

# Corporate and Securities Law Alert

## Extension of Required 409A Compliance Date

OCTOBER 5, 2006

The Internal Revenue Service and the Treasury Department issued Notice 2006-79 (the "Notice") on October 4, 2006 (<http://www.treas.gov/press/releases/hp128.htm>). The Notice extends the existing transition relief to January 1, 2008, with respect to nonqualified deferred compensation arrangements that will be subject to the regulations under Section 409A (still in proposed format). It is still expected that final regulations will be issued before the end of 2006. The Notice requires continued good faith operational compliance with Section 409A and full compliance with both the operational and the documentary requirements of Section 409A beginning January 1, 2008.

### Relief Extends to Most Arrangements

The extended transition relief applies generally to most arrangements subject to Section 409A. However, it is important to note that the transition relief is not extended to certain discounted stock options and stock appreciation rights that are subject to backdating concerns (discussed more fully below).

### Substitutions of Non-Discounted Stock Options and Stock Appreciation Rights in Place of Discounted Stock Options and Stock Appreciation Rights

The Notice extends to December 31, 2007, during which discounted stock options or stock appreciation rights may be fixed for Section 409A purposes. However, if the reissuance of the nondiscounted stock options or stock appreciation rights occurs in 2007 and is also accompanied with a payment of vested property or a cash payment, such payment may not vest or become payable before January 1, 2008. This extends the current transition relief under the proposed regulations where such "true-up payments" cannot be made with respect to discounted stock options or stock appreciation rights before January 1, 2007, if fixed for 409A purposes in 2006.

### Fixed Payment Terms for Discounted Stock Options or Stock Appreciation Rights

Discounted stock options or stock appreciation rights also may be amended to provide for fixed payment terms (*i.e.*, fixed exercise schedules) until December 31, 2007. The Notice makes clear that solely because a discounted stock option may be vested and exercisable in 2006 or 2007 it will not be taxable in such years, provided it is reasonably expected to be exercised in a subsequent year (for example, if a company wishes to modify

a vested discounted stock option in 2007 by adding a fixed exercise schedule, the fact that such discounted vested stock option is exercisable in 2007 will not automatically mean that the option is taxable in 2007 provided it is reasonably expected that the option will be exercised in a subsequent year (2008 and forward)).

### No Transition Relief for Certain Discounted Stock Options and Stock Appreciation Rights

Discounted stock options or stock appreciation rights will not be afforded the extension of time to January 1, 2008 in which to comply with Section 409A if (1) they were granted by a public company to a person who, as of the date of grant, was subject to Section 16, and (2) such stock option or stock appreciation right has been reported (or is reasonably expected to be reported) as a financial expense due to backdating problems under generally accepted accounting principles.

The effect of this carve-out from relief means that public companies considering use of the transition relief for backdated stock options for Section 16 officers must do so by the end of 2006. Because of possible tender offer (Schedule TO) filing requirements and the on-going nature of any backdating problems, this means that many issuers will not be able to use the transition relief under Section 409A for backdated options granted to their Section 16 officers.

If you have any questions regarding this Notice, please contact [Scott P. Spector](mailto:sspector@fenwick.com) (650.335.7251 – [sspector@fenwick.com](mailto:sspector@fenwick.com)) or [Blake W. Martell](mailto:bmartell@fenwick.com) (650.335.7606 – [bmartell@fenwick.com](mailto:bmartell@fenwick.com)) in the Executive Compensation and Employee Benefits Group.

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