

Is My 409A Stale?

A rapid self-audit for venture-backed companies issuing equity in changing markets. If your company has raised capital, expanded materially, issued new grants, or simply crossed the 12-month mark, your existing 409A may no longer qualify for IRS safe harbor protection.

Who is it For?

This checklist helps founders, CFOs, and legal teams quickly identify the hidden triggers that can invalidate a valuation before the next option grant creates tax exposure, audit risk, or board-level problems.

Private company rule: In a private company, common stock is always worth less than preferred stock because preferred carries liquidation preferences, anti-dilution rights, and investor protections that common does not. Your 409A must reflect this discount using an IRS-approved method (OPM backsolve, PWERM, or hybrid). A stale 409A means grants may have been issued at the wrong price exposing each employee to a **20% IRS excise tax + interest** on the full option value, on top of ordinary income tax.

1. THE 12-MONTH HARD RULE

409A appraisal is older than 12 months
IRS safe harbor under §1.409A-1(b)(5)(iv)(B) expires exactly 12 months from the appraisal date, no exceptions, no grace period.

Valuation is 10–12 months old with grants pending
Standard 409A engagements take 2–4 weeks. If grants are pending and you're inside the 10-month mark, order immediately.

Grant date predates board approval date
The IRS grant date is the date the board formally approves the grant not the employee's offer letter date, not their start date.

3. PRICED ROUNDS & PREFERRED STOCK

Closed a priced equity round (Seed, Series A, B, C...)
A new preferred stock issuance creates a new reference transaction that anchors FMV. The prior 409A was based on a different capital structure it's now structurally unreliable.

A term sheet has been signed (pre-close)
A signed term sheet is arm's-length evidence of enterprise value even before money is wired. The IRS may treat a pending round as a material event from the term sheet date.

Investor(s) are in diligence / advanced conversations
Not yet triggered but be cautious. Granting options while deep in diligence creates risk if a term sheet arrives quickly and the grant date is called into question.

Liquidation preference stack has changed since last 409A
New rounds add preferred layers with different preferences. The OPM model is sensitive to the total liquidation preference, a change of even 1x can meaningfully move the common stock value.

5. BUSINESS MILESTONES & FUNDAMENTAL

Company crossed from pre-revenue to revenue-generating
The transition from zero to meaningful revenue changes the applicable valuation methodology income approaches become relevant for the first time.

ARR / revenue has grown more than 40% since last 409A
Revenue growth is a primary driver of comparable company multiples and DCF projections both of which feed the income approach in your 409A.

Lost a major customer or entered financial distress
A significant negative event that reduces projected revenue or increases going-concern risk may lower FMV below your current 409A potentially making your option exercise price too high.

Headcount has more than doubled since last valuation
Rapid hiring changes the cost structure, burn rate, and cash runway all of which feed your projected financial model used in the income approach.

Why private companies face heightened risk: Unlike public companies where FMV is observable on an exchange, private company common stock value must be modeled using option pricing models (OPM), probability-weighted expected return methods (PWERM), or hybrid approaches. These models are sensitive to inputs: the last preferred price, liquidation preference stack, volatility assumptions, and time-to-exit. Any change in these inputs is a potential trigger. The IRS knows this, and specifically targets private company option grants in payroll audits particularly at IPO, when the SEC and underwriters independently review option pricing history. **The 12-month rule is a floor, not a ceiling.** Material events can require a new appraisal at any time..

Legal basis: Treasury Regulation §1.409A-1(b)(5)(iv)(B) provides a safe harbor from Section 409A treatment for stock options granted at FMV, as determined by a qualified independent appraisal performed within 12 months of the grant date by an appraiser with significant knowledge, experience, education, and training in valuing private company equity. Options outside this safe harbor are treated as nonqualified deferred compensation, subject to a 20% excise tax plus interest under §409A(a)(1)(B) — borne by the *employee*, not the company. The company may also face income and employment tax withholding obligations. **This checklist is for informational purposes only and does not constitute legal, tax, or valuation advice. Consult qualified counsel and a credentialed independent appraiser before making any grant decisions.**

2. SAFES & CONVERTIBLE NOTES

New SAFEs or convertible notes issued since last 409A
SAFES add future dilution and may carry valuation caps that affect how the OPM models the common stock value especially post-money SAFEs.

Outstanding SAFEs or notes have converted into preferred stock
Conversion changes the share structure, increases fully-diluted count, and alters the liquidation stack all of which are material OPM inputs.

SAFE valuation cap is significantly below expected round price
A wide gap between cap and round price means SAFE holders will receive more shares per dollar at conversion this dilution should already be reflected in your 409A if it was done knowing conversion was imminent.

4. M&A, EXIT SIGNALS & SECONDARIES

Received an acquisition offer or signed an LOI
An arm's-length acquisition offer is direct market evidence of FMV. The IRS treats this as a material event that voids prior 409A safe harbor for common stock valuation purposes.

Secondary share sale occurred at a price above your 409A FMV
Third-party secondary transactions (founder liquidity, early investor sales) at prices materially above your 409A common stock value are a direct IRS audit trigger.

Company is preparing for an IPO (S-1 in next 12–18 months)
As IPO approaches, the discount between preferred and common stock narrows often to zero at lock-up expiry. Your 409A must reflect this convergence using PWERM or a hybrid approach.

Strategic investor or corporate VC invested at a premium price
Strategic investors often pay a premium above pure financial value. If the premium was material, your valuation firm should have documented why the investment price does not fully reflect common stock FMV.

6. GRANT MECHANICS & COMPLIANCE

Option grants are pending without a current 409A in place
You must not issue option grants without a qualified independent appraisal that was completed within the past 12 months and predates the board approval date.

Past grants may have been issued at below-FMV exercise prices
Options granted at a discount to FMV are treated by the IRS as nonqualified deferred compensation triggering 20% excise tax + underpayment interest, borne by the employee.

Board consents for option grants predate the 409A appraisal date
The 409A appraisal must be completed before or concurrent with the board's approval of the grant. A 409A completed after the board consent date does not provide retroactive safe harbor protection.

Company grants options to non-US employees or contractors
Section 409A is a US federal rule. However, international jurisdictions have their own option fair value requirements UK EMI, Canadian Sec. 7, Australian ESS which may require separate local appraisals or different methodologies.