

## Business & Litigation Update Spring 2008

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### TABLE OF CONTENTS

[International Registration and Protection of Trademarks Under The Madrid Agreement and Protocol](#)  
[Important Tax Changes For 2008](#)  
[The Regional M&A Market In 2008: A Different World Overnight?](#)

#### **International Registration and Protection of Trademarks Under The Madrid Agreement and Protocol**

Many companies are engaged in, or seek to be engaged in, commerce that transcends the borders of the United States. With developments in technology today, entrance into the global marketplace is easier, more efficient and financially rewarding. For domestic U.S. companies that have invested heavily in protecting and promoting their trademarks and/or service marks in the United States, protection of their marks and the substantial goodwill associated with those marks in international markets is vitally important. International registration and protection of trademarks is a must for any U.S. company marketing and promoting the sale of its products overseas.

Two regional registration systems should be considered with regard to international registration and international protection of trademarks. One system involves protection within the European Union countries and is known as the Community Trademark (CTM). The other involves protection under the Madrid Agreement and the Madrid Protocol. Forty countries are signatories to the international treaty referred to as the Madrid Agreement. The Madrid Agreement provides a system in which an owner of a national registration in its country of origin can obtain an international registration designating other nations for extension. Under the Madrid Agreement, an applicant can effectively obtain a bundle of national registrations which can be renewed centrally. The central filing bureau is the Central Registration Bureau (CRB) in Geneva, Switzerland, which is administered by the World Intellectual Property Organization (WIPO). After a company obtains a national registration in its own country, it files a single application with the CRB in Geneva. Registrations under the Madrid Agreement last for a period of up to 20 years and are renewable for additional 20-year terms. The "Madrid System" is only available to nationals of countries which are members of the Madrid Union.

The "Madrid Protocol" was created in 1989 and was intended to expand the membership in the Madrid System. Among other things, the Madrid Protocol changed certain facets of the Madrid System, which required registration in the home country before international protection would be afforded to a trademark owner. Under the Madrid Protocol, instead of requiring home country registration, home country application is enough on which to base the international registration. In countries like the United Kingdom and the United

States, where an application often takes a substantial amount of time from issue to registration, allowing registration on an application is important. It should be noted that the United States is not a signatory to the Madrid Agreement or to the Madrid Protocol. Regardless, U.S. companies regularly file applications for registration and regularly seek international protection under this system. The initial and renewal terms of protection under the Madrid Protocol system are ten years, as is the case with a U.S. Federal registration.

International registration can be performed through the United States Patent and Trademark Office (USPTO) utilizing the "Madrid Protocol Forms." If the international application meets the requirements, the USPTO will certify and forward the international application to the International Bureau of the WIPO. An international application submitted through the USPTO must be based on either (1) an application currently pending in the USPTO; or (2) a registration that the USPTO has already issued. All fees associated with the international application, i.e., the U.S. certification fee and the international application fees, must be paid at the time of submission to the USPTO. The U.S. certification fee is \$100 per class if the international application is based on a single basic application or registration; or \$150 per class if the international application is based on more than one basic application or registration. A schedule of international fees and a fee calculator are available online at the USPTO website. The international application fees for a recent client were in excess of twelve thousand dollars. The international application fees may be paid through the USPTO in U.S. dollars or directly to the WIPO in Swiss francs. Many of the European Union countries now adhere to the Madrid Protocol.

Before embarking upon the international registration of a mark, it is important to conduct a "Madrid Protocol Search." The results of this search will enable the client to determine if there may be any conflicting marks for which applications are pending or which are registered under this international registration system.

[Back To Top](#)

## **Important Tax Changes For 2008**

The 2007 Tax Increase Prevention Act, carrying a number of important tax changes, was signed into law by President Bush on December 26, 2007. Most of these changes apply to tax years beginning in 2008, but some have retroactive application to 2007. This summary focuses on changes that impact individual taxpayers.

One of the significant changes that applies to 2007 is commonly referred to as the "AMT Patch," as it represents a compromise measure for those seeking to repeal the Alternative Minimum Tax (AMT) in its entirety and those seeking to prevent further revenue loss. It should be noted that the tax forms issued by the IRS for 2007 do not have this provision incorporated as yet. This change applies only to the 2007 tax year.

The newly enacted provision reduces AMT liability for taxpayers eligible for the AMT exemption by increasing the applicable AMT exemption amount. AMT starts with regular taxable income and is modified for various items such as dependency exemptions and nearly all income tax deductions. The increased amount, known as Alternative Minimum Taxable Income (AMTI) is then reduced by an applicable exemption amount. The result is then multiplied by an AMT tax rate of 26% or 28%, depending on taxable income levels (e.g., if married, filing jointly, AMTI of \$175,000 is the cutoff for the 26% rate).

The Act increases the AMT exemption amount over its 2006 level to the following amounts:

- \$66,250 for married individuals filing jointly and surviving spouses (compared to \$62,550 for 2006);
- \$44,350 for unmarried individuals (compared to \$42,500 for 2006); and
- \$33,125 for married individuals filing separately (compared to \$31,275 for 2006).

However, higher-income taxpayers may not be able to take advantage of this additional exemption because the AMT exemptions begin to phase out at certain AMTI levels. For unmarried individuals who are not surviving spouses, the AMT exemption is reduced by 25% of the amount by which AMTI exceeds \$112,500. Consequently, for 2008, individuals with AMTI over \$289,800 cannot claim any AMT exemption at all.

For taxpayers who are married and filing jointly, the AMT exemption begins to phase out in the amount of 25% of any AMTI over \$150,000. For example, assuming a couple filing jointly has AMTI of \$190,000, the \$66,250 exemption is reduced to \$56,250 or  $25\% \times (\$190,000 - \$150,000)$ . Given this adjustment, the AMT exemption is completely phased out for joint returns with AMTI of \$415,000 or more.

Two other AMT-related provisions in the Act address credits. The first allows certain personal tax credits such as the credit for dependent care and the Lifetime Learning credit. For 2007, these credits may be applied to offset both the regular tax liability and, more significantly, any AMT liability. The second provides that individuals who paid AMT as a result of the exercise of "incentive stock options," can claim this credit to a greater degree than allowed before.

A number of provisions relate to housing, the first of which involves foreclosures. Reacting to the mortgage lending crisis of the past year, a relief provision allows homeowners tax relief for mortgage debt that was forgiven. In general, any loans or other debt that is forgiven constitutes taxable income to the recipient. For example, if a bank forecloses on a home with a \$300,000 mortgage and it is ultimately sold for \$250,000, the \$50,000 that is in effect "forgiven," is taxable income to the taxpayer. Similarly, if a mortgage is renegotiated so that part of the outstanding debt is reduced, there is taxable income to the taxpayer. Given the subprime lending crisis of the past year, the law provides tax relief for homeowners whose mortgages are forgiven. For mortgages forgiven in 2007 through 2009, taxpayers do not have to pay income taxes on up to \$2,000,000 of debt forgiven for "qualifying loans" secured by a "principal residence."

Mortgage insurance premiums for insurance contracts issued after 2006 continue to be deductible through 2010. Typically only mortgage interest is deductible, but this rule allows insurance on the mortgage to be deductible as well. The taxable income phases out for higher levels of adjusted gross income (AGI). For taxpayers filing jointly, with each percent that the taxpayers' AGI exceeds \$100,000, the mortgage interest deduction is reduced by 10%. Therefore, taxpayers filing jointly with AGI in excess of \$109,000 cannot claim this deduction at all.

Code Section 121 allows an income exclusion of \$250,000 per individual homeowner for capital gains on the sale of a principal residence. Married taxpayers filing jointly can exclude up to \$500,000 of capital gains. Surviving spouses are limited to \$250,000 for sales of a principal residence occurring after the year of death. As of January 1, 2008 a surviving spouse can now claim an exclusion of up to \$500,000 of capital gains if (a) the sale is not later than two years after the death of the spouse; (b) either spouse owned the home for at least 2 of the 5 years preceding the sale; (c) both spouses used the home as a principal residence for at least

2 of the 5 years preceding the sale; and (d) neither spouse would be ineligible for the full exclusion because he or she took a Code Section 121 exclusion within the last two years.

Tax relief has been extended to volunteer firefighters and emergency medical responders by creating an income tax exclusion for qualified state or local tax benefits. Such relief includes tax rebates or certain reimbursement payments of up to \$360 a year granted to members of volunteer firefighter or medical responder organizations. These provisions are applicable for tax years commencing January 1, 2008 through 2010.

For tax years commencing in 2008, the amount of charitable contributions for appreciated property that an S corporation shareholder can deduct is no longer limited to basis. For example, let's assume an S corporation shareholder has a \$600 basis in his stock and he is the only shareholder. The S corporation decides to make a contribution of property with a basis of \$500 and a fair market value of \$1,000. Prior to 2008, the shareholder could only deduct \$600. Now the shareholder can deduct the full \$1,000 on his tax return.

One of the most interesting developments relates to taxation of net capital gains and qualified dividend income. As of the current year through 2010, a zero tax rate can apply to certain long-term capital gain and dividend income that would have previously been subject to the 15% rate (or the 10% rate, reduced last year to a 5% rate for lower income brackets). Only noncorporate taxpayers are eligible for this zero rate where there is a net capital gain or qualified dividend income. The zero tax rate will not apply to collectibles gain which is taxed at a different rate or recaptured on real estate depreciation.

The formula is as follows. Exclusive of collectibles gain or recapture, the amount eligible for a 0% rate is net capital gain and qualified dividend income that does not exceed the excess of (1) the amount of taxable income that would be taxed at a rate below 25% or (2) taxable income reduced by adjusted net capital gain. The balance of net capital gain is taxed at 15%. Taxable income does not include net capital gains or qualified dividend income.

This year, taxable income taxed at amounts below 25% is \$32,550 for single taxpayers or married taxpayers filing separately; \$65,100 for married taxpayers filing jointly or surviving; and \$43,650 for heads of households. Here's how it works. Imagine Mr. and Mrs. Smith have joint taxable income of \$60,000 and \$10,000 of qualified dividend income. The 0% rate will apply to the first \$5,100 of dividend income. The balance of dividend income will be taxed at 15%. Depending on the character and amount of income, this can present a significant tax savings to individuals with investment portfolios and lower taxable income. This will not necessarily reduce the kiddie tax since children are taxed at their parents' marginal tax rates.

These are just some of the recent changes impacting current tax liabilities that open opportunities to certain taxpayers. Taxes, like fashion, are ever-changing.

[Back To Top](#)

## **The Regional M&A Market In 2008: A Different World Overnight?**

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Regional mergers and acquisitions, defined as activity in Central and Eastern Pennsylvania, Delaware, and Southern New Jersey, has not necessarily correlated with M&A activity on a national level. Regionally, there has been a decline in deals starting in the third quarter of 2006, almost forecasting what would eventually reach the national level. Although not a perfect forecast, deals picked up again regionally in the second quarter of 2007 as the national M&A frenzy peaked. The increase from the third to the fourth quarter of 2007 shows a promising trend leading into 2008.

## **Private Equity**

Since 2002, private equity groups have played an increasing role in the M&A market, representing almost 30% of all buyers in U.S. transactions and approximately 15% of the regional buyers.

For many in the regional market, private equity is a name they hear but do not truly understand. Simply put, private equity firms attempt to buy stakes in private or public companies that they believe could achieve significantly greater growth and profitability with the right infusion of talent and capital, in the hope of selling them at a higher price later. Private equity groups range from huge national and internationally known names like KKR , who purchased Toys "R" Us and RJR Nabisco , and The Carlyle Group , who purchased Hertz and Manor Care , to regional and local names like Susquehanna Capital and Eureka Growth Capital. Because private equity groups represent approximately 15% of purchases in the region, business owners need to understand how private equity can affect the process of selling their business and its ultimate value.

Although private equity groups have existed in one form or another since the 1970s, they came of age in the 1980s, fueling the \$25 billion acquisition of RJR Nabisco and others. Since then, the industry has grown at a rapid pace. In 2006, KPMG estimated that the private equity industry had over \$750 billion in capital, which would have been enough to fund the acquisition of every company on the London Stock Exchange and the NASDAQ. Through another lens, that war chest was larger than the GDPs of Sweden, Australia, and the Netherlands.

Discussions about private equity transactions often involve complex verbiage and terminology, but the underlying transaction is actually quite simple. The purchase price is typically a combination of debt and equity. The private equity group relies on the acquired company's cash flow to pay off the debt, meanwhile increasing earnings so that the company is worth more. With the leverage created by the debt, private equity groups can realize large compounded returns. According to the Private Equity Council, the top quartile of private equity firms returned 39% per annum to their investors from 1980 through 2005, as opposed to the S&P 500 Index returns of 12% during the same time period.

## **Benefits of Private Equity to Business Owners**

Private equity can play an important role for business owners. Given that their business purpose is to invest capital, private equity groups can be a source of stability during turbulent times. Along the same lines, private equity groups function to buy companies and are willing to buy when a strategic buyer may be on the sidelines undertaking internal issues. Private equity groups also have more flexibility in structuring deals, and attractive deals with leverage possibilities may yield a healthy price. Private equity groups also provide confidentiality, as opposed to making a sale public to potential competitors who may also be interested in the acquisition. Simply having private equity firms involved in a transaction process can be extremely valuable. It enhances the competitive process while increasing the potential of receiving multiple acquisition proposals.



and resulting higher prices.

According to Jack Bovender, Jr., the CEO of HCA Inc., which was acquired by a private equity firm in 2006, being a private company allows the chance to focus on a much longer-term basis without worrying about quarter-to-quarter blips in earnings because decisions have been made for the long term. This could mean a more attractive alternative for a selling management team, as compared to selling to a public company.

## **Risks**

As beneficial as private equity groups may be to business owners, there are naturally risks involved. Since a private equity group exists to sell companies for a higher price than originally paid, there is a shorter term horizon than that of an owner who may have built the company over several decades. Private equity groups may also require management to stay in place, rather than cash out, or may require a continued investment in the company to align management interests with the private equity firm. While transaction structures can be flexible, there may be earn-outs that are paid over a number of years depending on the company's performance. Additionally, closing private equity transactions is often contingent on certain factors. The first is typically ensuring that financing for the debt needed to close the transaction will be in place, which has recently become more difficult. Private equity groups may also have a longer due diligence process, as they may require more education about the underlying business.

## **Non-Domestic Companies**

With some of the M&A market tensing up, as well as the falling dollar, there will be an increased likelihood that international buyers will become involved in transactions in the region. In 2007, foreign buyers accounted for some of the largest U.S. transactions. Locally, Campbell Soup announced the sale of their Godiva unit to a Turkish buyer.

As a percentage of total transaction volume, foreign buying of U.S. companies reached an all-time high in 2007.

Foreign buyers are winning deals because the appreciation of their currency against the U.S. dollar enables them to pay the highest prices. The opportunity to sell a company to a foreign buyer at a high price may be one of the bright spots in the regional M&A picture for 2008.

## **Debt Markets**

The second half of 2007 saw a dramatic tightening in the debt markets, as the chart below shows. Debt multiples, after reaching a high in the second quarter of 2007, have started to return to historical levels. As the debt markets continue to change with increased pricing and more stringent underwriting, private equity groups may have to change transaction structures by increasing the amount of equity in the deal, or there may be strategy changes in store for private equity groups as both acquisitions and investment exits become more difficult.

Despite the recent changes, data indicates a continued robust M&A market for regional companies and given the macro-environment of low capital gains rates (which may change), low interest rates, and continued availability of capital in the mid market, it remains a great time to sell.

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[Back To Top](#)