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February 27, 2006

Mr. Eric Solomon
Acting Deputy Assistant Secretary (Tax Policy)
Department of the Treasury
Room 3112 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Mark W. Everson
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Proposed Regulations Under Section 409A of the Internal Revenue Code

Dear Acting Deputy Assistant Secretary Solomon and Commissioner Everson:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1104 (the "Report") on the proposed regulations under Section 409A of the Internal Revenue Code (the "Proposed Regulations"). The Report follows our earlier report, No. 1091, on Notice 2005-1, which provided initial guidance under Section 409A.

In enacting Section 409A, Congress entered a highly complex and technical area with a relatively brief new statutory provision that nonetheless has broad implications for the compensation practices of businesses employing U.S. taxpayers. Treasury and the IRS issued preliminary guidance and needed transition relief in Notice 2005-1. With the Proposed Regulations, which are far more comprehensive in scope than Notice 2005-1, Treasury and the IRS continue to address the Congressional concerns that led to the enactment of Section 409A.

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The Proposed Regulations reflect a careful consideration by Treasury and the IRS of many comments received from practitioners, including a number of our prior suggestions. The proposals are a positive step in providing understandable rules that service recipients and service providers can apply in practice. We appreciate the attention to our concerns and, more generally, the thoughtful and responsive approach that the Proposed Regulations take to this new and complex statute.

Against this backdrop, we offer the enclosed Report. It provides our comments on a number of discrete issues arising under the Proposed Regulations, with a view to furthering the statute's purpose to curtail abusive deferral practices and manipulation of the timing of income recognition, while not unduly restricting legitimate and non-abusive compensatory practices.

One of the many issues addressed in the Report concerns the modification of stock rights. Part IV, A of the Report recommends that the Proposed Regulations should conform to the rules applicable under Section 424 of the Code. In general, this would mean that (1) if a stock right that was originally excluded from Section 409A is modified at a time when it is not "in the money," the stock right would continue to be so excluded and (2) if the modification occurs when the stock right is "in the money," the stock right would become subject to Section 409A but only as of the date of the modification, not from the date of grant as provided by the Proposed Regulations.

Another issue addressed by the Report concerns the definition of "preferred stock," which under the Proposed Regulations is excluded from the category of service recipient stock as to which a stock right falling outside of Section 409A may be granted. While we acknowledge the concerns underlying this exclusion, we think it is inappropriate to exclude from the definition of service recipient stock every class of stock that has any liquidation or dividend preference. We recommend that the final regulations narrow the definition of preferred stock to permit the use of stock that participates in corporate growth and meets certain other requirements designed to ensure that rights with respect to such stock cannot be used as a proxy for deferred compensation.

We believe that the rule of the Proposed Regulations limiting the definition of service recipient stock to the stock of a member of a controlled group that is publicly-traded, or to stock that constitutes the largest class of stock by value, is too limiting and will unduly restrict ordinary business practices in non-abusive situations. We recommend that the definition of service recipient stock include any class of acceptable stock of a service recipient or member of a controlled group, provided that the issuer thereof is in the same vertical chain with the service recipient, or the use of such stock is based on legitimate business criteria. We also recommend that it include any acceptable stock of the service recipient itself.

Please see the Executive Summary of the Report for a brief discussion of a number of the specific recommendations we make.

We appreciate your consideration of our comments and would be pleased to discuss them with you further. We would be happy to provide any other assistance that you would find helpful.

Respectfully submitted,



Kimberly S. Blanchard
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