

IRS Issues Guidance on the Application of Code Section 409A to Outstanding Stock Rights

January 4, 2006

Notice 2006-4 (to be published in Internal Revenue Bulletin 2006-3 on January 17, 2006), provides some additional guidance with respect to determining whether stock options and/or stock appreciation rights ("stock rights") may be excluded from the application of Code Section 409A. In general, stock rights are not subject to Code Section 409A if their exercise price can never be less than the stock's fair market value ("FMV") on the date of grant, and also if there is no additional deferral feature contained in the stock right. The exercise price for nonvested stock rights issued before January 1, 2005, can be determined by demonstrating that good faith was used to set the exercise price at FMV in accordance with the rules governing incentive stock options. All stock rights issued after December 31, 2004, but prior to the effective date of the final regulations (proposed to be January 1, 2007), can rely upon any reasonable valuation method to determine a stock right's FMV, as set forth in Notice 2005-1.

If you have further questions about this alert you may contact our Federal Tax and Employee Benefits Group; Michael A. Indenbaum at (313) 496-7679, email: indenbaum@millercanfield.com; Orin D. Brustad at (313) 496-7605, email: brustad@millercanfield.com; Deborah W. Thompson at (313) 496-7671, email: thompson@millercanfield.com; Ryan J. Riehl at (313) 496-7539, email: riehl@millercanfield.com; or Marianna J. Perakis at (313) 496-7558, email: perakis@millercanfield.com. This message is for general information only and should not be used as a basis for specific action without obtaining further legal advice.