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New Law & Supreme Court Ruling Impacts Intellectual Property

- On October 12, 2006, the New Jersey Supreme Court ruled that New Jersey can tax royalty income paid to out-of-state intellectual property holding companies even though they have no physical presence in the state. Lanco, Inc. v. Div. of Taxation, WL 2883340 (2006).
- On October 6, 2006, President Bush signed the Trademark Dilution Revision Act into law. The Act strengthens the protective rights afforded to owners of famous marks.

New Jersey Can Tax Royalty Income of Out-of-State Trademark Holding Companies

On October 12, 2006, the New Jersey Supreme Court ruled that New Jersey can tax royalty income paid to out-of-state intellectual property holding companies even though they have no physical presence in the state. Lanco, Inc. v. Div. of Taxation, WL 2883340 (2006). The court's opinion was extraordinarily brief (a single page), possibly signaling its anticipation that the case will be appealed to the U.S. Supreme Court.

This case is important to trademark owners nationwide. At issue is whether states can require company's with no physical presence in the state to pay *income* tax on intellectual property royalty payments received from businesses located in the state. Courts around the country are currently split on this issue.

By way of background, companies with numerous and/or valuable trademarks (or other intellectual property) frequently hold the trademarks in holding companies formed in states like Delaware, that do not tax royalty income. The holding companies then license the trademarks to other companies (sometimes affiliates of the holding company) which sell the goods and pay a royalty back to the holding company. The company paying the royalty generally gets a state tax deduction and the holding company avoids state income tax. Some would call this prudent tax planning. State taxing authorities, however, feel differently.

The focal point of the controversy is a 1992 U.S. Supreme Court decision holding that under the Commerce Clause of the U.S. Constitution, a company must be physically present in a state to be subject to sales and use tax in that state. Quill Corp. v. North Dakota, 504 U.S. 298 (1992). Since then, different state courts have split on the issue as to whether the U.S. Supreme Court intended its decision to apply only to sales and use tax or whether it applies to income tax too. In Lanco, the New Jersey Supreme Court decided that Quill was intended to be limited to sales and use tax. Therefore, so the reasoning goes, states have the right to charge income tax to companies with no physical presence in-state. The New Jersey Supreme Court decision does not offer any new rationale as to why income taxes should be treated qualitatively differently from sales and use taxes under the U.S. Constitution.

The Trademark Dilution Revision Act

On October 6, 2006, President Bush signed the Trademark Dilution Revision Act into law. The Trademark Dilution Revision Act (the “Act”) strengthens the protective rights afforded to owners of famous marks.

What are “famous” marks?

Famous marks are trademarks which are widely recognized as identifying of a source of goods or services associated with the owner of a given trademark, such as Coca-Cola® or McDonald’s®. When considering whether or not a trademark has achieved “fame,” courts will consider the following factors:

1. The length, degree and geographic breadth of advertising campaigns and publicity of the trademark;
2. Whether the owner of the mark or a third-party has conducted such advertising campaigns;
3. The amount, volume and geographic extent of sales of the goods or services associated with the trademark;
4. The level of recognition of the trademark by the general public; and
5. The registration status of the trademark.

Benefits of the Trademark Dilution Revision Act

The Act empowers owners of famous marks with the right to seek injunctive relief against another individual or entity who is utilizing a mark or trade name for a commercial purpose which is likely to cause *dilution by blurring* or *dilution by tarnishment* of the famous mark.

Dilution by Blurring: Dilution by blurring occurs when an individual or entity employs a mark or trade name which is similar to a famous mark and, as result of such use, the holder of such mark causes damage to the distinctive qualities of the famous mark. When analyzing

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whether or not a mark is causing dilution by blurring, the courts may consider the following factors:

1. The extent of similarity among the mark and the famous mark;
2. The level of intrinsic or acquired distinctiveness of the famous mark;
3. The degree to which the owner of the famous mark is utilizing the famous mark exclusively;
4. The level of identification by the general public associated with the famous mark;
5. Whether the owner of the mark intended to imply some connection between itself or its mark and the famous mark; and
6. Any actual association between the mark and the famous mark.

Dilution by Tarnishment: Dilution by tarnishment arises when a connection is drawn among the imposing mark and the famous mark, due to the similarity of the two and such connection causes damage to the reputation of the famous mark.

Exceptions to the Act

The following will not be considered actionable under the Act:

1. Any fair use of a famous mark by another entity, including but not limited to, advertisements that compare the good associated with the famous mark with another good, parody of the famous mark or commentary on the mark;
2. Any method of news commentary or reporting relating to the famous mark; or
3. Non-commercial use of famous mark.

Remedies Afforded to Owners of Famous Marks by the Act

In accordance with the Act, when the owner of a famous mark is able to establish dilution by blurring or dilution by tarnishment, irrespective of economic harm and actual or likely confusion and competition among the marks, such owner is entitled to seek an injunction against the owner of the imposing mark. The owner of the famous mark may also seek to recover the profits associated with the imposing mark, damages sustained by the owner of the famous mark and associated legal fees. In accordance with the Lanham Act, the court may also assess treble damages for any such action. Finally, in certain circumstances, the court may order the destruction of any products or related items which bear the infringing mark.

This information is not to be construed as legal advice. If you should have any questions relating to the New Jersey Supreme Court ruling on taxing royalty income or the Trademark Dilution Revision Act, or to discuss your company's intellectual property or trademark needs, please contact the Technology & Intellectual Property Department at 732-219-5491 or visit our website at www.ghclaw.com.

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