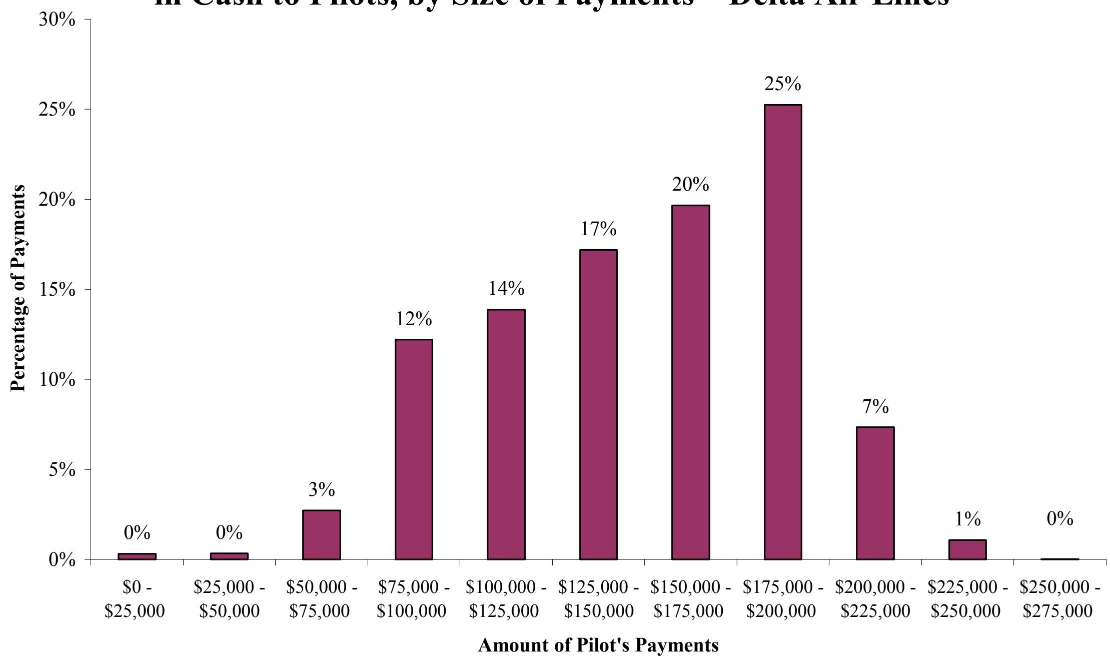
The analysis presented in each of the following sets of graphs is based on the size of the direct payment. With respect to Delta Air Lines, Graph 6a displays the percentage of pilots receiving direct payments in increments of $25,000, and Graph 6b displays the percentage of total dollars paid by the size of direct payments in increments of $25,000. Graphs 7a and 7b display the same data for United Airlines and Graphs 8a and 8b display the same data for Northwest Airlines.[19]

[19] Note that payments to US Airways employees are scheduled for distribution in 2010 and 2011.

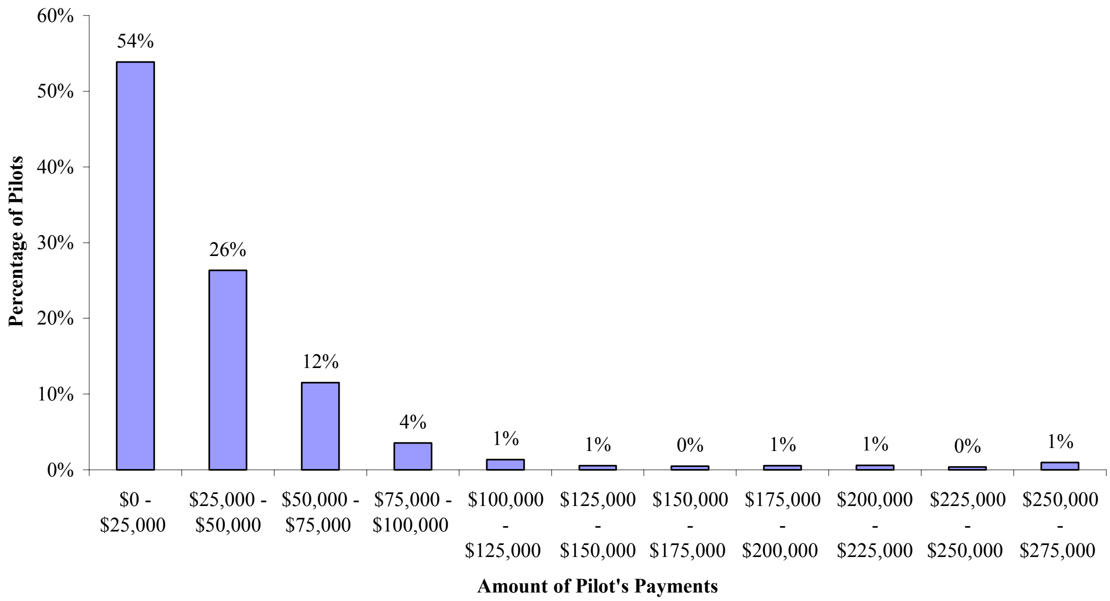
## Graph #6a Classification of Pilots by Size of Cash Payments In Respect of Bankruptcy Claim – Delta Air Lines



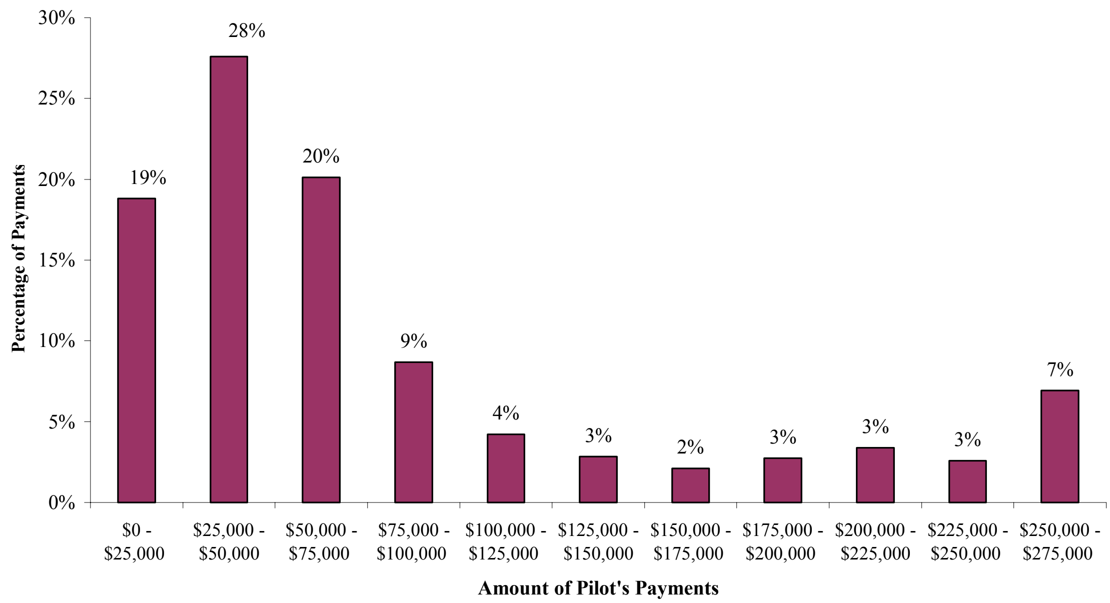

## Graph #6b Analysis of Total Bankruptcy Claim Dollars Paid in Cash to Pilots, by Size of Payments – Delta Air Lines



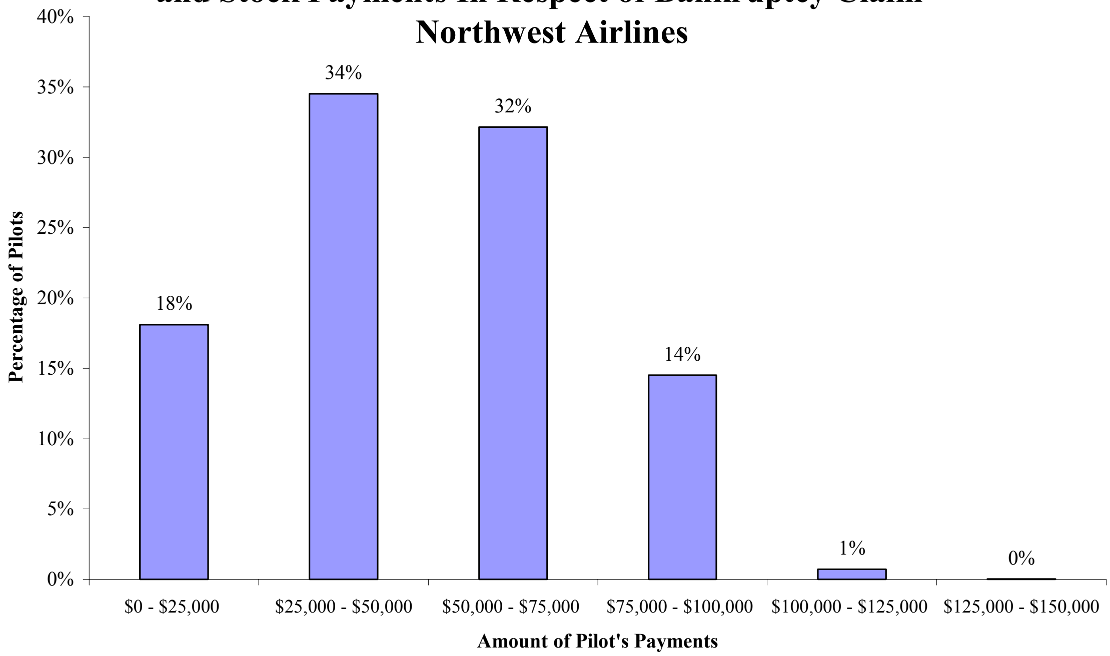
## Graph #7a Classification of Pilots by Size of Direct Cash and Stock Payments, In Respect of Bankruptcy Claim and Notes – United Airlines



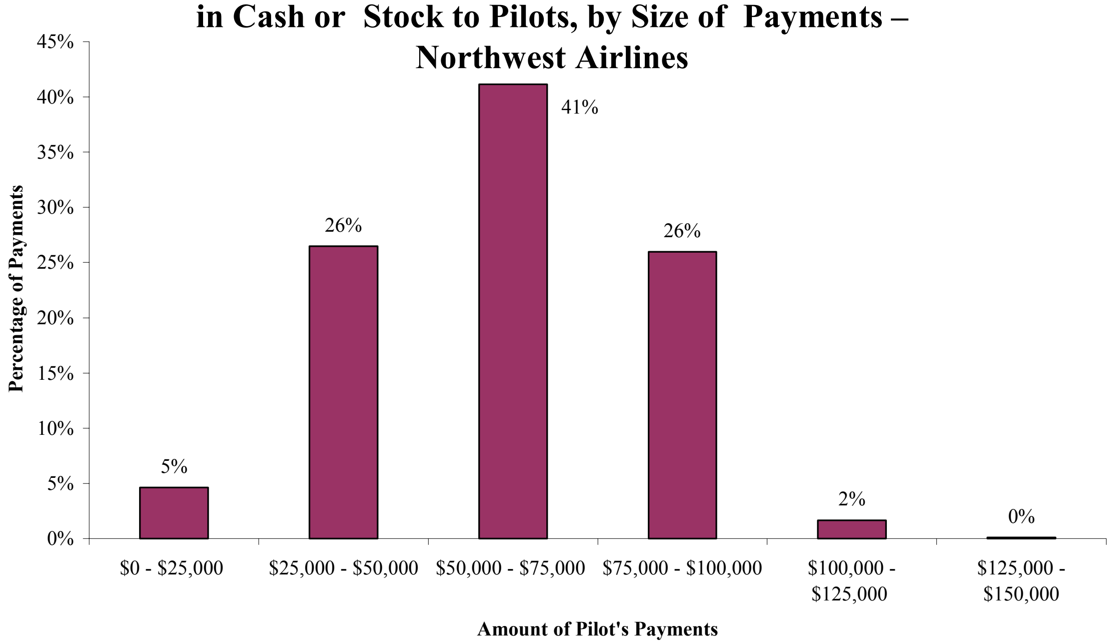

## Graph #7b Analysis of Total Dollars Paid Directly to Pilots, in Cash or Stock, in Respect of Bankruptcy Claim and Notes, by Size of Payments – United Airlines



## Graph #8a Classification of Pilots by Size of Direct Cash and Stock Payments In Respect of Bankruptcy Claim – Northwest Airlines




## Graph #8b Analysis of Total Bankruptcy Claim Dollars Paid in Cash or Stock to Pilots, by Size of Payments – Northwest Airlines



## F. Behavioral Response

***Empirical Research to Support the Behavioral Analysis*** – According to the most recent studies on uses of lump sum distributions, less than half of those receiving a lump sum distribution saved any portion of the distribution in tax qualified savings.[20] These recent findings are consistent with studies of lump sum distribution behavior conducted over the past ten years. There have been slight variations in the percentage of individuals saving the distribution in tax qualified savings accounts, but the variability has been quite small over time, with less than half of all recipients choosing tax qualified savings.

Generally speaking, the majority of lump sum recipients use the amounts to repay debt or for discretionary spending. According to Employee Benefits Research Institute (EBRI), 32.0 percent reported using the money for home, business, or other debts. Another 21.6 percent used these amounts for consumption. Further, approximately 10 percent used their amounts for education or job change-related expenses.[21] These statistics are particularly relevant to the airline employees that received bankruptcy payments because, at the time the payments were distributed, there was no available option to contribute these amounts to qualified savings plans. Therefore, in light of their past wage concessions, they are very likely to have used the amounts to repay debt or for consumption purposes.

Further inspection of the survey findings indicates that this behavior varies with certain characteristics. First, as more time lapses between receipt and use of the lump sum distribution, the less likely the person is to save the amounts in tax qualified savings. This is particularly relevant for those employees receiving amounts eligible for the rollover since the United Airlines distributions occurred in 2006, more than a year ago.

Second, as the amount of the distribution increases, the more likely recipients are to use the distribution for some form of savings. As shown in graphs 6b and 7b, the amounts paid to United Airlines and Northwest Airlines pilots are concentrated at the lower to middle end of the distribution. Further, these distributions were made to the pilots following years of wage concessions. In the case of the airline pilots, in particular, wage concessions made in years preceding the bankruptcy filing reduced wages by approximately 20 to 40 percent (for additional details see the previous section). It is reasonable to assume that many of those receiving distributions may have used the amounts to fund shortfalls in their living expenses.

Finally, the propensity to save the distribution is positively correlated with income. As the individual's income increases, the more likely he or she is to save the amounts received. However, this is likely to hold true for those with stable earning patterns. With respect to airline employees, this may have two distinct

[20] See EBRI Issue Brief Number 289, January 2006. Available at www.ebri.org
[21] These percentages reflect those reporting using any portion of their distribution for these purposes.

effects on an employee’s propensity to save the distributions. On one hand, with wages declining by nearly 40 percent in some cases, the individual receiving the distribution may feel inclined to spend the amounts due to past personal liquidity constraints.

On the other hand, the amounts were paid, in part, for concessions related to retirement benefits. Consequently, employees with higher incomes may represent those at the end of their earning career who may be more likely to restore the loss in retirement benefits. However, it is noteworthy to mention that at the time of these distributions, there was no available option such as the one detailed in this proposed legislation.

Because the option to contribute the bankruptcy payments to a qualified savings vehicle did not exist at the time of distribution, it is more likely that an airline employee would have spent, not saved, the payments. Consequently, the lack of a qualified savings option at the time of distribution is likely to have a dampening effect on the airline employee's ability to rollover the bankruptcy payments to a traditional or Roth IRA pursuant to the option subsequently made available under this proposed legislation.

# IV. SUMMARY OF EMPIRICAL FINDINGS

The information above provides the details necessary to conduct a thorough revenue analysis of the eligible employees and amounts available for the rollover treatment. This information provides support for the limited scope and closed nature of the proposed legislative change.

Generally, the framework to estimate the potential revenue changes associated with this provision relies on several steps. The first step is to classify the payments among employees based on the size of each employee's payment. It is important to consider separately each airline since there were variations in the size of the aggregate payments as well as the classification of individual amounts. In other words, certain airline employees received average amounts that exceeded those received by others. For example, approximately 99 percent of distributions to Northwest Airlines employees and all other non-pilot employee groups were considerably less than $150,000.

The second step involves classifying by income level the claim, note, and fixed obligation amounts to estimate the resulting taxable income. This step is necessary to determine the appropriate marginal tax rate for the employees receiving distributions. The impact of the effective tax rate is important to note. Normally, most pilots will earn approximately $150,000, but in light of these payments many will have to report nearly twice that amount. This means they will face a much higher effective tax rate due to the progressive tax rate structures. In other words, the amounts received are subject to tax at a much higher rate than they otherwise would face. Ironically, the amounts – paid to restore the loss in retirement benefits, among other things – will further erode without the much needed legislation.

The third step is to adjust the distribution amounts for likely behavior and willingness to contribute the amounts to an IRA. As with the above classification methodology, distinct behavioral assumptions were applied to employees of each airline. Treating each airline separately provides an opportunity to capture distinct behavioral responses that consider the classification of recipients by income level, and timing of the distribution.

Finally, the potential revenue loss associated with the proposal has two components, the possible income exclusion (traditional versus Roth IRA election) as well as the tax-deferred buildup associated with amounts rolled over to an IRA. If the rollovers are assumed to be made to a Roth IRA, the timing of the possible income inclusion must also be considered.

If the individual received the distribution prior to January 1, 2007, the amounts would already have been included in their taxable income. Consequently, for amounts already included in taxable income, contributing to a traditional IRA would require filing an amended return for tax year 2006.

In addition, individuals who received distributions in 2006 and elect to rollover the amounts to a Roth IRA may also elect to file an amended return for 2006 to spread the income inclusion over two tax years (2007 and 2008), rather than one.

The likely behavioral response to this proposed change depends heavily on the availability of the funds for rollover. The distributions began in 2006, continued at various times throughout 2007, and will continue into early 2008. Consequently in most cases, amounts distributed to individuals were not received in a single lump sum.

The likelihood of saving the funds is correlated positively with the size of the distribution. In other words, in light of the numerous wage concessions, it is more likely that receiving several smaller distributions would result in a greater likelihood of individuals spending rather than saving the amounts.

In addition, the individual could elect to contribute all or part of the distribution to an IRA. However, since the option to rollover amounts to a qualified retirement account was not available to the airline employees at the time they received their distribution, it is likely that employees used the bankruptcy payments to repay debt or for current consumption. Therefore, the likelihood of their being able to use the proposed rollover provision is likely to be considerably lower.

Further, the employees received the bankruptcy payments at various times and in various amounts, which increases the likelihood that these distributions will be used for consumption, and a smaller portion may be rolled over to the IRA. The proposal does not require the individual to contribute the distribution amount in its entirety. Therefore, to the extent that airline employees will have funds available, the likely behavioral response will be to rollover only a portion of the distribution.

Overall, there are several factors that work to dampen the potential revenue loss of this much needed employee relief provision. The primary factor that will dampen the revenue effect is that the proposal is defined narrowly. The legislative language intends to offer targeted relief that is not open-ended.

Such other factors as the timing and variability of the payments – some distributions occurred over a period of two years in various amounts – create a stronger likelihood that many of the recipients used their distributions for consumption rather than saving.[22] This empirical evidence supports a well-defined, targeted proposal that will have a likewise well-defined, targeted revenue effect.

[22] This is particularly true for this class of workers, many of whom experienced years of falling wages as a result of wage concessions.

## V. REFERENCES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## VI. APPENDIX A –

| **Table A-1 Domestic Airlines** |
|---|
| ***Major Network Airlines and Legacy Airlines*** |
| ABX Air |
| AirTran Airways |
| Alaska Airlines |
| American Airlines |
| American Eagle Airlines |
| Atlantic Southeast Airlines |
| Atlas Air/Polar Air Cargo |
| Comair |
| Continental Airlines |
| Delta Air Lines |
| FedEx Express |
| Frontier Airlines |
| JetBlue Airways |
| Mesa Airlines |
| Northwest Airlines |
| SkyWest |
| Southwest Airlines |
| United Airlines |
| UPS Airlines |
| US Airways |
| ***Mid-sized Airlines*** |
| Air Transport International |
| Air Wisconsin Airlines |
| Allegiant Air |
| Aloha Airlines |
| Amerijet International |
| ASTAR Air Cargo |
| ATA Airlines |
| Champion Air |
| Continental Micronesia |
| Evergreen International |
| Executive Airlines |
| ExpressJet Airlines |
| Florida West Airlines |
| Gemini Air Cargo |
| GoJet Airlines |
| Hawaiian Airlines |

| Table A-1 Domestic Airlines |
| --- |
| Horizon Air |
| Kalitta Air |
| Mesaba Airlines |
| Midwest Airlines |
| North American Airlines |
| Omni Air International |
| Pinnacle Airlines |
| PSA Airlines |
| Ryan International Airlines |
| Southern Air |
| Spirit Airlines |
| Sun Country Airlines |
| Trans States Airlines |
| USA 3000 Airlines |
| USA Jet Airlines |
| World Airways |
| ***Small Airlines*** |
| 40-Mile Air |
| Aerodynamics |
| Air Midwest |
| Alaska Central Express |
| Alaska Seaplane Service |
| Ameristar Air Cargo |
| Arctic Circle Air Service |
| Arctic Transportation |
| Arrow Air |
| Asia Pacific Airlines |
| Bemidji Airlines |
| Bering Air |
| Big Sky Airlines |
| Boston-Maine Airways |
| Cape Air |
| Capital Cargo International |
| Cargo 360 |
| Caribbean Sun Airlines |
| Centurion Air Cargo |
| Chautauqua Airlines |
| Colgan Air |
| CommutAir |
| Ellis Air Taxi |
| Empire Airlines |

| Table A-1 Domestic Airlines |
|---|
| ERA Aviation |
| Everts Air |
| Express.Net Airlines |
| Falcon Air Express |
| Focus Air |
| Freedom Air |
| Freedom Airlines |
| Frontier Flying Service |
| Grand Canyon Helicopters |
| Grant Aviation |
| Great Lakes Airlines |
| Gulf & Caribbean Air |
| Gulf Stream International Airlines |
| Hageland Aviation Services |
| Harris Air Services |
| Homer Air |
| Iliamna Air Taxi |
| Inland Aviation Services |
| Island Air |
| Katmai Air |
| Kenmore Air |
| Kitty Hawk Air Cargo |
| L.A.B. Flying Service |
| Lynden Air Cargo |
| M&N Aviation |
| MAXjet Airways |
| Miami Air International |
| NetJets |
| New England Airlines |
| Northern Air Cargo |
| Pace Airlines |
| Pacific Airways |
| Pacific Wings Airlines |
| PenAir |
| Piedmont Airlines |
| Primaris Airlines |
| Promech Air |
| RegionsAir |
| Republic Airlines |
| Salmon Air |
| Scenic Airlines |

| **Table A-1 Domestic Airlines** |
|---|
| Seaborne Airlines |
| Servant Air |
| Shuttle America |
| Sierra Pacific Airlines |
| Skagway Air |
| Sky King Airlines |
| Skyway Airlines |
| Smokey Bay Air |
| Spernak Airways |
| Tanana Air Service |
| Taquan Air |
| Tradewind Aviation |
| Tradewinds Airlines |
| US Helicopter |
| Victory Air Transport |
| Viegues Air Link |
| Vintage Props & Jets |
| Warbelow's Air Ventures |
| Ward Air |
| West Isle Air |
| Wings of Alaska |
| Wright Air Service |
| Xtra Airways |
| Yute Air Alaska |

Source: GAO Reports and Airline Industry websites.

| Table A-2 Airlines Filing Bankruptcy<br>After September 11, 2001 and Before January 1, 2007 | | |
|---|---|---|
| **Date of Bankruptcy Filing** | **Airline** | **Chapter** |
| | | |
| 1/2/2002 | Sun Country Airlines | 7 |
| 7/30/2002 | Vanguard Airlines | 11 |
| 8/11/2002 | US Airways | 11 |
| 12/9/2002 | United Airlines | 11 |
| 3/21/2003 | Hawaiian Airlines | 11 |
| 10/30/2003 | Midway Airlines | 7 |
| 1/23/2004 | Great Plains Airlines | 11 |
| 1/30/2004 | Atlas Air/Polar Air Cargo | 11 |
| 9/12/2004 | US Airways | 11 |
| 10/26/2004 | ATA Airlines | 11 |
| 12/1/2004 | Southeast Airlines | 7 |
| 12/30/2004 | Aloha Airlines | 11 |
| 9/14/2005 | Delta Air Lines | 11 |
| 9/14/2005 | Comair | 11 |
| 9/14/2005 | Northwest Airlines | 11 |
| 9/29/2005 | TransMeridian Airlines | 7 |
| 10/13/2005 | Mesaba Airlines | 11 |
| 11/7/2005 | Independence Air | 11 |
| 12/28/2005 | Era Aviation | 11 |
| 1/6/2006 | Independence Air | 7 |
| 2/21/2006 | Florida Coastal Airlines | 11 |

Source: GAO reports, Airline Annual Reports, Newspaper reporting, and bankruptcy documents.

**Table A-3 Airlines Filing Bankruptcy –
Eligible for the Proposal
(Employees participated in a qualified defined benefit plan
that was terminated or that is frozen and subject to accrual restrictions as provided in the Pension Protection Act of 2006)**

| Date of Bankruptcy Filing | Airline | Type of Bankruptcy Settlement Payments |
|---|---|---|
| | | |
| 8/11/2002 | US Airways | No claims, notes or fixed obligations paid (first bankruptcy filing) |
| 12/9/2002 | United Airlines | Claims and notes |
| 9/12/2004 | US Airways | Fixed Obligations (second bankruptcy filing) |
| 12/30/2004 | Aloha Airlines | No claims, notes, or fixed obligations paid |
| 9/14/2005 | Delta Air Lines | Claims and notes |
| 9/14/2005 | Northwest Airlines | Claims only |

Source: ALPA, Airline Annual Reports, newspaper reporting, and bankruptcy documents.