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Business and Finance Update

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Prepare Now for the Economic Recovery

By Paul A. Krulisky

Economic down times are the perfect time to be creative. Now is the time to take a hard look at your organization, analyze its strengths and weaknesses, and identify new opportunities. Many agree that a strategy of hunkering down, waiting for the economy to turn, and then attempting to accelerate past competitors will not work. The winners will have to do more than just survive this recession, they will have to take full advantage of the situation. Here are some recommendations.

In the current environment, getting your finances in order will help set a foundation for growth when the market turns around. If you wish to take on debt financing, now is the time to make sure you have the necessary documentation ready for banks and other creditors in the proper form. Also, it is important to start a dialogue with prospective financing sources to smooth the way for later financing.

If you will be seeking additional equity, you should take a look at your company through the eyes of a potential investor. Is your business plan up to date? Does your business plan clearly provide information about your organization's purpose, its products or services, the problems your products or services address, your competition, the size of the market for your products or services, your management team, and why an investment in your organization makes sense?

Also, it is important to take a hard look at your organization to spot any red flags that may make a potential investor wary and address those issues to the extent you can. Not only will taking a hard look at your organization help you prepare for handling inquiries from investors, it will give you an opportunity to refocus your strategies in light of the current market conditions, so you can be in a better position to take advantage of opportunities when the economy recovers. For example, the current economic downturn may present opportunities to capture market share by strategic acquisition. Some apparently strong companies with large customer bases, or that offer complimentary products or services, may struggle to survive under the current economic conditions. With market valuations down, companies with resources available to make strategic acquisitions may be able to earn higher returns than they could through organic growth. As with any acquisition, attention must be paid to capturing synergies and ensuring that you make acquisitions that fit into your strategic focus.

Aside from acquisitions, new opportunities may present themselves as competitors fail or suffer damage to their quality and service as a result of cost cutting measures. Therefore, it is important to monitor the performance of your competitors and look for opportunities to pick up additional customers with little investment.

If you have good talent now, you will want to take measures to keep it. If you need talent, there may be a good pool available among those who have fallen victim to downsizing. You may also have a good opportunity to elevate the quality of your team. Prospective employees may be more flexible in terms of compensation packages than they were before the downturn.

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In addition, in a down market you may have a better opportunity to tie compensation to individual or company performance. Handled properly, compensation tied to performance may help maintain employee loyalty while allowing for labor cost flexibility to help ride out the downturn.

Fennemore Craig's attorneys are prepared to help you identify and address challenges you face during this downturn and assist you in formulating and implementing appropriate strategies.

Securities Law Update: Revisions to and Electronic Filing of Form D

By Anne L. Kleindienst and Charles W. Ross

In February 2008, the Securities and Exchange Commission (SEC) adopted changes to Form D, including a requirement to electronically file Form D beginning on March 16, 2009 (see 17 CRF Parts 203, 232 and 239).

Form D is used to report securities offerings exempt from the registration requirements under the Securities Act of 1933 pursuant to Regulation D. Under the new rules, issuers are required to file Form D and amendments through the Internet using the SEC's electronic gathering, analysis and retrieval system (EDGAR). To file on EDGAR, issuers must obtain their own filer identification number called a Central Index Key (CIK) and set up access codes by submitting to the SEC a notarized document called a Form ID. An issuer may obtain its CIK number and access codes prior to the commencement of an offering. It may take anywhere from several hours to two business days for an issuer to obtain its CIK number and access codes so advanced planning is recommended.

The SEC also revised Form D by requiring issuers to disclose additional information including: (1) the date of the first sale of securities, (2) whether the offering will continue for longer than one year, (3) industry group information, (4) a broker/dealer CRD number for each broker/dealer receiving compensation in connection with the offering, (5) revenue information for operating companies and net asset values for hedge funds (but issuers may elect to decline disclosure), and (6) whether the issuer is exempted from registration as an "investment company" under the Investment Company Act of 1940.

Filing Form D with the SEC does not satisfy state filing requirements. One of the objectives of the SEC's new rules was to streamline SEC and state filing requirements. However, to date, states have not developed coordinated "one-stop" filing systems, so issuers will still be required to file paper copies of the Form D with the applicable state regulatory bodies.

New Law Permits Limited Deferral of COD Income

By Stephen A. Good and Christian M. Olson

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (Pub. L. 111-5) in an effort to stimulate economic growth. The Act incorporated several new tax laws, including a new Internal Revenue Code section 108(i) that permits taxpayers to defer certain cancellation of indebtedness (COD) income. Under existing law, taxpayers generally must include COD income in their gross income, subject to exclusions applicable to taxpayers in title 11 bankruptcy, insolvent taxpayers, qualified farm indebtedness, qualified real property indebtedness, and qualified principal residence indebtedness.

Under the new law, taxpayers may elect to include COD income ratably over a period of five years if the COD income results from the "reacquisition" of an "applicable debt instrument" in 2009 or 2010. If an election is made, the five year period for inclusion of COD income does not commence until 2014. For purposes of this rule, an "applicable debt instrument" is any debt issued by a C Corporation or any other person in connection with the conduct of a trade or business by such person. A "reacquisition" is an acquisition of a debt instrument by the original debtor or related party which involves: (1) the acquisition of the debt instrument for cash, (2) the exchange of the debt instrument for another debt instrument (including an exchange resulting from a modification), (3) the exchange of the debt instrument for corporate stock or a partnership interest, (4) the contribution of the debt instrument to capital, or (5) the complete forgiveness of the indebtedness by the holder.

Taxpayers may elect to defer COD income under this provision by including with their tax returns a statement which clearly identifies the debt instrument, the amount of deferred COD income, and any other information required by the Treasury. Once an election is made, it is irrevocable.

The election to defer COD income may be welcome news for taxpayers who are unable to take advantage of the limited exclusions applicable to COD income, but such an election may not be desirable in all circumstances. If a taxpayer elects to defer COD income, the exclusions for bankruptcy, insolvency, qualified farm indebtedness, and qualified real property indebtedness will not apply to the COD income. In the case of pass-through entities, elections must be made at the entity level. If a pass-through entity elects to defer COD income and one of its owners is insolvent, that owner will be precluded from taking advantage of the insolvency exclusion that would otherwise be available. Each taxpayer should evaluate the merits of deferring COD income in light of its particular situation.

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