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June 28, 2005

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

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. 1091 (the "Report") on the treatment of deferred compensation under Section 409A of the Internal Revenue Code. The Report focuses specifically on Notice 2005-1, which provides initial guidance under Section 409A.

Section 409A, which was added by the American Jobs Creation Act of 2004, provides a new statutory framework for the taxation of non-qualified deferred compensation. Congress recognized the complexity of the far-reaching changes that would be mandated under Section 409A and gave broad latitude to Treasury and the Service to craft regulations. Notice 2005-1 has provided thoughtful transition and other substantive guidance within the short timeframe mandated by Congress. We think the Notice provides a solid foundation on which to build further guidance. Set out below, however, are recommendations intended to refine some of the positions initially taken in the Notice and to respond to certain specific items on which comments were requested.

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Our recommendations have been guided by the proposition that new proposed or temporary regulations implementing Section 409A should (i) interfere as little as possible with legitimate compensatory practices that have independent business attributes apart from the deferral of taxation, (ii) not impose greater formality on regular compensatory practices than is necessary to monitor compliance with the statutory framework and regulatory exceptions, (iii) provide solutions that can be implemented and enforced in a uniform and practical way, and (iv) still provide assurance that the abusive practices at which Section 409A is aimed will be curtailed.

As more fully discussed in the Report, we recommend that (a) the categorization of “plans” into the three groups specified in the Notice should be refined for purposes of assessing the tax penalties for compliance failures, (b) certain specified circumstances that may cause a delay in payment of compensation should not be considered to violate the requirements of Section 409A (and the mere potential for deferral should not implicate Section 409A where no deferral in fact occurs), (c) the special purpose and nature of equity-based compensation should be recognized and its design impacted as little as possible -- for example, stock options and stock appreciation rights (including cash settled rights) should receive comparable tax treatment, (d) it may be appropriate to relax certain requirements to accommodate corporate transactions and restructurings (particularly in respect of the ability to terminate, cash out or modify outstanding equity-based plans or awards), and (e) the special nature of severance payments should be recognized with specific rules developed to regulate the particular abuses perceived by Congress (*e.g.*, key employees unfairly obtaining payments in advance of others).

Our Report contains additional technical recommendations. We appreciate your consideration of our comments. If you have any questions regarding this Report, please feel free to contact us and we will be glad to discuss them or to assist you in any way.

Respectfully submitted,



David P. Hariton  
Chair

cc: Michael J. Desmond, Acting Tax Legislative Counsel,  
Department of the Treasury  
W. Thomas Reeder, Associate Benefits Tax Counsel,  
Office of the Benefits Tax Counsel, Department of the Treasury  
Daniel Hogans, Attorney Advisor,  
Office of the Benefits Tax Counsel, Department of the Treasury  
Donald L. Korb, Chief Counsel,  
Internal Revenue Service  
Nancy J. Marks, Division Counsel/Associate Chief Counsel (TEGE),  
Internal Revenue Service  
Robert B. Misner, Senior Technician Reviewer,  
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Internal Revenue Service  
Stephen B. Tackney, Attorney,  
Office of Division Counsel/Associate Chief Counsel (TEGE),  
Internal Revenue Service