

## One Minute Memo™



# IRS Announces Correction Program for Discounted Stock Options Under §409A

The Internal Revenue Service has announced a correction program that will allow certain employees to avoid some of the §409A tax penalties that would otherwise result from the 2006 exercise of stock options and stock appreciation rights (SARs) with an exercise price below the fair market value of the stock at the time the award was granted. In order to use the program, an employer must file a notice with the IRS **not later than February 28, 2007**.

In addition to public companies that have granted discounted or backdated stock options and SARs, the program would also be available to privately held companies that have granted stock rights with an exercise price that does not reflect the full fair market value of the stock at the time of grant (for example, because a stale valuation was used to set the exercise price). Under §409A of the Internal Revenue Code, discounted stock rights are treated as a form of nonqualified deferred compensation, which may result in the employee who is granted the stock right being subject to a 20% penalty tax, and interest on the tax retroactive to the year in which the stock right was first granted.

The highlights of the program include:

- The program is available only for discounted stock rights exercised during 2006. Stock rights that were still outstanding at the end of 2006 may be corrected by the end of 2007 under the §409A transition rules.

This One Minute Memo is a periodical publication of Seyfarth Shaw LLP and should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult a lawyer concerning your own situation and any specific legal questions you may have. Any tax information or written tax advice contained herein (including any attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)

Copyright© 2007 Seyfarth Shaw LLP. All rights reserved.

- The program does not apply to insiders of public companies subject to §16 of the Securities Exchange Act of 1934.
- The program requires the employer to pay the 20% penalty tax, and interest retroactive to April 17, 2006, on the exercise of the discounted stock rights, and requires the employee to include this payment as additional compensation income in 2007.

The advantages of the program are that the employee is not individually subject to §409A penalties in 2006, and may also be relieved of penalties on other equity-based deferred compensation arrangements.

A complete copy of the program is contained in IRS Announcement 2007-18, a copy of which is available on the IRS's website at <http://www.irs.gov/pub/irs-drop/a-07-18.pdf>.

As noted above, an employer that wishes to utilize the program must file the initial notice with the IRS not later than February 28, 2007, so immediate action is necessary. If you have any questions about the program, or about §409A and its applicability to equity-based compensation, please contact your Seyfarth Shaw attorney, or any of the attorneys in the Employee Benefits & Executive Compensation Department at [www.seyfarth.com](http://www.seyfarth.com).