



Hearing Testimony
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Before the Internal Revenue Service
US Department of Treasury

Proposed Regulations on Internal Revenue Code Section 409A
Application to Nonqualified Deferred Compensation Plans

Private Company Stock Options Valuation Reform

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Good Morning. My name is Gary McGarrity. I am the President and Chief Executive Officer of Intronn. Intronn is a small privately-held biotech company in the field of RNA biology located in Gaithersburg, Maryland. We specialize in an RNA technology known as SMaRT™, which re-programs gene expressions to develop new therapeutics for human ailments affecting millions of Americans today. Intronn is the only company developing this technology, which is proprietary to Intronn.

On behalf of Intronn and the Biotechnology Industry Organization (BIO)¹, we appreciate this opportunity to speak to the panel about our concerns over the proposed regulations under the Internal Revenue Code (IRC) Section 409A, and more specifically, regarding the valuation of stock options for private companies.

Intronn is a true “blue collar” early stage biotechnology company. Unlike the more traditional path of biotech innovations, Intronn’s technology did not originate from government or academic laboratories. Rather, our technology was invented by a young pathologist in his living room while he was looking for employment following his training. He did not have a lab and never published in this field, but he had a great idea and those who understood his genius took the risk of investing in the technology, which is the foundation of Intronn’s innovations today.

¹ BIO represents more than 1,100 biotechnology companies, academic institutions, state biotechnology centers and related organizations in 50 U.S. states and 31 other nations. Majority of BIO member companies are small, private, research- and- development oriented companies that are eager to attract scientific talent, investment, and corporate partners to grow into the next generation of Fortune 500 firms.

Risk is high for the investors, management, and the employees who are the foundations of Intronn's success. Intronn currently has no products and no revenue stream other than funds from government grants and investors. Given the high risks, stock options have provided the needed incentive to attract the best talent and the commitment necessary from our employees to ensure Intronn's success. In fact, Intronn provides stock options to most of the employees and scientific consultants in lieu of formal, revenue-based bonus plans, 401 (k) company matches, and pension plans. Without the ability to maintain such incentive plans, we will not be able to maintain the workforce necessary to remain competitive.

The implications of section 409A, which imposes income tax liability and penalties on the employees who presumably receive below fair market value stock options, could have a chilling impact on the industry's ability to explore cutting edge innovations if not implemented appropriately.

We are here today to seek **Clarity and Certainty** in the proposed valuation rules for private company stock options. We have previously submitted comments through BIO that raised four recommendations for clarification and I would like to go over them and provide Intronn specific impact on the provisions.

1) The rules should provide through examples that a company's financial official or its board of directors would qualify as having "significant knowledge and experience" to do the valuations. Given the event-driven nature of the biotech industry and the huge volatility in the industry's external valuation models, it is critical that the fair market valuations are performed by those who have the requisite knowledge and experience with the industry and the company and by those who have the ability to weigh the factors that determine the fair market value of private company options.

As an early stage company, Intronn lacks many of the standard parameters for valuation such as revenues, products, and stock price. Intronn personnel; therefore, are the best qualified to render an accurate valuation considering past valuations used by investors, major events and milestones, and market dynamics since our last valuation.

2) The Rules should be further clarified to definitively state that no independent appraisal is required. Although the current rules provide a safe harbor from section 409A if a company has received an independent appraisal, given the volatility and the lack of external valuation standards for private company stock, we believe that company officials or the members of the board are in the best position to determine the fair market value of their common stock. Hiring an external appraiser would not only be costly, as most companies would need to invest upwards of \$100,000 in additional costs, it may also cause more confusion since there are no existing guidelines on who may qualify as an "independent" appraiser and what valuation standards the appraiser should use in a highly volatile market.

As I have previously mentioned, Intronn is the only company in this specific area. There are no comparables. It would be particularly costly and time consuming to educate an independent appraiser on the intricacies of RNA trans-splicing, RNA replacement, how our technology relates to competing approaches and how to value such a business.

3) The proposed rules regarding the reasonable expectation of a change in control or public offering should be clarified. The presumption of reasonableness and good faith valuation

may be subject to question only if a company has entered into a definitive agreement or filed its registration statement with the SEC at the time of the valuation or within 15 -30 days of the valuation.

What we are seeking is certainty in how to determine the timing of the change in control. Without certainty of these terms, many early stage companies could have their capital structures exposed to section 409A compliance scrutiny when pursuing acquisition deals or IPO offerings. It has been our experience that auditors and attorneys involved in these transactions will be compelled to seek clear evidence of early stage companies' compliance in order to move forward. Without certainty on these provisions, most of the early stage companies will suffer great harm in the form of time delays and additional cost burdens trying to explain and mitigate complex uncertainties to which their companies are or appear to be exposed. Thus, a clear action triggering event such as a formal agreement or filing of a registration statement with the SEC, which is not withdrawn or cancelled, could provide the much needed certainty and clarity on when the presumption of the valuation could arguably be questioned.

I have been associated with four biotechnology companies. The three companies prior to Intronn were all acquired by larger companies. In addition, one company also acquired another company. All transactions were influenced by market conditions. Given the high volatility associated with early stage biotechnology markets, it is highly desirable to have examination of good faith subject to question when it matters most, during acquisition or filing a registration statement with the SEC. Please allow companies like Intronn to concentrate on building our companies and achieving our corporate goals, knowing that there will be a gatekeeper to question our valuation when it matters most.

4) The application of section 409A should be prospective and all options granted by a private company based on a good faith valuation prior to the final rule publication date should be exempted from 409A.

Given the volatility and the lack of industry standards on the valuation of private company stock and the lack of formal guidance on such valuations, it is critical that all options granted by a private company prior to the date of the final rule publication be exempted from section 409A. Having the rules apply retroactively, where no clear guidance was provided, would unfairly punish companies and employees who have played by the rules and have made good faith efforts to comply without settled guidance.

Thank you for this opportunity to testify today. As I discussed in my testimony, the appropriate treatment of stock options valuation within the context of Section 409A is critical to maintaining the competitiveness and ultimately the success of the biotech industry in the United States. We appreciate your consideration and I look forward to your questions.