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Facebook IPO Lawsuits: Will IRS Share?

The Facebook IPO was much anticipated—in fact, it was downright [hyped](#). That was then. Now lawsuits are flying. See [Facebook: Lawsuits Piling Up](#). If you lost money, you may have a claim. See [Facebook, Zuckerberg Sued Over IPO](#). But if you do, will it go into your pocket or must you split it with the IRS?



Say you bought Facebook stock for \$38, it drops, to \$30, and then you get \$5 back in a settlement. Do you have to report it as income? Like so much in the tax world, it depends.

An investor settling a claim that he lost money because of bad conduct by a company, bank, or brokerage firm ordinarily has an incentive to assert the loss was capital in nature and that any resulting settlement should be capital too. The IRS, on the other hand, has an incentive to argue for ordinary income treatment.

To resolve this standoff, look to the origin of the claim. It controls the tax treatment of a recovery from a lawsuit. In investment loss cases, the plaintiff will generally assert that the recovered funds are nontaxable as a recovery of basis, or represent capital gain. Usually, this invites questions into what the plaintiff has already done on his tax return in relation to this investment loss. See [Stakes Loom Large in Determining Taxation of Investment Loss Lawsuit Recoveries](#).

If the plaintiff has already claimed a tax loss on the investment, then that tax loss must be taken into account in determining how the proceeds of any ultimate recovery will be treated. In the typical investment loss case, the plaintiff is claiming that the defendant's conduct (accounting problems, mismanagement, conversion, fraud, etc.) lead to the loss or diminution in value of the plaintiff's investment. The plaintiff should not get favorable taxation on the recovery **and** a tax deduction for the investment loss. See [Securities Lawsuit Recoveries: Capital Gain or Ordinary Income?](#)

One key issue is what triggers capital treatment. A capital gain is generally defined by reference to the gain on the sale of a capital asset. See [IRS Tax Topic 409, Capital Gains and Losses](#). The mere settlement of a lawsuit is usually not a disposition, but in the context of recovering damages in lawsuits, the courts and IRS have often allowed capital gain treatment even though you still hold the investment.

Suppose you bought Facebook stock for \$38, it drops to \$18, and you later recover \$20. Depending on your facts, it might be treated as a recovery of your basis and therefore nontaxable even if you still hold the stock.

More taxpayers today recover amounts related to investments. More companies, banks, brokerage firms, and investment advisers today fall subject to these claims. The tax issues for the recovering plaintiffs often revolve around ordinary income versus capital gain, and gain versus basis recovery issues. Bottom line: the federal income tax stakes can be quite large. Plan ahead.

For more, see:

[Stakes Loom Large in Determining Taxation of Investment Loss Lawsuit Recoveries](#)

[Facebook IPO: Individual investors get burned](#)

[Carried Interests Taxed As Capital Gain? It's Poetry](#)

[Should Carried Interest Be Taxed as Ordinary Income, Not as Capital Gains?](#)

[IRS: Ten Important Facts About Capital Gains and Losses](#)

[Ten Facts About Tax Expatriation](#)

[Expats Face Steep Exit Tax Courtesy Of Facebook](#)

[All You Need To Know About IPOs, Going Public And Stock Options](#)

[Taxes From A To Z: C Is For Capital Losses](#)

[Grab Your Fistful Of Zuckerberg's IPO Dollars](#)

[Ten Tax Tips For Stock Options](#)

[Top Tax Tips From Zuckerberg's Facebook Bonanza](#)

[How Mark Zuckerberg's Taxes Change Now That He's Married](#)

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