January 3, 2006

CC:PA:LPD:PR (REG-158080-04)
Internal Revenue Service
Room 5203
P. O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Comments on Proposed Regulations Under Section 409A

Dear Sir or Madam:

We are writing on behalf of our clients to request guidance on issues under section 409A of the Internal Revenue Code (the "Code") and the proposed regulations thereunder. 70 Fed. Reg. 57930 (Oct. 4, 2005). The issues discussed below are extremely important to our clients as they attempt to address the impact of section 409A and IRS guidance thereunder on their compensation and benefit plans. We understand that Treasury and IRS personnel are trying to finalize regulations under section 409A on an expedited basis. We appreciate your considering the requests discussed below.

Executive Summary

1. Extension of Option Exercise Period

We request that regulations provide that the extension of an option exercise period beyond the timeframe provided in the proposed regulations will not subject the option to section 409A. We also request that regulations provide transition relief for the extension of an option exercise period prior to the effective date of final regulations, based on good faith reliance on section 409A and Notice 2005-1.

2. Electronic Administration

We request that regulations confirm that any action taken by a service provider or a service recipient through electronic media, including an initial deferral election or an election to change the time or form of distribution, does not fail to meet the requirements of section 409A merely because it is made through electronic media.

3. **Alternative Payment Schedules Upon a Permissible Distributable Event**

We request that regulations expand the rule that allows alternative payment schedules based on whether a permissible distributable event occurs on or before one (but not more than one) specified date. Specifically, the regulations should (1) allow alternative payment schedules based on whether a permissible distributable event occurs on or before a participant reaches "retirement age," as that term is defined under the arrangement, or (2) allow alternative payment schedules based on more than one date.

4. **Exemption for Moving Expense Reimbursements**

We request that regulations make clear that, solely for purposes of the exemption for termination-related reimbursements, "reasonable moving expenses" include losses and other costs incurred by a service provider in connection with the purchase or sale of a primary residence. In addition, we request that regulations provide a parallel exemption for such reimbursements paid when an individual starts work at a new location.

5. **Flexibility in Application of Specified Employee Rule**

We request that regulations permit the 12-month period when individuals will be treated as specified employees to begin as of any date between (1) the date on which such individuals are determined to be specified employees (the "identification date") and (2) the first day of the fourth month following the identification date.

Supporting Explanation

1. **Extension of Option Exercise Period**

Proposal: We request that regulations provide that the extension of an option exercise period beyond the timeframe provided in the proposed regulations will not subject the option to section 409A. We also request that regulations provide transition relief for the extension of an option exercise period prior to the effective date of final regulations, based on good faith reliance on section 409A and Notice 2005-1.

Explanation: The proposed regulations under section 409A generally provide that an otherwise exempt stock option becomes subject to section 409A if the option exercise period is extended beyond the later of December 31 of the calendar year in which, or 2 ½

months following the date at which, the option would otherwise have expired. Prop. Reg. § 1.409A-1(b)(5)(v). While this rule provides some limited flexibility for extending an option's exercise period, among other problems, it does not provide for equal treatment of all employees. For example, an employee terminated in January could be given substantially more time to exercise an option under this rule than an employee terminated in December.

A. Permit Longer Extensions

i. Extensions to End of Original Term

We request that regulations provide that an extension of an option exercise period will not subject the option to section 409A, as long as the extension does not exceed the original term of the option. But for an employee's separation from service, a vested option would be exercisable for the full original term (typically 10 years from grant date). Thus, permitting extensions to the end of the original term will not result in an "additional deferral" beyond the date the compensation could have been paid under the original terms of the arrangement.[1] An employer may desire to keep an involuntarily terminated employee whole by extending the option exercise period following termination, but the rule in the proposed regulations effectively eliminates the employer's ability to do so.

ii. Alternative Relief

If the regulations do not permit an extension for the remainder of the original term, we request that regulations permit (1) an extension up to a one-year safe harbor period, and (2) an extension for all options (up to the original term) held by affected employees following a specific business event.

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[1] We note that the NYSE states in its "Frequently Asked Questions on Equity Compensation Plans" that such an extension of post-termination option exercise periods would not be considered a material revision requiring shareholder approval for the same reason.

The first proposal eliminates the unequal treatment of employees discussed above by permitting an employer to provide each employee with up to a one-year period of time to exercise an option after termination. Importantly, this one-year safe harbor period will not provide for the deferral of income into years beyond those otherwise permitted by the proposed regulations. For example, under the proposed regulations, an employee who terminates on December 1, 2007 could have until February 15, 2008 to exercise an option, and thus, any income generated from the exercise would be recognized no later than 2008. Similarly, under the proposed one-year safe harbor, an employee terminated on December 1, 2007 would have until November 30, 2008 to exercise the option and recognize the income in 2008.

The second proposal would permit longer extensions where employees are terminated pursuant to a specific business event (e.g., a merger or reduction in force), provided that all similarly situated employees receive the same treatment. As many employers provide options to all or a substantial portion of their workforce, such a rule could help minimize the impact of such events on rank-and-file employees. The IRS has provided similar exceptions in other areas to allow employers to provide more favorable treatment to displaced workers on a nondiscriminatory basis. For example, the regulations under Code section 401(a)(4) preventing discrimination under qualified plans permit the crediting of imputed service after a termination of employment so long as all similarly-situated employees receive the same treatment (See Treas. Reg. § 1.401(a)(4)-11(d)(3)); and also provide more favorable testing rules for "early retirement window" benefits (See Treas. Reg. § 1.401(a)(4)-3(f)(4)).

B. Good Faith Reliance Prior to Proposed Regulations

We also request that regulations provide relief for extensions made in good faith reliance on section 409A and Notice 2005-1 through the effective date of the final regulations. Nothing in section 409A nor Notice 2005-1 clearly indicated that an extension of an option exercise period would subject an otherwise exempt option to section 409A, and many taxpayers and their advisers reasonably believed that such extensions would be permitted. Treasury and IRS personnel have repeatedly indicated that they do not want the section 409A rules to create traps for the unwary. Unless additional relief is provided, however, the option extension rule could do so and require employers to rescind or revisit any such extensions.

2. Electronic Administration

Proposal: We request that regulations confirm that any action taken by a service provider or a service recipient through electronic media, including an initial deferral election or an election to change the time or form of distribution, does not fail to meet the requirements of section 409A merely because it is made through electronic media.

Explanation: Under the proposed regulations, a nonqualified deferred compensation arrangement subject to section 409A must be set forth in writing. However, no provision of section 409A, its legislative history, Notice 2005-1, or the proposed regulations (1) requires that any action taken by a service provider or service recipient under such an arrangement be conducted through written paper documents, or (2) prohibits conducting any such transactions through an electronic media.

In Notice 99-1, the IRS found that no provision of Code section 401(a) or Code section 401(k), applicable regulations thereunder, or other published guidance (1) required that, among other things, participant enrollments, contribution elections, or direct rollover elections be conducted through written paper documents, or (2) prohibited conducting such transactions through electronic media. Based on this finding, the IRS concluded that a plan does not fail to meet the requirements of Code sections 401(a) and 401(k) merely because it permits a participant or beneficiary to use electronic media for such transactions. Because the IRS has confirmed the use of electronic media for these purposes, we request that, the IRS confirm that the same is true for purposes of section 409A.

In addition to Notice 99-1, the IRS recently issued proposed regulations that reflect the Electronic Signatures in Global and National Commerce Act ("E-SIGN"), relating to numerous employee benefit plan requirements. 70 Fed. Reg. 40675 (July 14, 2005). Under the proposed regulations, transactions that are otherwise required to be in writing under the Code or IRS regulations may be conducted through an electronic media if certain requirements are met. For those transactions not required to be in writing, the regulations would function as a safe harbor. The proposed regulations did not address section 409A arrangements, possibly because the statutory provisions are relatively new. We recommend that so long as the requirements of the proposed regulations are satisfied, the IRS should allow any action otherwise required under section 409A to be conducted

through an electronic media, regardless of whether such actions are required to be in writing.

We respectfully submit that consistent guidance in the electronic administration of plans will produce cost savings and administrative benefits to employers, administrators, and plan participants and further the evolution to paperless plan administration. Thus, it is important that Treasury and the Service provide favorable guidance in this area as soon as possible.

3. Alternative Payment Schedules Upon a Permissible Distributable Event

Proposal: We request that regulations expand the rule that allows alternative payment schedules based on whether a permissible distributable event occurs on or before one (but not more than one) specified date. Specifically, the regulations should (1) allow alternative payment schedules based on whether a permissible distributable event occurs on or before a participant reaches "retirement age," as that term is defined under the arrangement, or (2) allow alternative payment schedules based on more than one date.

Explanation: Under the proposed regulations, an arrangement may allow for an alternative payment schedule if a permissible distributable event occurs on or before one (but not more than one) specified date. The proposed rules provide the following example to illustrate this rule:

> For example, an arrangement may provide that a service provider will receive a lump sum payment of the service provider's entire benefit under the arrangement on the first day of the month following a separation from service before age 55, but will receive 5 substantially equal annual payments commencing on the first day of the month following a separation from service on or after age 55.

Prop. Reg. § 1.409A-3(c).

Similar to this plan design, many nonqualified deferred compensation plans provide that a service provider will receive a lump sum payment if a separation from service occurs before reaching "retirement age," but will receive payments according to his elected schedule if the separation occurs after reaching "retirement age." For

example, the plan may define "retirement age" as the earlier of the date on which a participant (1) attains age 55 and completes 10 years of service, or (2) attains age 65.

In this common plan design, although a participant could reach "retirement age" on more than one date, in operation, the participant will attain "retirement age" on only one date – the earlier of the dates in the definition. Thus, "retirement age" should be construed to represent one date. Therefore, we request that the IRS expand the rule to include alternative payment schedules based on whether a permissible distributable event occurs on or before a participant reaches "retirement age," as that term is defined under a plan. This limited expansion of the alternate payment schedule rule would not lead to the abuses the rule is intended to prevent.

If final regulations do not treat this type of "retirement age" as a single date, we request that the IRS allow alternative payment schedules based on multiple dates. Allowing alternative payment schedules based on more than one date will accommodate those arrangements that define "retirement age" in the manner described above.

4. Exemption for Moving Expense Reimbursements

Proposal: We request that regulations make clear that, solely for purposes of the exemption for termination-related reimbursements, "reasonable moving expenses" include losses and other costs incurred by a service provider in connection with the purchase or sale of a primary residence. In addition, we request that regulations provide a parallel exemption for such reimbursements paid when an individual commences work at a new location.

Explanation: The proposed regulations generally provide an exemption from section 409A for "payment by a service recipient for a limited period of time of reimbursements... [of] reasonable moving expenses actually incurred by the service provider and directly related to the termination of services for the service recipient." Prop. Reg. § 1.409A-1(b)(9)(iv). Although this exemption provides helpful relief, additional clarification on the scope of the term "reasonable moving expenses" would be helpful. For example, employers often provide relocation assistance following a separation from service, including reimbursement for travel costs as well as losses and closing costs and fees (including real estate commissions) associated with the purchase or

sale of a primary residence. We request that the regulations clarify that these types of relocation expenses are reasonable moving expenses for this limited purpose.

The same types of relocation assistance are often provided by employers as a result of an individual commencing work at a new location. We also request that the regulations provide a parallel exemption for such reasonable moving expense reimbursements as a result of an individual starting work at a new location.

5. **Flexibility in Application of Specified Employee Rule**

Proposal: We request that regulations permit the 12-month period when individuals will be treated as specified employees to begin as of any date between (1) the date on which such individuals are determined to be specified employees (the "identification date") and (2) the first day of the fourth month following the identification date.

Explanation: The proposed regulations provide that an individual who qualifies as a specified employee on an identification date will be treated as such "for the 12-month period beginning on the first day of the fourth month following the identification date." Prop. Reg. § 1.409A-1(i)(1). During this 12-month period, the specified employee will be subject to a six month delay on payments triggered by a separation from service.

Although the three to four month period this rule provides to implement the delay for specified employees is appreciated, additional flexibility with respect to the commencement of the 12-month period would be helpful. For example, some employers who will use December 31 as the identification date would like to begin the 12-month period on January 1 of the following year. Such a rule would provide employers with two administratively convenient features: (1) the ability to use annual compensation data (e.g., Form W-2 wages) to determine specified employees and (2) the ability to run the 12-month period on a calendar year basis.

We request that regulations permit the 12-month period to begin as of any date between (1) the date on which such individuals are determined to be specified employees (the "identification date") and (2) the first day of the fourth month following the identification date. Even with this additional flexibility, the 12-month period would always begin on or before the date provided in the proposed regulations (the first day of the fourth month following the identification date).

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We hope that these comments are helpful to you in providing additional guidance under Code section 409A. Please contact us at 202-857-0620 if we can answer any questions or provide any further information.

Sincerely,

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