

Frederic W. Cook & Co., Inc.

New York • Chicago • Los Angeles • San Francisco

October 11, 2006

HEADS-UP ON DEFERRED COMPENSATION GUIDANCE

**Extension of Section 409A Plan Amendment
Deadline and Other Transition Relief**

The Internal Revenue Service has extended until December 31, 2007 the deadline for amending nonqualified deferred compensation plans and arrangements to comply with the deferred compensation provisions of Section 409A of the Internal Revenue Code (IRC).

Other transition relief contained in IRS Notice 2006-79 (issued on October 4th) extends until December 31, 2007 the date for:

- Making new payment elections as to the time and form of payment of deferred compensation without being subject to the requirements for a change in payment elections (including the prohibition on acceleration of payment)
- Linking a payment election under a nonqualified deferred compensation plan to an election under a tax-qualified retirement plan without violating Section 409A
- Amending a discount stock option to provide for fixed payment terms consistent with Section 409A or to permit the optionee to elect fixed payment terms
- Replacing or modifying a discount stock option subject to Section 409A with an option that would not be treated as providing for deferred compensation under Section 409A

None of the transition relief applies to certain discount stock options that are the result of backdated options. Accordingly, any action to avoid the application of Section 409A to these options must be taken by the end of 2006.

DECEMBER 31, 2007 AMENDMENT DEADLINE

The deadline for amending nonqualified deferred compensation plans and arrangements for compliance with Section 409A has been extended by an additional year. A plan or arrangement adopted (or entered into) before December 31, 2007 must be amended by December 31, 2007 to conform to the requirements of Section 409A.

The plan or arrangement must be operated through that date in good faith compliance with Section 409A, the provisions of Notice 2005-1, and any other generally applicable published guidance that has an effective date prior to January 1, 2008. It is permissible to comply with a provision of the proposed Section 409A regulations issued on September 29, 2005, or the final regulations when they are issued (which is expected later this year), if the provision is inconsistent with the Notice. In addition, a provision of the proposed regulations may be followed prior to January 1, 2008 even if it is inconsistent with a provision of the final regulations.

NEW PAYMENT ELECTIONS

A new payment election of the time or form of payment of amounts subject to Section 409A is generally required to (i) be made at least 12 months prior to the scheduled payment date, (ii) result in a delay of payment for at least 5 years from the scheduled payment date and (iii) not accelerate payment. IRS Notice 2006-79 extends until December 31, 2007 the date that a new election can be made without being subject to those requirements. The plan or arrangement must be amended by December 31, 2007 to provide for the new elections. Multiple elections are permissible.

However, if the new election is made in 2006 it can only be made with respect to payments that would otherwise be received after 2006 and cannot result in payments being made in 2006. Similarly, a new election in 2007 cannot be made with respect to payments that would otherwise be received in 2007, nor can it result in payments being made in 2007.

IRS Notice 2006-79 also provides that a deferral election may be made with respect to a “short-term deferral” as defined in the proposed regulations under Section 409A if the election is made before both

- January 1, 2008; and
- The year in which the amount would otherwise have been paid.

PAYMENTS BASED ON QUALIFIED RETIREMENT PLAN ELECTION

Payments under supplemental executive retirement plans and excess retirement plans that are determined by payment elections made under a tax-qualified retirement plan can be made or commenced through December 31, 2007 without violating the requirements of Section 409A relating to the timing and form of payment, provided that such determinations are made in accordance with the terms of the plan as of October 3, 2004. IRS Notice 2006-79 extends this relief to other employer plans in addition to tax-qualified retirement plans under IRC 401(a); i.e., IRC Section 403(b) annuities, deferred compensation plans of state and local governments and tax-exempt organizations that meet the requirements of IRC 457(b), and certain foreign broad-based plans as described in the proposed IRC Section 409A regulations.

DISCOUNT STOCK OPTIONS

Election of Fixed Payment Terms. The extension of the deadline for new payment elections can also be applied to modify a discount stock option or a stock appreciation right (SAR) that was not fully vested on December 31, 2004¹ to comply with Section 409A. The option or SAR may be amended to provide for one or more fixed exercise dates or to provide the holder of the option or SAR with an election to specify a fixed exercise date or dates, provided that the amendment is made on or before December 31, 2007 and any elections are made on or before that date.

Replacement of Discount Stock Options and SARs. IRS Notice 2006-79 extends until December 31, 2007 the deadline to replace discount stock options and SARs that were not fully vested as of December 31, 2004 with stock options or SARs that eliminate the discount. The replacement cannot result in the cancellation of a deferral in exchange for cash or vested stock (or other property) in the year of cancellation; i.e., if the replacement occurs in 2006 (or 2007) cash or vested property cannot be issued in 2006 (2007).

NO EXTENSION FOR BACKDATED OPTIONS

None of the extended transition relief in IRS Notice 2006-79 applies to certain backdated stock options (or SARs) that were not vested on December 31, 2004. According to the Notice, the transition relief is not available to a discount stock option or SAR

- Granted by a publicly traded corporation as of the date of grant;
- Granted to a person subject as of the date of grant to the disclosure requirements of Section 16(a) of the Securities Exchange Act of 1934; and
- If the corporation with respect to the grant has reported (or reasonably expects to report) a financial expense that
 - Is due to the issuance of a discount stock option or SAR; and
 - Was not timely reported on financial statements or reports for the period in which the related expense should have been reported under GAAP.

As a result, all necessary action required to avoid the treatment of the stock option or SAR as deferred compensation under Section 409A must be taken no later than December 31, 2006.

¹ Section 409A does not apply to discount stock options and SARs to the extent they were vested on December 31, 2004.

This letter is intended to alert compensation professionals about developments that may affect their companies, and should not be considered or relied upon as legal advice. Specific questions about the applicability of Section 409A to compensation plans and arrangements should be discussed with appropriate counsel. General questions applicable to Section 409A may be directed to Richard Alpern in our New York offices at 212-299-3599 or by email at ralpern@fwcook.com. Copies of this letter and other published materials relating to Section 409A are available on our website, www.fwcook.com, under the following links:

<u>Date</u>	<u>Title</u>	<u>Website Link</u>
October 12, 2004	Heads-Up on Deferred Compensation Legislation	http://www.fwcook.com/alert_letters/10-12-04_Heads-Up_on_Deferred_Compensation....pdf
December 2, 2004	Provisions Affecting Deferred Compensation in the American Jobs Creation Act of 2004	http://www.fwcook.com/alert_letters/12-2-04_Provisions_Affecting_Deferred_Compensation.pdf
December 22, 2004	Heads-Up On Deferred Compensation Guidance	http://www.fwcook.com/alert_letters/12-22-04_Heads-Up_on_Deferred_Compensation_Guidance.pdf
February 28, 2005	Action Items in Response to IRS Guidance on Deferred Compensation	http://www.fwcook.com/alert_letters/2-28-05_Action_Items_In_Reponse_to_IRS_Guidance_On....pdf
October 7, 2005	Heads-Up On Deferred Compensation Guidance	http://www.fwcook.com/alert_letters/10-7-05_Heads-Up_On_Deferred_Compensation_Guidance.pdf
November 3, 2005	Year End Action on Deferred Compensation	http://www.fwcook.com/alert_letters/11-3-05_Year-End-Action-on-Deferred-Compensation.pdf