

Update

Pensions Law

October 2, 2006

Potential Effect of New Rules under Section 409A of the U.S. Internal Revenue Code on Certain Canadian Plans

If your company sponsors an equity incentive plan under which stock options or stock appreciation rights have been granted with an exercise price that was below fair market value at the time of the grant, or a supplemental employee retirement plan, deferred stock unit plan, or other type of incentive or retirement compensation plan that falls within the broad meaning of “Deferred Compensation” for purposes of the Internal Revenue Code, plan amendments may be required in order to avoid adverse U.S. tax consequences for certain plan participants. If your plan includes U.S. taxpayers as members, you may need to take steps before December 31, 2006 to ensure that plan members who are U.S. taxpayers are not exposed to a 20% additional tax and certain other U.S. tax penalties by reason of the failure to comply with the new requirements.

Section 409A of the U.S. Internal Revenue Code sets out conditions that non-qualified deferred compensation plans (NQDCs) must meet to qualify for tax deferral. Certain transitional rules under this section, which allow employers to amend plans, make certain elections or replace plans that are not compliant, are set to expire on December 31, 2006. If you have a NQDC plan that is subject to the new rules and does not meet the conditions in Section 409A, deferred compensation under the plan will be included in the income of a U.S. taxpayer in the year it vests, an additional 20% tax will be imposed and certain other penalties may apply.

U.S. tax advice should be obtained if you have an existing deferred compensation plan, or are introducing a new plan, that includes U.S. taxpayers as members, regardless of where they are resident.

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