

Tax Alert

IRS Program for Correcting Underwithholding of 409A Taxes on “Backdated Options”

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THE PROGRAM

The IRS has announced a voluntary correction program (the “**Program**”) that employers can use to correct underwithholding of certain taxes incurred from the exercise in 2006 of “backdated options.” The employer may pay the underwithheld federal taxes (described below) and the additional income and employment taxes on those tax payments (the additional tax payments are commonly referred to as a “gross-up”) on behalf of the employees affected. If the employer completes the Program, then the employee and the employer are relieved of any penalties the IRS might impose for underwithholding of these taxes. Further, if the W-2 issued to the employee did not already reflect the effect of these taxes, then the employer also will not need to issue a corrected W-2. Participation in the Program does not reduce the amount of any tax owed.

ELIGIBILITY LIMITED TO CERTAIN OPTIONS AND RELIEF LIMITED TO CERTAIN TAXES

- **No eligibility** for stock options exercised by a person who was subject to the reporting requirements of Section 16(a) of the Securities Exchange Act of 1934 at either: (i) the time of entry in the Program, or (ii) the time of option grant.
- **Relief** is limited only to the taxes imposed by Section 409A of the Internal Revenue Code of 1986, as amended (“**Section 409A**”), and only with respect to option exercises in 2006.

TIMELINES FOR ACTION

- The deadline for entering this voluntary compliance program is February 28, 2007.
- Employees for whom the correction is being made must be notified within 15 days after entry into the program, and the IRS must be notified of the identities of these employees within the same 15 days.

- The employer must pay all the taxes and interest due by June 30, 2007.
- The employer must deliver an additional notice to employees by July 15, 2007.

“GROSSING UP” WILL BE ADDITIONAL INCOME TO EMPLOYEES

Employers must report any gross-up payments as additional income received by the employee in 2007, and must timely withhold and remit an additional amount to the IRS (and any applicable state tax authority) in satisfaction of the tax withholding obligation with respect to the gross-up payments.

UNEXERCISED OPTIONS REMAIN SUBJECT TO SECTION 409A

Some unexercised “backdated options” are eligible for remedial upward adjustment of their exercise price to make them no longer subject to the additional taxes imposed by Section 409A. Such amendments must be made by December 31, 2007. If not timely amended, then these options will remain subject to the additional taxes imposed by Section 409A and the employer will be required to timely withhold these taxes and comply with the W-2 reporting requirements. It is unlikely that the IRS will extend the Program to apply to exercises in 2007 or later years.

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