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TECHNOLOGY PRACTICE GROUP

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A Message from the Tech Practice Group

Every company is at a different stage of their corporate lifecycle. But regardless of whether you're six months old or six years old, you should be aware of the final IRS regulations under Section 409A. You're not familiar with 409A? Not to worry, we are.

Here are the basics: stock options and deferred compensation plans are very popular in the technology industry. The section of the Internal Revenue Code (409A) that governs these plans has very broad definitions. That's why you need to be cautious when treading in this area. Make certain that your plan meets the complex requirements of the Internal Revenue Code. Why? **Because non-compliance with the tax rules can result in:**

- Taxation at the time of option vesting rather than the intended date of option exercise.
- 20% additional federal tax on the individual in addition to the regular income and employment taxes.
- Potential state tax penalties.
- Potential interest charges.

If not handled properly these regulations and compliance issues can trigger substantial unintended and unplanned costs. Let the members of our Technology Practice Group help guide you through this complicated area.

All the best,

Steve, Jeff and George
Technology Practice Group
Batchelor, Frechette, McCrory, Michael & Co.

THE 4-1-1 ON 409A

A basic introduction to 409A:

1. Determine the fair market value of your company's stock.
2. Identify arrangements that provide for compensation deferral.
3. Develop and implement administrative procedures to ensure compliance.
4. Evaluate compliance on an ongoing basis.
5. Retain the services of a tax professional.

Jeff Allain and Steve Noyes meet with Cliff Grimm (center), Finance and Administrator Manager at EpiVax, Inc. in the Knowledge District.

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A Closer Look at Potential 409A Issues

In April 2007, the IRS issued final regulations under Section 409A. Section 409A applies to compensation that workers earn in one year but that is not paid until a future year, resulting in nonqualified deferred compensation. Under the regulations, unless certain requirements are satisfied, amounts deferred under a nonqualified deferred compensation plan currently are includable in gross income unless such amounts are subject to a substantial risk of forfeiture.

Specifically relating to your stock option plan, if a stock option has an exercise price less than the fair market value of the common stock as of the option grant date, this could constitute a deferred compensation arrangement. The 409A regulations made it more important to have an accurate and objective valuation of the company. The old rule of thumb that the option exercise price could be 10% of the preferred stock price is not a valid and acceptable method of pricing the instrument by the IRS.

Needless to say, the regulations can present compliance issues that could result in negative financial consequences. Quite the opposite goal of having a deferred compensation plan in place.