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Management Alert

Executive Compensation Round-Up: 2008 Planning Tips

IRS Releases Limited Code Section 409A Compliance Program

The IRS has established a limited voluntary correction program for inadvertent operational failures of a nonqualified deferred compensation plan to satisfy Code Section 409A. Under the program, certain unintentional failures may be corrected within the same taxable year, with no income inclusion or penalties. In addition, for 2008 and 2009, the program provides relief for violations involving amounts within the Code Section 402(g) limit ($15,500 for 2008) that are not corrected during the taxable year of the violation. In such cases, only the amount of the violation is taxed and subject to penalty (not all amounts deferred under the plan).

Planning Tip: As the compliance program provides for only very limited relief, companies should actively ensure they are acting in good faith compliance with Section 409A and seek to identify and correct unintentional operational failures *very* quickly.

ISO and Stock Purchase Plan Tax Returns

Code Section 6039 requires that every corporation file an information tax return for any calendar year in which it either:

- transfers to any person a share of stock pursuant to such person's exercise of an incentive stock option (as provided under Code Section 422) (an "ISO") or
- records a transfer of the legal title of a share of stock acquired by an employee pursuant to an employee stock purchase plan (an "ESPP share").

In addition, every corporation that is required to file the above information return must also furnish a written statement to each person named in the information return setting forth certain information prescribed by the Department of Treasury. Such written statement must be provided to individuals no later than January 31 of the year following the calendar year which includes the transaction (*i.e.,* for 2007 transactions, the written statement must be provided by January 31, 2008).

Although the written statement requirement has been in place for many years, the information return filing requirement was added to the Code in 2006, effective for 2007 and later years.

Notice 2008-8, released on December 19, 2007, waived the information return filing requirement for the 2007 calendar year because Code Section 6039 regulations had not yet been issued. However, the Notice reiterated that corporations must continue to furnish to persons who exercise ISOs or transfer ESPP shares the requisite stock transfer information.

Planning Tip: Participant statements regarding 2007 ISO and ESPP transactions must be distributed by January 31, 2008.

Registration Exemption for Stock Options

In December 2007, the Securities Exchange Commission (SEC) adopted two new securities registration exemptions that may affect private and public companies that issue compensatory stock options.

Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") requires a company with (i) 500 or more holders of record of a class of equity security and (ii) assets in excess of $10 million at the end of its most recently ended fiscal year to register that class of equity security unless an exemption from registration is available. While Exchange Act rules provided an exemption for interests in employee pension benefit plans, no such exemption was available to compensatory employee stock options. Although the SEC began issuing no-action letters for compensatory stock options, private and public companies wishing to grant stock options to more than 500 individuals generally were required to register the options as a separate class of equity.

The two new exemptions that were issued in December 2007 will allow, *subject to certain conditions,* both private and public companies to issue compensatory options to more than 500 individuals without having to register the options *(note: in the case of public companies, the underlying stock will still need to be registered).*

For private companies to qualify for the exemption:

(1) the options must be issued under one or more written stock option plans;

(2) grantees must be limited to employees, directors, consultants, and advisors of the issuer, its parents, or majority-owned subsidiaries of the issuer or its parent;

(3) the plan must prohibit the transfer of options (and, prior to exercise, the shares to be received upon exercise) *except* for one transfer in the event of a family gift, domestic relations order, death, or disability; and

(4) every six months, the issuer must provide to option holders certain risk and financial information required under Rule 701 under the Securities Act of 1933.

Public companies are subject to the first and second of the above requirements only.

Planning Tip: In order for the exemption to apply, the requirements must be contained in the written plan document. The first three requirements generally will not be problematic as most compensatory options are issued pursuant to written plans and those plans generally contain the second and third requirement. For private companies, however, the fourth requirement (providing risk and financial information) may be objectionable. Companies that need or wish to take advantage of the exemption should contact counsel to review their plans and applicable disclosure requirements.

Rule 144 Restricted Stock Holding Periods Shortened

Securities acquired in a public or private transaction generally must be resold in compliance with Rule 144 under the Securities Act of 1933 (the "Securities Act") unless the resale itself is registered. These rules are relevant to companies using equity compensation, as such rules generally apply to stock obtained through a compensatory equity plan.

Recent amendments generally ease Rule 144 restrictions. The chart on the following page summarizes the general requirements and impact of recent amendments.

Rule 144 Requirement Prior to Amendment	Impact of Rule 144 Amendment
A purchaser of restricted securities was subject to a minimum one-year holding period before permissibly reselling the securities in a broker transaction (subject to volume limitations and certain other conditions)	▪ Provided the issuer has been a reporting company (*i.e.*, a company required to file reports under 13 or 15(d) of the Exchange Act) for at least 90 days, the holding period is reduced from one year to six months ▪ Restricted securities of a non-reporting company remain subject to a one-year holding period
A non-affiliate holding restricted securities was subject to a two-year holding period before permissibly reselling the securities (without regard to the volume limitations and other conditions)	▪ Non-affiliates may freely resell restricted securities of reporting companies following the six-month holding period, subject only to the requirement of Rule 144(c) that there be available current public information about the company ▪ Non-affiliates may freely resell restricted securities of both reporting and non-reporting companies held for at least one year without having to comply with any other Rule 144 condition
Resales by affiliates of control securities needed to comply with volume limitations and certain other conditions regardless of how long the securities were held	Affiliates remain subject to the volume limitations and other restrictions under Rule 144, however those restrictions have been eased (although most of the easing has occurred with respect to debt securities, not equity securities)
"Restricted securities" are those securities acquired other than in a public offering (*i.e.*, securities acquired pursuant to certain exemptions from registration). **"Control securities"** are securities held by affiliates of the issuer. **Affiliates** generally include all directors, most executive officers and significant shareholders of a company.	

Planning Tip: For public companies who register their equity compensation plans on a Form S 8, these changes should have little effect on employees and consultants other than those who are affiliates. The changes will impact directors (who generally are affiliates) and employees and consultants who are affiliates holding control securities, since control securities must generally be sold pursuant to Rule 144 unless a resale registration has been filed. In addition, the changes may impact non-affiliate employees of a public company if any restricted stock was granted, or options exercised, prior to the filing of the Form S-8 unless a reoffer prospectus was filed with the Form S-8.

409A is Not Dead, Just Napping

In Notice 2007-86, the IRS postponed the effective date of the final regulations under Code Section 409A. Although this meant that employers could postpone the inevitable for awhile longer (perhaps in the hope that the IRS would issue more definitive guidance in certain key areas), it did not mean that employers should turn away from grappling with 409A compliance issues. Good faith compliance is still the flavor of the day. In addition, the "compliance program" described above requires paying attention to the details and jumping on any corrections issues at once.

Planning Tip: Start cranking the 409A compliance wheel once again. Make sure that all agreements, plans and programs that are subject to Code Section 409A are properly identified. Transition rules may still apply and give some flexibility to amendments, but time is of the essence.

If you have any questions regarding this Management Alert, please contact the Seyfarth Shaw attorney with whom you work, or any Employee Benefits attorney on our website, www.seyfarth.com.

ATLANTA
One Peachtree Pointe
1545 Peachtree Street, N.E.
Suite 700
Atlanta, GA 30309-2401
404-885-1500
404-892-7056 fax

BOSTON
World Trade Center East
Two Seaport Lane
Suite 300
Boston, MA 02210-2028
617-946-4800
617-946-4801 fax

CHICAGO
131 South Dearborn Street
Suite 2400
Chicago, IL 60603-5577
312-460-5000
312-460-7000 fax

HOUSTON
700 Louisiana Street
Suite 3700
Houston, TX 77002-2797
713-225-2300
713-225-2340 fax

LOS ANGELES
One Century Plaza, Suite 3300
2029 Century Park East
Los Angeles, CA 90067-3063
310-277-7200
310-201-5219 fax

NEW YORK
620 8th Avenue
32nd Floor
New York, NY 10018
212-218-5500
212-218-5526 fax

SACRAMENTO
400 Capitol Mall
Suite 2350
Sacramento, CA 95814-4428
916-448-0159
916-558-4839 fax

SAN FRANCISCO
560 Mission Street
Suite 3100
San Francisco, CA 94105-2930
415-397-2823
415-397-8549 fax

WASHINGTON, D.C.
815 Connecticut Avenue, N.W.
Suite 500
Washington, D.C. 20006-4004
202-463-2400
202-828-5393 fax

BRUSSELS
Boulevard du Souverain 280
1160 Brussels, Belgium
(32) (2) 647 60 25
(32) (2) 640 70 71 fax

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ATTORNEYS

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