GD Gunderson Dettmer Client Alert

2012 Year-End Executive Compensation Matters:

Section 409A Compliance Opportunity, Year-End Stock Plan Transaction Reporting and Other Recent Developments

November 2012

This Alert highlights certain compensation-related matters that clients should consider as we approach the end of 2012.

Window Closing to Correct Certain IRC Section 409A Arrangements

As in recent years, the end of this calendar year presents another opportunity to take certain corrective actions with respect to compensation arrangements having implications under Internal Revenue Code Section 409A. Section 409A applies a 20% penalty tax, plus interest, to nonqualified deferred compensation arrangements that do not comply with its strict payment timing rules and other requirements.

During the past couple of years, one of the most common corrective methods has been to amend unvested but potentially noncompliant arrangements under proposed income inclusion regulations, which offer a flexible corrections approach that requires neither IRS filings nor penalty payments. The proposed regulations generally permit amendments to correct an arrangement in a year prior to the year in which the amounts payable under the arrangement are triggered and paid. Treasury Department personnel have signaled that when final proposed income inclusion regulations are released in 2013, this "loophole" is likely to be narrowed significantly. Accordingly, for arrangements not expected to vest and be paid during 2012, the end of this year may present a final opportunity to utilize this corrections method.

In addition, under guidance released in 2010, employers have only until December 31, 2012 to correct certain employment, severance, change in control and similar arrangements under which an employee must execute a release of claims before receiving a payment (such as severance), where the timing of a payment depends on the date when the employee delivers an executed release. An arrangement specifying that a release can be delivered to the employer during a period that spans two tax years (e.g., a 60-day period that could commence after the beginning of November and extend into the following year) provides the employee or employer with impermissible discretion to select the year of payment. It is important to note that only an arrangement that is subject to Section 409A (that is, is not eligible for an exemption from application of Section 409A) must be corrected under this formal process. Also, this process is available only for arrangements that were in effect on December 31, 2010.

Many of our clients' employment, severance, change in control and similar arrangements that make a payment contingent upon a release of claims are structured to be exempt from Section 409A, and many exempt and non-exempt arrangements of this type were amended in 2010 to "hard-wire" the year in which a payment is to be made. Nonetheless, if an employer has an arrangement under which a payment is conditioned on the employee's delivery of a release of claims and the payment timing depends on the date when the release is delivered or becomes effective without addressing the "spanning two years" situation, then we recommend having such an arrangement reviewed to determine whether it is advisable to make any 409A-driven changes prior to December 31, 2012.

Year-End Reporting of ISO Exercises and ESPP Purchases

This is a reminder that employers must file information returns with the IRS and provide employees with information statements related to incentive stock option exercises that occurred during the 2012 calendar year. Similarly, employers (typically relevant only for public companies) must file information returns with the IRS and provide employees with information statements related to initial transfers of stock acquired during the 2012 calendar year under an employee stock purchase plan that complies with Internal Revenue Code Section 423.

The information returns to be filed with the IRS are Form 3921 (for incentive stock option exercises) and Form 3922 (for transfers of shares acquired under an employee stock purchase plan). Employers may satisfy the requirement to provide employees with an information statement (formerly referred to as a Section 6039 statement) by delivering to the employee "Copy B" of the applicable Form 3921 or 3922 or they may use substitute forms for the employee information statements, so long as the substitute forms meet published IRS guidance as to form and content.

The delivery and filing deadlines are as follows:

- January 31 – Deadline to furnish an information statement to employees.
- February 28 – Deadline to file return, if filing a paper copy.
- April 1 – Deadline to file return, if filing electronically with IRS. (March 31 falls on a Sunday, so the deadline this year is April 1)

Companies reporting 250 or more transactions (applied separately to transactions under each of Form 3921 and Form 3922) in a year are required to file electronically. Note that each option exercise or stock transfer is a separate transaction, and therefore multiple transactions by a single individual trigger multiple filings.

The penalty for late and incorrect filings ranges from $30 - $100 per form, with a maximum penalty of $1.5 million. The penalty for intentional disregard of these requirements is $250 per form, with no maximum. The IRS will grant an automatic 30-day extension upon filing a Form 8809, which must be filed electronically or by paper by the applicable deadline. Companies may request an additional 30-day extension due to a claimed hardship, but such extension will not be automatically granted by the IRS.

Third-party vendors are available to assist companies with preparing and filing Forms 3921 and 3922. For a list of vendors, please contact the attorney with whom you regularly work at Gunderson Dettmer or see the IRS website at www.irs.ustreas.gov/pub/irs-pdf/p1582.pdf.

Reporting Requirements of U.S. Taxpayers Holding Equity Awards From Non-U.S. Employers

This is a reminder that taxpayers receiving equity awards or certain other compensation from foreign companies must file a form with the IRS as part of their 2012 tax returns. The Foreign Account Tax Compliance Act (FATCA), which is intended to combat tax evasion by U.S. taxpayers holding non-U.S. assets, has a very broad reach. One component of FATCA may require U.S. taxpayers receiving equity awards from foreign companies to file a form with the IRS as part of their 2012 tax returns.

FATCA requires that U.S. taxpayers (*i.e.*, U.S. citizens, U.S. tax residents, and non-resident aliens who have elected to be taxed as U.S. residents) report to the IRS information annually on Form 8938 about their non-U.S. financial assets, if those assets exceed certain thresholds. For this purpose, non-U.S. financial assets include equity compensation awards, incentive compensation, pension, deferred compensation and other compensation plans sponsored or granted by a non-U.S. employer or a non-U.S. parent or holding company. (Assets not subject to FATCA reporting include assets held in a U.S. financial account or an account of a non-U.S. subsidiary of a U.S. financial institution.)

For individuals living in the U.S. (*i.e.*, those who do not qualify for the foreign earned income exclusion under Section 911 of the Code), the reporting thresholds are as follows:

Filing Status	Value of Specified Non-U.S. Assets Exceeds	
	On Last Day of Year	At Any Time During Year
Single or Married Filing Separately	$50,000	$75,000
Married Filing Jointly	$100,000	$150,000

Higher thresholds apply to those living outside the U.S. (*i.e.*, those who qualify for the foreign earned income exclusion under Section 911 of the Code).

Note that this reporting obligation falls entirely on U.S. employees and consultants, rather than their employers. However, employees will need guidance from their employers about the value of plan awards in order to comply with the reporting requirements. As a result, employers may want to consider communicating the requirement and the value of plan awards to individuals who are subject to FATCA reporting.

FATCA reporting for the 2012 tax year is due on April 15, 2013, unless an individual obtains an extension to file his or her 2012 federal income tax return. The penalty for failure to file a timely Form 8938 is $10,000, which can be increased up to $50,000 for each failure.

California Requires All Commissions Plans To Be In Writing

Effective January 1, 2013, employees performing any work in California and paid in whole or in part on a commission basis must be provided a written agreement setting forth the method by which their commissions will be computed and paid. For this purpose, “commissions” excludes (a) bonuses and profit-sharing plans, unless the employer pays a fixed percentage of sales or profits as compensation for work to be performed; and (b) temporary, variable incentive payments that increase, but do not decrease, compensatory payments.

This requirement applies to all employers with commissioned employees who provide services within California, regardless of whether the employer has a fixed place of business in California. Accordingly, even out-of-state employers without physical facilities in California are subject to this requirement with respect to any commissioned employees who work in California. Moreover, employees whose primary work location is out-of-state but who nonetheless render part of their commissioned services in California are also subject to this requirement.

The written commission agreement must be signed by the employer, and the employee must sign a receipt for the agreement. We recommend that the signed acknowledgement be placed in the employee's personnel file.

Lastly, if the written commission agreement expires and the employee continues working without a new agreement, the terms of the expired agreement will continue to govern until superseded by a new agreement or until termination of the employment relationship by either party.

Supplemental Unemployment Compensation Benefits Potentially Not Subject to FICA Taxes

In *U.S. v. Quality Stores*, No. 10-1563 (6th Cir. Sept. 7, 2012), the Sixth Circuit Court of Appeals held that supplemental unemployment compensation benefits, or SUB payments, are not wages subject to FICA taxes. In general, SUB payments are paid to employees pursuant to a plan in connection with an involuntary separation from employment resulting from a reduction in force or discontinuance of a plant or operation.

This holding is contrary to IRS guidance and prior case law, and we anticipate that it will not be the last word on this topic. The Department of Justice has already filed a petition for a rehearing of the case with the Sixth Circuit, and has indicated that total refund claims nationwide already exceed $1 billion. Nonetheless, employers may want to consider filing refund claims for FICA taxes paid on past severance payments that qualify as SUB payments. The statute of limitations for filing a refund claim for SUB payments paid in 2009 ends on April 15, 2013. Prospectively, the case presents tax planning opportunities for companies engaging in reductions in force.

California Court Calls into Question Post-Employment Non-Competition and Non-Solicitation Restrictions Related to Business Sale

In *Fillpoint, LLC v. Maas*, No. G045057 (Cal. Ct. App. Aug. 24, 2012), a California court has called into question the enforceability of a non-competition and non-solicitation agreement with a specified restriction period tied to termination of employment with the buyer, rather than to the closing of a merger transaction. California provides an exception for non-competition and non-solicitation restrictions when executed in connection with the sale of a business in order to protect the goodwill of the seller company.

In the *Fillpoint* case, the court held that a restriction period tied to subsequent termination of employment did not operate to protect the goodwill of the seller company, particularly since the sale of the business had occurred more than three years prior to the termination of employment.

Although the impact of this case on the practice of implementing non-competition and non-solicitation restrictions entered into in connection with mergers and acquisitions remains to be seen, companies are advised to review these restrictions carefully.

Gunderson Dettmer's lawyers are available to assist in addressing questions you may have regarding the issues discussed in this Alert. Please contact the Gunderson Dettmer attorney with whom you regularly work. Contact information for our attorneys can be found at www.gunder.com.