

## Message from Our Boston Office

As we look back on the second quarter, the Boston office has welcomed three new partners: Russ Barron (IP), Robert Chow (Corporate and Securities), Todd Feinsmith (Bankruptcy) and associate Katherine Hollingsworth (Litigation). Our strategic focus on corporate and patent litigation has allowed us to expand our client roster and hire experienced attorneys during this turbulent economy.

In this issue, Mr. Gilman writes about ways public companies selling equity securities during the economic downturn may need to offer investors numerous incentives to obtain the investment.

Merger and acquisition activity is likely to increase this year because of the high level of distressed debt, according to a study commissioned by Carl Marks Advisory Group LLC and Pepper. We're hosting a webinar on this topic; see page 2 for details.

On August 5, in another online webinar, Ms. Demont, Mr. London and Mr. Rosener will address recent trends in shareholder activism and reasons why directors and management should be proactive.

Lastly, Mr. Schwartz and Mr. Schneidman write about a voluntary disclosure program to encourage compliance with foreign account reporting requirements.

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## Discounted Financing Transactions: A Tool for Tough Times

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Public companies selling equity securities during the economic downturn may need to offer investors numerous incentives to obtain the investment, including the sale of the company's stock at a substantial discount to the trading price of the stock.

Companies listed on NASDAQ or the NYSE, however, must obtain stockholder approval prior to issuing stock at a discounted price, if the amount of stock to be issued would exceed 20 percent of the company's outstanding stock prior to the transaction. Companies have historically sought stockholder approval of these types of transactions after the deal is agreed upon between the company and the investors, which can take up to 90 days. For small and mid-cap public companies that need capital quickly, this time lag could be disastrous, since events can occur after the deal is signed but before stockholder approval is received that cause investors to walk away from the transaction.

In today's world, in which the financial markets remain turbulent and volatile, companies should consider strategies and techniques to minimize this risk. One such way is seeking stockholder approval in advance of any agreed upon discounted financing. This technique, which has been used effectively by small publicly held biotech and life sciences companies, has enabled these companies to close a transaction quickly after agreement is reached with investors, rather than waiting for stockholder approval after finalizing the deal.

To obtain this general authorization from stockholders, the company must comply with applicable securities laws and follow specific disclosure guidance from the company's

stock exchange, including specifying the maximum dollar amount to be raised; maximum number of shares to be issued; maximum discount to the market price that the shares will be sold; and general timeframe within which the deal might take place, which typically should be no longer than three months after the stockholder approval.

Small and mid-cap public companies requiring additional capital in this troubled economic environment should position themselves to act quickly and opportunistically to take advantage of small open windows in market activity. Obtaining stockholder approval in advance of a discounted financing transaction could mean the difference between continuing normal operations and having to make some difficult operational decisions because of limited cash resources.

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## **Distressed M&A Outlook Webinar**

August 11, 2009

12:00 – 1:00 P.M. EASTERN

To gain perspective on the current distressed M&A market, Carl Marks Advisory Group LLC and Pepper Hamilton LLP commissioned mergermarket, a research and publishing company, to survey a diverse group of corporate executives, private equity practitioners, hedge fund investors and lawyers regarding the foremost issues facing distressed investors today.

Join us for a complimentary, one-hour online seminar, that will discuss the report findings and implications for the combination of eager sellers and opportunistic buyers who will undoubtedly provide fuel for distressed activities in the second half of 2009.

Register online at [https://www.regonline.com/Distressed\\_MA\\_Opportunities](https://www.regonline.com/Distressed_MA_Opportunities).

Please contact Brian Dolan at [dolanb@pepperlaw.com](mailto:dolanb@pepperlaw.com) with questions about the event or to request a copy of the study.

## **Voluntary Disclosure Program Encourages Compliance with Foreign Account Reporting**

Last year, we examined the significantly increased efforts by federal prosecutors and IRS agents to investigate taxpayers for failing to file Foreign Bank Account Reports (FBARs) and foreign earned income.<sup>1</sup> The United States' tax laws require that money kept in foreign accounts be reported to the Department of Treasury if (1) the taxpayer has an interest in, signature authority, or any other authority over accounts in a foreign country, and (2) the aggregate value of the accounts exceed \$10,000 at any time during the calendar year. The deadline to file the FBAR reports for foreign accounts held during 2008 is June 30, 2009.

In May 2008, media attention focused on UBS banker Bradley Birkenfeld for his role in concealing client assets in secret offshore bank accounts. The Birkenfeld case was part of a larger tax probe to determine whether financial institutions helped their clients evade United States taxes by placing unreported money in secret foreign bank accounts. While Birkenfeld eventually pleaded guilty to

felony tax charges arising out of his helping clients to evade taxes, the IRS is still seeking unreported or underreported offshore assets and income, whether these assets are in traditional tax havens such as Switzerland and the Cayman Islands, or in the home countries of legal U.S. resident aliens in places such as the United Kingdom, France, Spain, Japan or India.

In pursuit of its goal of enforcing compliance with United States tax laws, the IRS instituted the Voluntary Disclosure Program (VDP), which encourages taxpayers to come forward with information about their previously unreported foreign bank accounts and foreign income. Taxpayers making voluntary disclosures under the VDP face reduced civil penalties and can avoid criminal prosecution. IRS Commissioner Doug Shulman recently explained, “[f]or taxpayers who continue to hide their head in the sand, the situation will only become more dire. They should come forward now under our voluntary disclosure

practice and get right with the government.”<sup>22</sup> The deadline to make a voluntary disclosure of past years of unreported offshore assets and income is September 23, 2009.

Disclosing taxpayers will need to pay back taxes and interest on the income earned from the undisclosed foreign accounts for the past six years and will also have to pay an accuracy penalty of 20 percent of the taxes due. Further, taxpayers disclosing under the program will pay a penalty for not filing FBARs of 20 percent of the amount in the account for the year in which the account had the highest asset value during the last six years.

While these penalties may be significant (depending on the amount of unreported income and the size of the foreign accounts), disclosure under the VDP provides taxpayers certainty in determining the extent of their liability and allows taxpayers to bring themselves into compliance with their obligations under United States tax laws. VDP disclosure can be especially attractive to taxpayers because the IRS will not recommend criminal prosecution to the Department of Justice if a taxpayer complies with all VDP requirements.

In contrast, taxpayers who decide not to comply with United States tax law and do not disclose offshore assets face potentially severe civil and criminal penalties. Failure to disclose foreign accounts and pay tax on foreign income can lead to felony criminal charges of tax evasion, filing a false tax return, and failure to file an income tax return. The failure to file an FBAR and/or filing a false FBAR are also felony criminal violations that can result in up to 10 years of imprisonment. Further, if the IRS discovers an unreported or underreported foreign bank account, the account holder is responsible for tax and accuracy-related penalties plus interest, FBAR penalties, a possible 75 percent fraud penalty, and other civil penalties, all of which can be significantly greater than the penalties imposed through the VDP.

Corporations, partnerships, trusts, and other entities are eligible for disclosure under the VDP. Similarly, holders of offshore merchant accounts can disclose under VDP provisions. However, once the IRS commences an examination of a taxpayer, the taxpayer is no longer eligible to disclose under the VDP, regardless of whether the examination relates to foreign bank accounts. Further, if there is an illegal source of income for the foreign bank account, the voluntary disclosure practice may not apply. The IRS recommends that taxpayers disclose under the

VDP even if they currently cannot fully pay all penalties. Taxpayers that cannot pay can request alternative payment arrangements. If the IRS determines that an inability to pay is genuine, it will work with the taxpayer to establish acceptable alternative arrangements. Similarly, the IRS states that taxpayers having difficulty obtaining records from their offshore accounts should disclose their intention to participate in the VDP before September 23, 2009. If necessary, the IRS will work with the taxpayer to obtain the required records.

If a taxpayer already has filed an amended return reporting previously unreported offshore assets without making a voluntary disclosure (referred to as a “quiet disclosure”), the taxpayer may want to retain counsel and apply to participate in the VDP. The IRS states that taxpayers making “quiet disclosures” without applying through the VDP can still face criminal penalties for previously failing to disclose their foreign accounts.

Taxpayers who reported income from their offshore bank accounts but failed to file an FBAR need not apply under the VDP. To come into compliance, these taxpayers need only submit their delinquent FBAR forms, a statement of explanation for failure to file the forms, and the past tax returns on which the offshore bank account information was reported. The VDP is intended to bring into compliance and set reduced penalties for taxpayers who did not report offshore income, not taxpayers who merely failed to file an FBAR.

To decide whether to make a disclosure under the VDP, a taxpayer should:

- **Learn the Policy:** The IRS has specific disclosure requirements for FBARs and specific eligibility requirements for VDP disclosures. The best way to avoid liability for failure to disclose foreign bank accounts and to become compliant under the VDP is to be aware of these filing and disclosure requirements, and to seek the assistance of a professional in understanding the complexities of the disclosure obligations.
- **Evaluate Liability:** Taxpayers with foreign bank accounts that may be unreported or underreported to the IRS need to determine if they are liable for penalties. Someone who believes they may have unreported or underreported foreign bank accounts should retain counsel to determine their liability.
- **Contact Counsel:** Due to the time-sensitive nature of the disclosure program, individuals with questions

about the need to disclose or the proper methods of disclosure should contact experienced tax counsel as soon as possible. Further, if the IRS contacts an individual for failure to disclose foreign assets, he or she should retain criminal tax counsel to attempt to minimize possible penalties and avoid criminal prosecution.

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**Endnotes**

- 1 Schwartz, Schneidman, and Razzano, Federal Prosecutors and IRS Investigation Agents Are Investigating the Failure to Disclose Foreign Bank Accounts: Reports of Foreign Bank and Financial Accounts are Due June 30, 2008 (June 11, 2008), available at [http://www.pepperlaw.com/publications\\_update.aspx?ArticleKey=1174](http://www.pepperlaw.com/publications_update.aspx?ArticleKey=1174).
- 2 Statement from IRS Commissioner Doug Shulman on Offshore Income (March 26, 2009) available at <http://www.irs.gov/newsroom/article/0,,id=206014,00.html>.

## Addressing Recent Trends In Shareholder Activism: Directors and Management Should be Proactive

August 5, 2009

12:00 – 1:00 P.M. EASTERN

Join us for a complimentary, one-hour online seminar that will focus on the trends in shareholder activism, recent developments in Delaware corporate law, the SEC's proposed regulations on proxy access, the current status of poison pills and recommended actions for directors and management.

**Speakers**

Valérie Demont, Partner, Pepper Hamilton LLP

Richard De Rose, Managing Director,  
Houlihan Lokey

Steven R. London, Partner, Pepper Hamilton LLP

James D. Rosener, Partner, Pepper Hamilton LLP

Register online at

[https://www.regonline.com/Shareholder\\_Activism](https://www.regonline.com/Shareholder_Activism) or  
contact Brian Dolan at [dolanb@pepperlaw.com](mailto:dolanb@pepperlaw.com).

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