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Branding Taxation

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BRANDING TAXATION

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I. INTRODUCTION

Consider this scenario: You are a junior trademark lawyer at your firm. You are proud of your work for the Client, protecting and enforcing the Client's young brand name. The Client is a midsize company, seeking to increase growth and working hard to compete against others in the marketplace. Last year, you helped the Client to conclude a lawsuit against an infringer who had adopted a mark very similar to the Client's trademark. In the complaint, you included both federal trademark infringement and unfair competition claims. As usual, you requested injunctive relief, damages, attorney's fees, and costs in the complaint. The litigation was factually intensive, as you had to establish likelihood of consumer confusion for both the trademark infringement and unfair competition claims. In the end, you won for the Client. The Client incurred half a million dollars in litigation costs.

You have just received a call from the Client. The IRS has challenged the Client's claimed deduction of the $500,000 in litigation costs as ordinary business expenses. The Commissioner reasons that the two claims contained in the complaint for the trademark litigation drafted by you are very distinct, warranting different tax treatments. The Commissioner also wants to arbitrarily apportion the costs: $250,000 for the infringement claim and $250,000 for the unfair competition claim. The cost associated with the unfair competition claim is allowed to be immediately deducted, while the cost for the trademark infringement claim must be capitalized.

You are confused. You don't know anything about taxation of trademarks. You only know trademark law, the subject matter that you fell in love with during law school. You and everyone who practices trademark law know that trademark infringement and unfair competition claims are virtually the same. Something about the distinction in tax treatment of the two claims bothers you. The Client now asks you to take care of this matter. You have no idea what to do at this moment.

Consider the next scenario: Still feeling quite confused, you decide to take a break by focusing on different matters for the Client for the time being. You notice that the Client has typically expended a large sum every year in advertising expenditures in its efforts to sell products in connection with the Client's trademark. The Client engages in a wide range of branding activities, ranging from placing ads in the local newspapers, maintaining a strong presence online through social media outlets, purchasing keywords from Google, and keeping the Client's website fresh with new content. The Client generally seeks a tax deduction in full for the costs associated with these usual branding activities, and the IRS has not challenged such tax return position. Recently, the Client has decided to rejuvenate its brand with a new advertisement campaign to inject a new image of youthfulness, boundless energy, and fun. You, however, believe that the existing brand is doing just fine, as goods are selling well. Therefore, you don't quite see the need for a new, extensive, and expensive advertisement campaign. On the trademark front, you are pleased that this new campaign will enhance the visibility of the trademark, cultivating an identity for the brand and increasing the level of protection for the trademark.

The Client calls you again, inquiring whether the costs associated with the expensive advertisement campaign to rejuvenate the trademark will also be deductible like other usual brand advertisement expenditures. You politely remind the Client that you know next to nothing about the tax treatment of branding expenditures. The Client insists that you look into the matter because, after all, you are the trademark maven and this matter does relate to trademark. Again, you don't know where to look for the answer.

Unfortunately, the answers for the two scenarios above are contained in a web of tax statutes, regulations, cases, and administrative rulings that emerged in the absence of a rational legal framework, providing a host of incoherent tax distinctions for branding investment. Welcome to branding taxation, a zone of discomfort for both intellectual property and tax scholars and practitioners.

Branding is important not only to businesses,[1] but also to the economy.[2] The intellectual property laws and tax laws should thus

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[1] *See generally* Katya Assaf, *Brand Fetishism*, 43 CONN. L. REV. 83 (2010) (observing modern usage of brands by corporations to build spiritual attachments); Deven R. Desai,

further the legitimate goals of encouraging and protecting brand investments while maintaining a sound tax base. Intellectual property protections for branding depend on advertisement and enforcement, both of which demand significant amounts of private investment by firms. Although one would expect similar tax treatments of both categories of investment, the categories are actually treated as vastly different for federal income tax purposes. Additionally, tax distinctions also exist within each category. The result is that some branding investments are expensed and others are not. No article has explored in depth these tax distinctions for branding activities. This Article fills that void by evaluating tax rules governing branding within a normative tax policy framework and advancing several proposals where tax distinctions lack theoretical justification.

This Article proceeds as follows: Part II focuses on the branding role in business. This Part investigates how companies assert their presence through branding and utilizing a wide range of tactics to attract attention, build loyalty, and enhance goodwill. Companies also embrace major branding campaigns to rescue brands from fiascos or to inject new life into stale brands.

In addition to branding expenditures, companies fiercely protect their brands through applicable laws. Parts III and IV of this Article turn to trademark law and copyright law, respectively, for potential claims asserted by brand owners against infringers. The Lanham Act, under the theories of trademark anti-dilution,

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From Trademarks to Brands, 64 FLA. L. REV. 981 (2012) (acknowledging modern business practices with brands and advancing a new brand theory for trademarks); Jeremy N. Sheff, *Biasing Brands*, 32 CARDOZO L. REV. 1245 (2011) (discussing brand equity and suggesting a new alternative model for brand equity with consumer protection).

[2] Companies were projected to spend $180 billion on advertising expenditures in 2014. *Total Media Advertising Spending in the United States from 2011 to 2018*, STATISTA, http://www.statista.com/statistics/272314/advertising-spending-in-the-us/ (last visited Dec. 27, 2015). The impact of branding expenditures support job creation in the United States. For every $1 million of advertising money expenditures, eighty-one jobs are created. Press Release, Ass'n of Nat'l Advertisers, New Study Underscores Advertising's Role as a Critical Driver of the U.S. Economy (Jan. 14, 2014), http://www.ana.net/content/show/id/29144. The contribution of the advertising industry to the economy also occurs outside the United States. *See generally* ALEXANDRA ALBERT & BENJAMIN REID, THE CONTRIBUTION OF THE ADVERTISING INDUSTRY TO THE UK ECONOMY: A CREATIVE INDUSTRIES REPORT (2011), http://www.theworkfoundation.com/DownloadPublication/Report/295_The%20contribution%20of%20advertising% 20to%20the%20UK%0economy%20311011.pdf.

infringement, and unfair competition, protects brands that are primarily words or logos, as well as the total image, look and feel, and packaging of a product or service.[3] In branding activities, companies often create brand content protected under copyright law. In the enforcement of brands and brand content, companies incur substantial litigation costs under trademark law and copyright law.

Part V of this Article explores the evolution of the current tax regime governing brand building and enforcement. Under the present system, advertising costs to foster brand equity are expensed (with the exception of the costs of tangible assets associated with advertising). In contrast, litigation costs incurred to protect that enhancement of value must be capitalized (with the exception of legal costs in unfair competition claims).

Part VI of this Article critiques the current tax regime governing branding and makes appropriate recommendations where current rules lack theoretical justification. It offers sound policy arguments in support of tax law's current treatment (expensing) of *usual brand advertising*—the costs of ordinary product, institutional, or goodwill advertising. Chiefly, expensing ordinary brand advertising stimulates economic growth and furthers administrative efficiency. Further, expensing creates an even playing field between businesses that advertise their own brands and businesses that choose, instead, to license from others the right to use well-known trademarks in connection with products they manufacture and sell. Part VI, however, also questions whether the current unfavorable tax treatment of tangible assets associated with advertising potentially distorts firms' brand strategies, thus violating the principle of tax neutrality.

Part VI then makes the case that tax law should be changed to require the capitalization of unusual brand advertising—the costs of marketing campaigns, graphic designs, and package designs. This Part critiques the historic development of rules governing campaign expenditures, suggesting they resulted from a lack of clarity over the proper standard to apply. This Part also suggests that a more appropriate standard might be found in the rules

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[3] *See generally* 15 U.S.C. § 1051 (2012).

governing the tax treatment of repairs and improvements to tangible property. Specifically, it argues that advertising campaign expenditures, which strengthen, restore, or elevate the brand, can be analogized to improvement costs of tangible property, which have long been considered nondeductible capital expenditures.

Part VI concludes by identifying an appropriate tax framework for brand enforcement expenditures. It criticizes the current tax distinction between litigation costs incurred in connection with trademark infringement claims (capitalized) and similar costs incurred in connection with unfair competition claims (expensed), arguing that such distinction merely elevates form over substance. If substance is to prevail in tax jurisprudence, the litigation costs associated with both actions should be capitalized, reflecting that both are brought primarily to establish the taxpayer's trademark and not to recover income. Likewise, consistent tax treatment curbs arbitrary apportionment of costs.

II. THE BRANDING ROLE IN BUSINESS

Branding is everywhere.[4] Branding is one of the most important aspects of any business.[5] Branding allows a company to

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[4] *See, e.g.*, Joseph C. Daniels, *The Branding of America: The Rise of Geographic Trademarks and the Need for a Strong Fair Use Defense*, 94 IOWA L. REV. 1703, 1720–21 (2009) (noting the wide spread of branding by public and private entities throughout the United States); Daniel J. Kevles, *A Primer of A, B, Seeds: Advertising, Branding, and Intellectual Property in an Emerging Industry*, 47 U.C. DAVIS L. REV. 657, 657–65 (2013) (discussing branding and tracing its history in the innovation of seeds and related industries); Paul Ohm, *Branding Privacy*, 97 MINN. L. REV. 907, 910–13 (2013) (studying the function of brands and recommending the use of brands to signify privacy commitments); Omari Scott Simmons, *Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law*, 42 U. RICH. L. REV. 1129, 1133, 1143–51 (2008) (analyzing how Delaware becomes a brand for corporate charters and noting that the "Delaware brand is more than mere marketing or advertising; it is a mixture of tangible and intangible elements that firms value"). *See generally* Victor Fleischer, *Brand New Deal: The Branding Effect of Corporate Deal Structures*, 104 MICH. L. REV. 1581 (2006) (exploring the effects of branding consumers through a study of four corporate deal structures).

[5] John Williams, *The Basics of Branding*, ENTREPRENEUR, http://www.entrepreneur.com/article/77408 (last visited May 24, 2016); *see also* Marion Crain, *Managing Identity: Buying Into the Brand at Work*, 95 IOWA L. REV. 1179, 1182–85 (2010) (explaining that corporate branding is important to not only the customers, but also the employees, of a company); Ohm, *supra* note 4, at 937 (noting that words and symbols are information devices used to

communicate with its customers what they can expect from the company's products or services as well as distinguish the company's offerings from those of competitor.[6] Branding provides the company opportunities to deliver its promises to customers, build customers' emotional attachment to products, and cultivate long-lasting customer affinity.[7] Branding also allows a customer to express her preference, individuality, and identity.[8]

Companies deploy their branding strategies in multiple, creative ways.[9] For example, Hyundai entices customers to buy cars by providing them the Hyundai Assurance—if the customer loses income the year following purchase, Hyundai will allow the customer to return the car.[10] Southwest Airlines operates revolutionarily differently from all other airlines by providing FREE BAGS, FLY HERE™ service as part of its image as the "people's airline."[11] Starbucks adopted the unprecedented listening-to-action concept in My Starbucks Ideas to get 150,000 ideas from its customers, "leading to the implementation of 277 new innovations for Starbucks."[12] Burger King promoted the

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efficiently "communicate to potential customers that the product or service has been backed by a known source who guarantees a specific level of quality and accountability").

[6] Williams, *supra* note 5 ("[Y]our brand is your promise to your customer. It tells them what they can expect from your products and services, and it differentiates your offering from your competitors.").

[7] *Id.*

[8] *See* Desai, *supra* note 1, at 989 ("[C]onsumers may simultaneously use brands as expressions of individuality and identity as they take a brand and alter it to match what they see as the meaning of the brand and how that meaning relates to their self-image or message."); Jeremy N. Sheff, *Veblen Brands*, 96 MINN. L. REV. 769, 803 (2012) ("[T]he 'quality' sought by consumers in the market for status goods is the quality of the *message* the brand conveys: its ability to communicate social status to others.").

[9] *See* Gus Lubin, *60 Daring Brand Strategies That Paid Off*, BUS. INSIDER (May 14, 2012, 11:17 AM), http://www.businessinsider.com/brands-that-get-people-talking-2012-5?O p=1 (listing various creative techniques for branding, including "making new rules, marketing a belief, creating belonging inability expression, creating culture, leveraging tension, using scarcity and encouraging play").

[10] *Id.*

[11] *Id.*

[12] Press Release, Starbucks, Starbucks Celebrates Five-Year Anniversary of My Starbucks Idea (Mar. 29, 2013), http://www.businesswire.com/news/home/20130328006372/en/Starbuck s-Celebrates-Five-Year-Anniversary-Starbucks-Idea; *see also* Mike Schoultz, *How Starbucks Used My Starbucks Idea to Ace Crowdsourcing*, DIGITAL SPARK MKTG., http://www.digitalspar kmarketing.com/innovation/my-starbucks-idea/ (last visited Dec. 27, 2015) (summarizing how Starbucks crowdsources through My Starbucks Idea by "encourage[ing] customers to submit

brand strategy for its Whopper with the Whopper Sacrifice reward, in which customers could earn a free Whopper each time they sacrificed and "defriended" ten friends on Facebook in the "Friendship is strong, but the Whopper is stronger" campaign.[13] Ben & Jerry's "blend[ed] Wall Street finance with Main Street values" when the company offered its stock directly to customers, employees, and friends of "Vermont residents" during its initial public offering.[14]

With the arrival of online social media, companies have begun to identify and adopt new branding approaches to reach more customers.[15] They embrace social media and sites like Twitter, LinkedIn, Google+, Facebook, YouTube, and Pinterest to increase their visibility to customers, partners, and searchers.[16] Companies understand that online visibility enhances and nurtures real relationships in both the virtual and real worlds.[17] In other words, they follow the mantra preached by brand executives: "Social media is a powerful tool for increasing visibility, building relationships, and connecting with others who are not in your geography. Build your social media strategy around your personal brand with authenticity, focus and consistency."[18]

Examining various branding campaigns reveals that companies continuously search for and adopt creative and provocative methods to attract attention to their products or services.[19]

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ideas for better products, improving the customer experience, and defining new community involvement, among other categories").

[13] Andrew LaVallee, *Burger King Cancels Facebook Ad Campaign*, WALL ST. J. (Jan. 15, 2009, 4:47 PM), http://blogs.wsj.com/digits/2009/01/15/burger-king-cancels-facebook-ad-campaign/.

[14] Fleischer, *supra* note 4, at 1606.

[15] *See* William Arruda, *Three Elements of an Effective Social Media Strategy*, FORBES (Aug. 27, 2013, 8:31 AM), http://www.forbes.com/sites/williamarruda/2013/08/27/three-elements-of-an-effective-social-media-strategy/ ("Social media can be your *best* opportunity for enhancing relationships and expanding your brand.").

[16] *Id.*

[17] *See id.* ("If you're avoiding social media, you're invisible to those who seek what you have to offer. Be visible and available in the virtual world so you can expand your success in the real world! Connecting with your virtual brand community helps you build and nurture real relationships — relationships that will increase your success and fulfillment.").

[18] *Id.*

[19] *See* Lubin, *supra* note 9 (explaining different creative branding methods used by various companies).

Companies know that without effective branding strategies, their products or services will very soon become unnoticed and forgotten. As a result, small and large companies spend vast monetary sums in their branding efforts. For example, in 2014, global advertising expenditures were expected to reach $523 billion.[20] In the United States, companies spent $167 billion in advertising expenditures in 2013, and the figure is predicted to reach $190 billion in 2016.[21] Furthermore, the phenomenal growth in online advertisements delivered through mobile devices and desktop computers surpassed newspaper advertisements in 2012 and likely exceeded both magazine and newspaper advertisements in 2015.[22]

With all the branding strategies culminating in staggering advertising expenditures, companies compete for customer and partner attention. Some companies aim higher, reaching for and achieving the status of top national or global brands. Every year, Interbrand publishes its list of top global brands, showing the fluctuations among brands due to increases or decreases in their estimated values.[23] The active movements among brands hint at fierce competition in the marketplace. For example, in 2011, Apple was eighth in the top brand list, Coca-Cola first, and Google fourth.[24] In 2012, Coca-Cola maintained first, Apple leaped to second, and Google remained fourth.[25] In 2013, Apple became the new leader, Google jumped to second, and Coca-Cola fell from first place for the first time in thirteen years to third.[26] More profoundly, the movements among brands reflect "how we buy,

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[20] JONATHAN BARNARD, ZENITH OPTIMEDIA, EXECUTIVE SUMMARY: ADVERTISING EXPENDITURE FORECASTS SEPTEMBER 2014 (2014), http://www.ZenithOptiMedia.si/media/uploads/_custom/adspend_forecasts_september_2014_executive_summary_2.pdf.

[21] *Id.*

[22] *Id.*

[23] *See e.g.*, *Best Global Brands 2013*, INTERBRAND, http://interbrand.com/wp-content/uploads/2015/08/Interbrand-Best-Global-Brands-2013.pdf (last visited Dec. 27, 2015) (listing Apple, Google, and Coca-Cola as the top three brands of 2013).

[24] *Interbrand's Best Global Brands Report 2011*, CAMPAIGN BRIEF, http://www.campaignbrief.com/FINAL%20Interbrand%20Best%20Global%20Brands%202011.pdf (last visited Dec. 27, 2015).

[25] *See* Stuart Elliott, *Apple Passes Coca-Cola as Most Valuable Brand*, N.Y. TIMES (Sept. 29, 2013), http://www.nytimes.com/2013/09/30/business/media/apple-passes-coca-cola-as-most-valuable-brand.html?_r=0 (reporting brand movements between 2012 and 2013).

[26] *Id.*

how we communicate with each other, even whether we speak with each other."[27] In other words, companies rely on branding to sell their products and services, and along the way, branding influences and changes "the way we live our lives."[28]

Understanding the impact of brands in the marketplace, companies zealously guard the accumulated goodwill embodied in a brand. In addition to advertising expenditures, companies spend considerable efforts to minimize attracting negative attention to brands.[29] For example, when Netflix faced major negative publicity when 800,000 subscribers dropped its service, Netflix immediately fixed the problem by rebranding itself from "being a home deliverer of discs to a producer of video content and streamer of video content to the homes of global subscribers, including a voice recognition system named 'max' that quizzes subscribers and gives them movie suggestions."[30] Addressing negative publicity decisively with the new rebranding campaign, Netflix understood that the customer is fundamental to the creation of goodwill in the brand. In the fierce, competitive business world, goodwill is the "brand equity" or value that companies highly prize and protect in order to survive and strive.[31]

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[27] *Id.*

[28] *Id.*

[29] *See, e.g.*, Chris Book, *4 Keys to Turning Negative Commenters into Brand Advocates*, CONVINCE & CONVERT, http://www.convinceandconvert.com/social-crm/4-keys-to-turning-negative-commenters-into-brand-advocates/ (last visited Dec. 28, 2015) (providing advice on how to respond to online critics); Caysey Welton, *How to Respond If You Find Your Brand on Consumer Reports' 'Naughty List' this Season*, PR NEWS (Nov. 25, 2013), http://www.prnewsonline.com/water-cooler/2013/11/25/what-to-do-if-find-your-brand-on-the-naughty-list/ (describing remedial actions for brands in the face of bad PR).

[30] Edward Lawler, *Netflix: We Got It Right!*, FORBES (June 24, 2013, 5:00 AM), http://www.forbes.com/sites/edwardlawler/2013/06/24/netflix-we-got-it-right/.

[31] *See* Gigi DeVault, *How to Measure Brand Equity*, ABOUT.COM, http://marketresearch.about.com/od/market.research.advertising/ht/How-To-Measure-Brand-Equity.htm (last visited Dec. 28, 2015) ("The impact that a brand has on consumer purchases or perceptions about a product is known as *brand equity*. The word *equity* indicates that an asset has been generated. In brand equity, the asset is intangible and is measured in terms of the value attributed by a consumer or potential consumer to the product or service. Brand equity translates into consumer goodwill and propensity to prefer or buy a branded product or service."); *see also Brand equity*, BUS. DICTIONARY, http://www.businessdictionary.com/definition/brand-equity.html (last visited May 24, 2016) ("A brand's power derived from the goodwill and name recognition that it has earned over time, which translates into higher sales volume and higher profit margins against competing brands.").

III. PROTECTING BRANDS THROUGH LITIGATION

In addition to fiercely promoting brands in the marketplace,[32] companies rely on the legal system to enforce their brands against unauthorized use that may harm and reduce the value of their brand. There are three different theories of protection that provide possible causes of action to brand owners, depending on the level of brand recognition and the types of harm inflicted by unauthorized users. The three theories of protection are available to brands that are words, phrases, logos, and symbols, as well as trade dress or the total look and feel of a product or service.

A. TRADEMARK DILUTION

Famous brands and trademarks are omnipresent. They appear in digital and print media. They perch on bright billboards, moving vehicles, and glossy brochures. They are the embedded metatags programmed to appear on top of a search engines' results,[33] or the keywords for searches directed to sponsored links.[34] They run across banner ads on computer screens and the digital screens in Times Square. They are the icons, images, and arbiters of culture, taste, desire, and power.[35] Famous names like Apple, Google, Microsoft, Samsung, Intel, BMW, Louis Vuitton,

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[32] Samsung is a good example of how a company has engaged in the highly competitive tech industry to become a leading brand. *See* Eric Pfanner & Brian Chen, *Samsung: Uneasy in the Lead*, N.Y. TIMES, Dec. 14, 2013, http://www.nytimes.com/2013/12/15/technology/Samsung-uneasy-in-the-lead.html?_r=0 (describing Samsung's plan to maintain its lead amongst competitors).

[33] *See* Venture Tape Corp. v. McGills Glass Warehouse, 540 F.3d 56, 59 (1st Cir. 2008) (defining "metatags" as "a component of a web-page's programming that contains deceptive information about the webpage which is typically not observed when the webpage is displayed in a web browser" and noting that a competition had embedded the metatags of another company in its website to attract more consumers).

[34] *See* Network Automation, Inc. v. Advanced Sys. Concepts, Inc., 638 F.3d 1137, 1142 (9th Cir. 2011) (noting how companies advertise through the keyword method).

[35] R. Charles Henn, Jr. et al., *Protecting Collegiate Color Schemes: How Recent Developments in Trademark Law Enable Institutions to Further Preserve and Strengthen Their Brand Identities*, 12 VA. SPORTS & ENT. L.J. 1, 4 (2012) ("Consumers' buying decisions directly result from trademark owners' cultivation of brand identities and brand personalities with which consumers desire to affiliate."). *See also* Desai, *supra* note 1, at 985 (explaining how brands function as information sources for preferences, desires, and identity).

Coca-Cola, and McDonald's[36] achieve their iconic status over time, largely due to enormous investment and vigilant enforcement by brand owners.

The investment includes not just building the brand names in the marketplace, but also aggressive policing against any unauthorized use.[37] When a third party uses a mark that may dilute the distinctiveness of the brand, the brand owner will lean on trademark dilution law to enjoin the allegedly dilutive use.

Under trademark dilution law, dilutive use covers the types of use that may likely cause tarnishment or blurring of the brand.[38] Tarnishment involves the defendant's use of the brand in an unwholesome way.[39] For example, the Louis Vuitton brand owner

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[36] Apple ($98 billion), Google ($93 billion), Coca-Cola ($79 billion), Microsoft ($59 billion), McDonald's ($42 billion), Samsung ($39 billion), Intel ($37 billion), BMW ($31 billion), and Louis Vuitton ($24 billion) are among the top global brands. Aaron Taube, *These Are the 20 Most Valuable Brands in the World*, BUS. INSIDER (Sept. 30, 2013, 5:02 PM), http://www.businessinsider.com/these-are-the-20-most-valuable-brands-in-the-world-2013-9?op=1.

[37] Aggressive tactics or trademark bullying can also go too far and may cause unwanted negative publicity. The Supreme Court in *Already, LLC v. Nike, Inc.*, 133 S. Ct. 721, 733–34 (2013) recognizes the problem of trademark bullying:

> Courts should be well aware that charges of trademark infringement can be disruptive to the good business relations between the manufacturer alleged to have been an infringer and its distributors, retailers, and investors. The mere pendency of litigation can mean that other actors in the marketplace may be reluctant to have future dealings with the alleged infringer. Nike appears to have been well aware of that dynamic in this case.

See also Tamlin H. Bason, *What Did We Learn from* Already v. Nike?, BLOOMBERG BNA INTELL. PROP. BLOG (Jan. 17, 2013), http://www.bna.com/learn-already-nike-b17179871889/ (discussing trademark bullying tactics employed by brand owner Nike); Jesse Bidgood, *Chicken Chain Says Stop, but T-Shirt Maker Balks*, N.Y. TIMES (Dec. 4, 2011), http://www.nytimes.com/2011/12/05/us/eat-more-kale-t-shirts-challenged-by-chick-fil-a.html?_r=0 (reporting on the publicity relating to the fight between Chick-Fil-A and the Vermont artist's "Eat More Kale" T-shirt).

[38] *See* 15 U.S.C. § 1125(c)(1) (2012) ("Subject to the principles of equity, the owner of a famous mark that is distinctive, inherently or through acquired distinctiveness, shall be entitled to an injunction against another person who, at any time after the owner's mark has become famous, commences use of a mark or trade name in commerce that is likely to cause dilution by blurring or dilution by tarnishment of the famous mark, regardless of the presence or absence of actual or likely confusion, of competition, or of actual economic injury."); Apple Inc. v. Samsung Elecs. Co., 735 F.3d 1352, 1373 (Fed. Cir. 2013) (discussing the federal trademark dilution statute).

[39] *See* 15 U.S.C. § 1125(c)(2)(C)(D) (" '[D]ilution by tarnishment' is association arising from the similarity between a mark or trade name and a famous mark that harms the reputation of the famous mark."); V Secret Catalogue, Inc. v. Moseley, 605 F.3d 382, 385

brought an action under dilution law against a defendant for tarnishing the distinctiveness of the Louis Vuitton brand by adopting "Chewy Vuitton" for cheap dog toys.[40]

Blurring use of a brand involves "association arising from the similarity between a mark . . . and a famous mark that impairs the distinctiveness of the famous mark," irrespective of "the presence or absence of actual or likely confusion, of competition, or of actual economic injury."[41] In *Starbucks Corp. v. Wolfe's Borough Coffee, Inc.*, Starbucks brought a blurring dilution claim against the defendant for using the term "Charbucks" in connection with the defendant's coffee products.[42] To succeed, the brand owner must establish, through evidence as required by the statute, that there is an association between the two marks.[43]

The tarnishment and blurring grounds of dilution, however, are only available to marks that have achieved the "famous" status under the law.[44] Very few trademarks can attain the "famous" status, as the law is designed to extend protection only to the special trademark that has become "widely recognized by the general consuming public" as a source of goods or services.[45] In other words, a famous mark must be a "household name."[46] For example, the owner of the trademark Louis Vuitton successfully

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(6th Cir. 2010) (affirming the district court decision that "Victor's Little Secret" tarnishes the famous trademark Victoria's Secret).

[40] Louis Vuitton Malletier S.A. v. Haute Diggity Dog, LLC, 507 F.3d 252 (4th Cir. 2007). *Compare id.* at 260–61 (finding successful defendant's argument that "Chewy Dog" was a parody providing social commentary critical of today's material, status-obsessed consumer culture), *with V Secret Catalogue, Inc.*, 605 F.3d at 389 (finding that defendant's mark raised a strong inference of tarnishment of plaintiff's brand through lewd or offensive sexual association).

[41] 15 U.S.C. § 1125(c)(1)(2).

[42] 736 F.3d 198, 200 (2d Cir. 2013) (affirming the district court's finding that the plaintiff failed to demonstrate likelihood of dilution by blurring because the association between Starbucks and Charbucks is very weak).

[43] 15 U.S.C. § 1125(c)(1)–(2).

[44] *See* Everest Capital Ltd. v. Everest Funds Mgmt., LLC, 393 F.3d 755, 763 (8th Cir. 2005) ("The judicial consensus is that 'famous' is a rigorous standard.").

[45] 15 U.S.C. § 1125(c)(2)(A) (providing that "a mark is famous if it is widely recognized by the general consuming public of the United States as a designation of source of the goods or services of the mark's owner").

[46] *See* Coach Servs., Inc. v. Triumph Learning LLC, 668 F.3d 1356, 1373 (Fed. Cir. 2012) ("A famous mark is one that has become a 'household name.'" (quoting Nissan Motor Co. v. Nissan Computer Corp., 378 F.3d 1002, 1012 (9th Cir. 2004))).

established that the mark is famous for protection under the dilution law.[47] On the other hand, the trademark COACH for bags has recently been found by the court as not sufficiently famous for protection under trademark dilution law.[48] Despite the COACH brand owner's evidence of high volume of sales and advertising figures, extensive unsolicited media attention, numerous federal registrations, strong demand for joint marketing efforts, and positive brand awareness survey results, the court held that the evidence was insufficient to satisfy the requisite level of fame for a dilution claim.[49]

B. TRADEMARK INFRINGEMENT

Most brand owners rely on trademark infringement theory to police and enforce their trademark rights against third-party use that is likely to cause consumer confusion.[50] Under a trademark infringement claim, brand owners do not have to prove that they own a famous trademark.[51] They only need to establish that the

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[47] *See Louis Vuitton Malletier S.A.*, 507 F.3d at 265 (noting that "LVM owns famous marks that are distinctive" is not at issue for dilution claim purpose); Rosetta Stone Ltd. v. Google, Inc., 676 F.3d 144, 172–73 (4th Cir. 2012) (remanding the case for the district court to determine whether Rosetta Stone became famous by applying the statutory factors, even though Rosetta Stone's brand awareness had reached 75% in 2009).

[48] *See Coach Servs., Inc.*, 668 F.3d at 1373–74 (finding substantial evidence to support the conclusion that "CSI failed to show the requisite level of fame for dilution").

[49] *See id.* at 1374–76 (analyzing each piece of evidence proffered by Coach and concluding that the Trademark Trial and Appeal Board did not err in its decision that Coach failed to show fame for the dilution claim).

[50] *See, e.g.*, Water Pik, Inc. v. Med-Systems, Inc., 726 F.3d 1136 (10th Cir. 2013) (featuring a competitor seeking a declaratory judgment to prove its mark does not infringe a preexisting mark); Kelly-Brown v. Winfrey, 717 F.3d 295 (2d Cir. 2013) (featuring an owner of a motivational service business enforcing its right to the term "Own Your Power" against Oprah Winfrey); B & B Hardware, Inc. v. Hargis Indus., Inc., 716 F.3d 1020 (8th Cir. 2013) (featuring an owner of the trademark "Sealtight" protecting its product from being confused with a product called "Sealtite"); Swarovski Aktiengesellschaft v. Bldg. No. 19, Inc., 704 F.3d 44 (1st Cir. 2013) (featuring a crystal figuring maker barring a reseller of its product from using its name in an advertisement).

[51] *See* Midwestern Pet Foods, Inc. v. Societe des Produits Nestle S.A., 685 F.3d 1046, 1053 (Fed. Cir. 2012) (affirming the Trademark Trials and Appeals Board's ruling that "BEGGIN' STRIPS, although not a famous mark, has enjoyed 'at least a high degree of recognition' that has rendered the mark 'distinctive and strong and entitled to a broad level of protection' "); Palm Bay Imps., Inc. v. Veuve Clicquot Ponsardin Maison Fondee En 1772, 396 F.3d 1369, 1375 (Fed. Cir. 2005) ("[L]ikelihood of confusion fame 'varies along a

trademark is distinctive.[52] A word, phrase, or symbol can be deemed distinctive if it is arbitrary, fanciful, or suggestive.[53] For example, Apple is an arbitrary name for computers, as it has absolutely no connection with computers when the brand owner selects the word "apple" for computers.[54] Clorox is a fanciful trademark, because it is a coined term—a made-up, nonexistent word when the brand owner creates the mark.[55] Polar Bear is a suggestive trademark for outerwear, as the mark is "connected with the concept of cold weather and protection from the elements. It suggests that the type of outerwear and boots sold by [the brand owner] offer the sort of protection afforded by bears' skins."[56]

Words that describe figure, size, taste, function, or characteristic of a product are not inherently distinctive and have no protection under trademark law.[57] Descriptive trademarks can gain protection only if they have acquired secondary meaning, becoming distinctive through years of use and achieving consumer recognition as source identifiers.[58] The burden is on the owner of

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spectrum from very strong to very weak.'" (quoting *In re* Coors Brewing Co., 343 F.3d 1340, 1344 (Fed. Cir. 2003))).

[52] *See* Miller's Ale House, Inc. v. Boynton Carolina Ale House, LLC, 702 F.3d 1312, 1317 (11th Cir. 2012) ("The starting point for an assessment of the validity of a mark is to query whether or not the purported mark is distinctive."); Welding Servs., Inc. v. Forman, 509 F.3d 1351, 1357 (11th Cir. 2007) (nothing that distinctive trademarks are entitled to protection).

[53] Two Pesos, Inc. v. Taco Cabana, Inc., 505 U.S. 763, 768–69 (1992).

[54] *See* Icebreaker Ltd. v. Gilmar S.P.A., 911 F. Supp. 2d 1099, 1113 (D. Or. 2012) (defining "arbitrary trademarks" as "actual words with no connection to the product" and listing Apple computers and cancel cigarettes as prime examples) (quoting Entrepreneur Media, Inc. v. Smith, 279 F.3d 1135, 1141 (9th Cir. 2002)).

[55] Bear Republic Brewing Co. v. Cent. City Brewing Co., 716 F. Supp. 2d 134, 150 (D. Mass. 2010) (noting that "Clorox" is a fanciful trademark).

[56] Bear U.S.A., Inc. v. A.J. Sheepskin & Leather Outerwear, Inc., 909 F. Supp. 896, 904 (S.D.N.Y. 1995) (finding the trademark composing of the word "bear," along with the image of a polar bear, a suggestive mark for outerwear and boots). *See also* Heartland Animal Clinic, P.A. v. Heartland SPCA Animal Med. Ctr., LLC, 503 Fed. App'x 616, 619–20 (10th Cir. 2012) (affirming the district court's finding that the mark "Heartland" for animal clinic services is suggestive); *Two Pesos*, 505 U.S. at 768 (a suggestive mark is "deemed inherently distinctive and [is] entitled to protection").

[57] Sara Lee Corp. v. Kayser–Roth Corp., 81 F.3d 455, 464 (4th Cir. 1996) (stating that a descriptive mark is not inherently distinctive because it "merely describe[s] a function, use, characteristic, size, or intended purpose of the product").

[58] To prove that a descriptive mark has become distinctive or has acquired a "secondary meaning," the brand owner must establish that "a substantial number of present or prospective customers understand the designation when used in connection with a business

the descriptive trademark to demonstrate the acquisition of a distinctive secondary meaning through direct evidence of consumer survey or indirect evidence such as sale volume, advertisement expenditure, and unsolicited media coverage.[59] For example, Coca-Cola as a name for beverages from the cola nut tree has become "the paradigm of a descriptive mark" that has acquired distinctiveness.[60]

The owner of an arbitrary, fanciful, or suggestive trademark, or descriptive trademark with secondary meaning, can assert trademark infringement against a third party's use that is likely to cause consumer confusion.[61] Courts typically apply a list of factors in analyzing whether there is likelihood of consumer confusion between the brand owner's trademark and the defendant's trademark.[62] Overall, the likelihood of consumer confusion test is factually intensive and costly for brand owners.[63] Unfortunately, if

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to refer to a particular person or business enterprise." Perini Corp. v. Perini Constr., Inc., 915 F.2d 121, 125 (4th Cir. 1990) (quoting Food Fair Stores, Inc. v. Lakeland Grocery Corp., 301 F.2d 156, 160–61 (4th Cir. 1962), *cert denied*, 371 U.S. 817 (1962)); *see also* George & Co. v. Imagination Entm't Ltd., 575 F.3d 383, 394 (4th Cir. 2009) ("Descriptive marks are not inherently distinctive; rather, they require a sharing of secondary meaning before they receive trademark protection." (citing Retail Servs., Inc. v. Freebies Publ'g, 364 F.3d 535, 538 (4th Cir. 2004))).

[59] *See* Flynn v. AK Peters, Ltd., 377 F.3d 13, 20 (1st Cir. 2004) (citing Bos. Beer Co. v. Slesar Bros. Brewing Co., 9 F.3d 175 (1st Cir. 1993)) (stating that secondary meaning can be established "through the use of direct evidence, such as consumer surveys or testimony from consumers," or through circumstantial evidence regarding: "(1) the length and manner of its use, (2) the nature and extent of advertising and promotion of the mark and (3) the efforts made in the direction of promoting a conscious connection, in the public's mind, between the name or mark and a particular product or venture.").

[60] *Sara Lee*, 81 F.3d at 464.

[61] *See, e.g.*, Citigroup Inc. v. Capital City Bank Grp., Inc., 637 F.3d 1344, 1354–56 (Fed. Cir. 2011) (discussing the relevant factors used in determining the likelihood of consumer confusion); Virgin Enters. Ltd. v. Nawab, 335 F.3d 141, 146–47 (2d Cir. 2003) (discussing the factors of consumer confusion and noting that the owner of arbitrary, fanciful, suggestive, or descriptive trademarks can assert trademark infringement).

[62] *See* Dorpan, S.L. v. Hotel Meliá, Inc., 728 F.3d 55, 65 (1st Cir. 2013) (applying the First Circuit's "*Pignons* factors" of (1) similarity of marks, (2) similarity of goods or, in service mark cases, services, (3) relationship between parties' channels of trade, (4) juxtaposition of parties' advertising, (5) classes of prospective purchasers, (6) evidence of actual confusion, (7) defendant's intent in adopting its allegedly infringing mark, and (8) strength of plaintiff's mark, in determining likelihood of consumer confusion).

[63] *See id.* at 66 ("Because the likelihood of confusion analysis is a particularly fact-intensive one, resolving this issue on summary judgment is disfavored."); Oriental Fin.

the brand owner fails to prosecute a third party's infringing use of the protected trademark, there is a strong risk of weakening the strength of the trademark[64] and losing the trademark rights through abandonment.[65]

C. UNFAIR COMPETITION

The goodwill and reputation associated with a trademark are accumulated through years of use and advertisement of the trademark in the marketplace.[66] Consequently, trademark right is based on actual use of the trademark in connection with products or services in commerce.[67] That also means trademark rights are not afforded to those who quickly rush to the United States Trademark Office first for registration without actual use of the

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Grp., Inc. v. Cooperativa de Ahorro y Credito Oriental, 698 F.3d 9, 17 (1st Cir. 2012) (recognizing that the likelihood of confusion factors test is "a highly fact-intensive inquiry").

[64] *See* Taza Sys., LLC v. Taza 21 Co., No. 2:11cv073, 2013 WL 5145859, at *9 (W.D. Pa. Sept. 13, 2013) (recognizing that "the presence of many users in the national marketplace could demonstrate that the mark, although valid and enforceable, is weak and entitled to limited protection against only exact, or near-exact, third-party uses").

[65] *See* Milacron LLC v. Stough Tool Sales, No. 1:12-CV-119, 2012 WL 2366639, at *3 (S.D. Ohio June 21, 2012) (noting that under the trademark statute, "[w]hen any course of conduct of the owner, including acts of omission as well as commission, causes the mark to become the generic name for the goods or services on or in connection with which it is used or otherwise to lose its significance as a mark," abandonment of the trademark occurs without the trademark owner's intent to abandon the trademark).

[66] Courts recognize that brand owners expend significant resources to build the goodwill in brands and often take note of the expenditures in fashioning damages in trademark infringement and unfair competition cases. *See* Smith Corona Corp. v. Pelikan, Inc., 784 F. Supp. 452, 476 (M.D. Tenn. 1992) ("[I]n order to calculate damage to a corporation's goodwill due to a competitor's false advertising, one must take into account the amount of money expended by the injured corporation in the promotion of its trademark."); *see also* Skydive Ariz., Inc. v. Quattrocchi, 673 F.3d 1105, 1112 (9th Cir. 2012) (observing that the district court "noted the significant and 'voluminous' evidence concerning Skydive Arizona's 'stellar business reputation,' and the hundreds of thousands of dollars Skydive Arizona spent in developing and advertising its business in awarding damages").

[67] *See* Ross v. Roberts, 478 F. App'x 426, 427 (9th Cir. 2012) ("[O]nly lawful use in commerce can establish trademark rights." (citing CreAgri, Inc. v. USANA Health Scis., 474 F.3d 626, 630 (9th Cir. 2007))); Knights Armament Co. v. Optical Sys. Tech., Inc., 654 F.3d 1179, 1188 (11th Cir. 2011) ("Actual substantive rights to a trademark arise based on its use in commerce and its distinctiveness."); *see also* United Drug Co. v. Theodore Rectanus, Co., 248 U.S. 90, 97 (1918) ("There is no such thing as property in a trade-mark except as a right appurtenant to an established business or trade in connection with which the mark is employed. . . . [T]he right to a particular mark grows out of its use, not its mere adoption.").

mark in commerce.[68] In fact, registration is not required for trademark protection in the United States.[69]

To protect the public and the trademark owner's investment in a trademark, regardless of registration, unfair competition law prevents a third party from using a mark that is likely to cause false association or mislead the consumer.[70] In 1946, the Lanham Act codified unfair competition law relating to third-party use of names, logos, and phrases in sales and advertisements.[71] The federal unfair competition statute is broad in scope, covering the defendant's use of a mark or symbol that causes false representation, false advertisement, and misrepresentation of "the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities."[72]

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[68] *See In re* Omega SA, 494 F.3d 1362, 1364 (Fed. Cir. 2007) (discussing the Patent Trademark Office's rules about "the trademark owner's rights, which are based on use of the mark and identification of the goods, not on the class in which the mark is registered").

[69] *See* Gen. Healthcare Ltd. v. Qashat, 364 F.3d 332, 335 (1st Cir. 2004) ("Trademark rights may arise under either the Lanham Act or under common law, but in either circumstance, the right is conditioned upon use in commerce."); Tally-Ho, Inc. v. Coast Cmty. Coll. Dist., 889 F.2d 1018, 1022–23 (11th Cir. 1989) ("Trademark ownership is always appurtenant to commercial activity. Thus, actual and continuous use is required to acquire and retain a protectible interest in a mark.").

[70] *See* Moseley v. V Secret Catalogue, Inc., 537 U.S. 418, 428 (2003) ("Traditional trademark infringement law is a part of the broader law of unfair competition that has its sources in English common law, and was largely codified in the Trademark Act of 1946 (Lanham Act)." (citations omitted)), *superseded by statute*, Trademark Dilution Revision Act of 2006, 15 U.S.C. §§ 1125, 1125(c) (2012), *as recognized in* Levi Strauss & Co. v. Abercrombie & Fitch Trading Co., 633 F.3d 1158 (9th Cir. 2011); Petroliam Nasional Berhad v. GoDaddy.com, Inc., 737 F.3d 546, 549 (9th Cir. 2013) ("The Lanham Act, 15 U.S.C. § 1051 et seq., passed in 1946, codified the then existing common law of trademarks, which in turn was based on the tort of unfair competition.").

[71] *See* Schlotzsky's, Ltd. v. Sterling Purchasing & Nat'l Distrib. Co., 520 F.3d 393, 397 (5th Cir. 2008) ("The Lanham Act codified and unified the common law on unfair competition and trademark protection, and through several amendments since its adoption in 1946, remains the principal statutory protection of trademarks.").

[72] 15 U.S.C. § 1125(a)(1)(B). The Act provides in pertinent provisions:

> (1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which –
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>> (A) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or

A brand owner, in asserting claims against third-party use of a similar mark, can avail to unfair competition law, and in some cases, both trademark infringement and unfair competition provisions of the Lanham Act.[73] Courts apply the same likelihood of consumer confusion test in trademark infringement to unfair competition cases.[74] If the evidence warrants it, courts do not hesitate to uphold verdicts with large damages against defendants for intentionally harming the goodwill and reputation of the plaintiff's trademark through false or misleading representation and advertisement.[75]

In addition to federal claims, brand owners can look to state law for unfair competition against third parties for engaging in passing off or palming off the goodwill of the trademark.[76] For instance, under New York state law of unfair competition, courts recognize

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> (B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities,
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> shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

Id. § 1125(a).

[73] *See, e.g.*, Secular Orgs. for Sobriety, Inc. v. Ullrich, 213 F.3d 1125, 1129 (9th Cir. 2000) (noting that the plaintiff asserted both trademark infringement and unfair competition claims against the defendant); Hester Indus., Inc. v. Tyson Foods, Inc., 160 F.3d 911, 914 (2d Cir. 1998) (same).

[74] *See* Two Pesos, Inc. v. Taco Cabana, Inc., 505 U.S. 763, 780 (1992) (Stevens, J., concurring) ("[T]he test for liability is likelihood of confusion: '[U]nder the Lanham Act [§ 43(a)], the ultimate test is whether the public is likely to be deceived or confused by the similarity of the marks. . . . Whether we call the violation infringement, unfair competition or false designation of origin, the test is identical—is there a 'likelihood of confusion?' " (citation omitted)); Audi AG v. D'Amato, 469 F.3d 534, 542 (6th Cir. 2006) ("[W]e use the same test to decide whether there has been trademark infringement, unfair competition, or false designation of origin: the likelihood of confusion between the two marks.").

[75] *See* Skydive Ariz., Inc. v. Quattrocchi, 673 F.3d 1105, 1116 (9th Cir. 2012) (upholding a jury verdict of $10 million in damages in a trademark infringement and false advertisement case).

[76] *See, e.g.*, Automobili Lamborghini, S.p.A. v. Sangiovese, LLC, No. 2:11-CV-1154-KJD-CWH, 2013 WL 5371421, at *2 (D. Nev. Sept. 24, 2013) (enforcing an injunction that prohibited "engaging in any activity constituting unfair competition with Lamborghini, or constituting an infringement of any or all of Lamborghini's Marks, or of Lamborghini's rights in, or to use or exploit, any or all of Lamborghini's Marks or engage in any activity that deceives the public and/or the trade, including, without limitation, palming-off or the use of design elements and designations associated with Lamborghini or Lamborghini's marks").

both palming off and misappropriation.[77] New York defines "palming off" as "the sale of the goods of one manufacturer as those of another."[78] New York law even extends protection to brands that have no secondary meaning, as long as there is evidence of a third party's intent to trade off on the goodwill and reputation of the name.[79] Obviously, in state unfair competition cases, the brand owner must establish that it suffers losses directly from the defendant's palming-off conduct.[80]

In summary, a brand owner can rely on trademark dilution, trademark infringement, and unfair competition law to police and enforce its trademark rights against third-party use to protect its substantial investment in building the goodwill in the brand.

D. TRADEMARK LITIGATION COSTS

Brand owners, relying on federal and state law to protect and enforce their rights in brands, incur significant costs in trademark litigation. According to the American Intellectual Property Law Association's 2013 Report of the Economic Survey, average litigation costs in 2012 for a trademark litigation ranged from $375,000 when less than $1 million was in controversy to $2

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[77] *See* Yantha v. Omni Childhood Ctr., Inc., No. 13-CV-1948, 2013 WL 5327516, at *6 (E.D.N.Y. Sept. 20, 2013) ("New York recognizes two theories of common-law unfair competition: palming off and misappropriation."); Shaw v. Time-Life Records, 341 N.E.2d 817, 820 (N.Y. 1975) ("The essence of an unfair competition claim is that the defendant assembled a product which bears so striking a resemblance to the plaintiff's product that the public will be confused as to the identity of the products.").

[78] ITC Ltd. v. Punchgini, Inc., 880 N.E.2d 852, 858 (N.Y. 2007) (footnote omitted) (" 'Palming off'—that is, the sale of the goods of one manufacturer as those of another—was the first theory of unfair competition endorsed by New York courts, and 'has been extended . . . to situations where the parties are not even in competition." (quoting Electrolux Corp. v. ValWorth, Inc., 161 N.E.2d 197, 203 (N.Y. 1959))).

[79] *See* Lincoln Rest. Corp. v. Wolfies Rest. Inc., 291 F.2d 302, 303 (2d Cir. 1961) (stating that even without secondary meaning, "intent to trade on plaintiffs' reputation and plaintiffs' name was specifically found, and we see no distinction between this and ordinary 'palming off' ").

[80] *See* Barbagallo v. Marcum LLP, 820 F. Supp. 2d 429, 447 (E.D.N.Y. 2011) (stating that the plaintiff must show "that defendant diverted plaintiff's customers and business"); Coca-Cola N. Am. v. Crawley Juice, Inc., No. 09 CV 3259, 2011 WL 1882845, at *6 (E.D.N.Y. May 17, 2011) (requiring that, to state a claim for unfair competition, a plaintiff must allege either a "direct financial loss, lost dealings, or . . . [lost] profits resulting from the 'anticompetitive acts' at issue" (quoting CA, Inc. v. Simple.Com, Inc., 621 F. Supp. 2d 45, 52 (E.D.N.Y. 2009)) (internal quotation marks omitted)).

million when more than $25 million was in controversy.[81] The costs include "outside and local counsel, associates, paralegal services, travel and living expenses, fees and costs for court reporters, copies, couriers, exhibit preparation, analytical testing, expert witnesses, translators, surveys, jury advisors, and similar expenses."[82]

To limit harms to the goodwill of a trademark and to control litigation costs, many brand owners often seek a preliminary injunction in the early stages of trademark litigation.[83] A preliminary injunction serves two purposes. First, brand owners want to stop as early as possible the harms to the goodwill of the brand inflicted by unauthorized third-party use of the brand. The injury is irreparable because there is already a likelihood of consumer confusion as to the source of the products or services.[84] Damages to the goodwill of the brand are difficult to measure, and monetary damages are inadequate to make the brand owner whole again when the harms occur.[85] A preliminary injunction can curb the harms prior to trial.[86] Second, the costs incurred at the preliminary injunction stage are significantly less than those

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[81] AM. INTELL. PROP. L. ASS'N, REPORT OF THE ECONOMIC SURVEY (2013), http://www.patentinsurance.com/custdocs/2013AIPLA%20survey.pdf.

[82] *Id.*

[83] *See* Meredith Wilkes & Anna E. Raimer, *Preliminary Injunctions in U.S. Trademark Infringement Cases and the Presumption of Irreparable Harm*, 68(3) INT'L TRADEMARK ASS'N BULL. (INT'L TRADEMARK ASS'N), Feb. 1, 2013, http://www.inta.org/INTABulletin/Pages/PreliminaryInjunctionsinUSTrademarkInfringementCasesandthePresumptionofIrreparableHarm.aspx (detailing grounds for a preliminary injunction, including different approaches to show irreparable harm).

[84] *See* J. Thomas McCarthy, *Are Preliminary Injunctions Against Trademark Infringement Getting Harder to Achieve?*, 14 INTELL. PROP. L. BULL. 1, 4–5 (2009) ("Like trying to un-ring a bell, trying to use dollars to 'compensate' after the fact for damage to business goodwill and reputation cannot constitute fair or full compensation. Damage to business reputation and good will is inherently 'irreparable.' ").

[85] *Id.*

[86] *Id.* at 1 ("Getting a preliminary injunction means that the trademark owner can force the alleged infringer to immediately stop all use of the challenged mark and undergo an expensive change to a significantly different mark. That change will last for the months or years that will ensue until all the issues can be hashed out in a full-fledged trial on the merits. In some situations, getting a preliminary injunction means that the trademark owner will immediately receive just about all the relief it would be entitled to even after a win on the merits at trial.").

incurred when the case proceeds to trial.[87] The majority of cases settle after the issuance of a preliminary injunction before trial, reducing litigation costs.[88]

E. TRADE DRESS PROTECTION

The anti-dilution, infringement, and unfair competition causes of action are also available to trade dress. Trade dress is the total look and feel, appearance, or image of a product or service.[89] For example, in *Two Pesos v. Taco Cabana,* the Supreme Court extended the protection available to trademarks under the Lanham Act to the look and feel of a fast food restaurant.[90] As long as a trade dress is inherently distinctive and non-functional,[91] it enjoys the same protection available to trademarks.[92] Indeed, the owner of a trade dress can seek injunctive relief and damages in the form of defendant's profits and enhanced damages for willful

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[87] AM. INTELL. PROP. L. ASS'N, *supra* note 81 (showing that the costs of trademark litigation at the end of the full survey are less than going to trial, indicating that costs at preliminary injunction are even less).

[88] Anthony DiSarro, *A Farewell To Harms: Against Presuming Irreparable Injury in Constitutional Litigation,* 35 HARV. J.L. & PUB. POL'Y 743, 746–47 n.8 (2012).

[89] *See Trade Dress,* INT'L TRADEMARK ASS'N (Nov. 2015), http://www.inta.org/TrademarkBasics/FastSheets/Pages/Trade-Dress.aspx ("Trade dress is the overall image (look and feel) of a product and distinguishes it from those of others.").

[90] 505 U.S. 763, 775–76 (affirming the Fifth Circuit's finding that Taco Cabana's trade dress was inherently distinctive and required no secondary meaning, thereby providing protection to Taco Cabana's "look and feel"). *See generally* Xuan-Thao Nguyen, *Should It Be a Free for All? The Challenge of Extending Trade Dress Protection to the Look and Feel of Web Sites in the Evolving Internet,* 49 AM. U. L. REV. 1233 (2000) (discussing the grounds and challenges associated with extending trade dress law to protect websites).

[91] "Substantively, the trade dress must be both distinctive . . . and nonfunctional (i.e., not be essential to the use of purpose of, and not affect the cost or quality of, the product or service) [to be registerable]. Functional trade dress is not registerable . . . ." *Trade Dress, supra* note 89; *see, e.g.,* Fruit-Ices Corp. v. Coolbrands Int'l, Inc., 335 F. Supp. 2d 412 (S.D.N.Y. 2004) (holding that the plaintiff's trade dress for frozen fruit bars is entitled to protection, because it is inherently distinctive and non-functional). Mattel, Inc. v. MGA Entm't, Inc., 782 F. Supp. 2d 911, 1004 (C.D. Cal. 2011) (articulating the established test of inherently distinctive trade dress).

[92] *Two Pesos,* 505 U.S. at 774 (stating that there is no distinction under the Lanham Act for the protection of inherently distinctive trademarks and trade dress); *see also* Aromatique, Inc. v. Gold Seal, Inc., 28 F.3d 863, 868 (8th Cir. 1994) ("The difference between trade dress and trademark is no longer of importance in determining whether trade dress is protected by federal law. Trade dress, regardless of whether it is registered, is protectable under Section 43(a) of the Lanham Act, 15 U.S.C. § 1125(a).").

infringement of the trade dress.[93] The seminal decision in *Two Pesos* expands legal protection to new trade dress, ranging from the look and feel of a website[94] to packaging designs for crayons.[95] As with trademarks, an owner of a trade dress can seek registration of the trade dress with the United States Patent and Trademark Office.[96]

IV. COPYRIGHT PROTECTION FOR BRANDING CONTENT

Copyright law protects original content fixed in a tangible medium.[97] As long as the content contains a modicum of creativity, the content is eligible for copyright protection.[98] The duration of copyright protection is significantly long. For example,

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[93] *See* Djarum v. Dhanraj Imports, Inc., 876 F. Supp. 2d 664, 669–70 (W.D.N.C. 2012) (ordering a permanent injunction, disgorgement of the defendant's profits, and treble damages against the defendant in a case where the defendant had intentionally infringed the plaintiff's trade dress for a cigar packaging design).

[94] *See* Conference Archives, Inc. v. Sound Images, Inc., No. 3:2006-76, 2010 WL 1626072, at *21 (W.D. Pa. Mar. 31, 2010) (recognizing trade dress protection for the plaintiff's website upon observing that "[l]ike the packaging of a product, the look and feel of a web site invites the user in. It offers a familiar interface, with recognizable elements. Similar colors, sizes, and layouts make navigation and interaction facile."); Blue Nile, Inc. v. Ice.com, Inc., 478 F. Supp. 2d 1240, 1244 (W.D. Wash. 2007) ("[D]efendant has cited no authority for proposition that plaintiff cannot qualify its trade dress description as one seeking protection for the 'look and feel' of its website in response to a motion to dismiss.").

[95] *See* Rose Art Indus., Inc. v. Swanson, 235 F.3d 165, 174–75 (3d Cir. 2000) (stating that "each line having its own distinctive packaging, and if the packaging of each line has its own 'consistent overall look,' then the packaging of each line would constitute recognizable trade dress regardless of whether the packaging of the three lines together have a 'consistent overall look' and regardless of whether some crayons were packaged in other types of packaging").

[96] *See Aromatique*, 28 F.3d at 868 (noting that the trade dress in the present case had been registered and therefore enjoyed all the benefits available for registered trademarks). Registration of a distinctive trade dress prohibits trade dress that is "as a whole functional" pursuant to 15 U.S.C. § 1052(e). McAirlaids, Inc. v. Kimberly-Clark Corp., 756 F.3d 307, 310 (4th Cir. 2014).

[97] The 1976 Copyright Act protects "original works of authorship fixed in any tangible medium of expression." 17 U.S.C. § 102(a) (2012); *see* Deepa Varadarajan, *Trade Secret Fair Use*, 83 FORDHAM L. REV. 1401, 1407 (2014) (comparing copyright protection to different types of intellectual property).

[98] Oren Bracha & Talha Syed, *Beyond the Incentive—Access Paradigm? Product Differentiation & Copyright Revisited*, 92 TEX. L. REV. 1841, 1910 (2014) (stating that in a vast majority of cases, copyright protection is available if a work is "merely to be independently created rather than copied, and . . . exhibit[s] a modicum of creativity, one small enough to be present" (footnote omitted)).

the term of copyright protection for individual authors is the life of the author plus seventy years.[99] For entity authors who hire others to create works of authorship, the duration is ninety-five years from publication or 120 years from creation, whichever is shorter.[100] Ownership of a copyright means having a bundle of exclusive rights, including the exclusive right to make copies, prepare derivative works, distribute the works, publicly perform the work, and publicly display the work.[101] Copyright owners can bring infringement litigation against others for violation of any of the exclusive rights.

Branding content in traditional mediums such as billboards, catalogs, flyers, newspapers, and trade journals is protected under copyright law.[102] This content is typically in the form of photographs, collages, or combinations of pictures and text in prints.[103] The content, of course, often includes the name of the brand, logos, or phrases. The arrival of the Internet has revolutionized branding content and the means to deliver content in recent years.[104] Online branding content is now a combination

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[99] *See* Abraham Bell & Gideon Parchomovsky, *Reinventing Copyright and Patent*, 113 MICH. L. REV. 231, 261 (2014) (recognizing the "extremely long duration of copyright protection" and proposing different packages of terms of protection, with the minimum package having a very short minimum term of one to five years and the maximum package having the "maximum terms of 70 years plus life, 120 years from creation, or 95 years from publication"); Deven R. Desai, *The Life and Death of Copyright*, 2011 WIS. L. REV. 219, 222–43 (tracing the history of the duration of copyright protection after the life of the author).

[100] 17 U.S.C. § 302(c) (2012); *see also* Joshua L. Simmons, *Inventions Made For Hire*, 2 N.Y.U. J. INTELL. PROP. & ENT. L. 1, 6–7 (2012) (discussing works made for hire under copyright law).

[101] *See* 17 U.S.C. § 106 (providing the exclusive rights); H.R. REP. NO. 94-1476, at 61 (1976) ("These exclusive rights, which comprise the so-called 'bundle of rights' that is a copyright, are cumulative and may overlap in some cases."); Llewellyn Joseph Gibbons, *Love's Labor's Lost: Marry for Love, Copyright Work Made-for-Hire, and Alienate at Your Leisure*, 101 KY. L.J. 113, 117–18 (2013) (discussing copyright ownership).

[102] *See, e.g.*, Schiller & Schmidt, Inc. v. Nordisco Corp., 969 F.2d 410, 413 (7th Cir. 1992) (exemplifying protection of branding content in catalogs under copyright law); Kleier Adver., Inc. v. Premier Pontiac, Inc., 921 F.2d 1036, 1038 (10th Cir. 1990) (in billboards); Inkadinkado, Inc. v. Meyer, No. CIV.A. 03-10332-GAO, 2003 WL 22282177, at *3 (D. Mass. Sept. 16, 2003) (in collages).

[103] *See, e.g.*, Jarvis v. K2 Inc., 486 F.3d 526, 529 (9th Cir. 2007); Gener-Villar v. Adcom Grp., Inc., 560 F. Supp. 2d 112, 126 (D. P.R. 2008).

[104] *See* BARNARD, *supra* note 20 (noting that globally, the Internet continues to dominate as the medium of choice for advertisements).

of software, images, and text.[105] A video clip advertisement to be delivered via smartphones or desktops is one example of such a combination.[106] A game created for advertisement purposes is another example of multimedia, interactive software.[107] Yet another example of the software-images-text combination is an app designed to build brand loyalty.[108] Branding content has proliferated with the explosion of mobile devices in addition to the widely available, ubiquitous desktop computer.[109]

In summary, branding serves to build the goodwill in a brand, name, or logo. Trademark law extends protection to the brands, for purposes of protecting both the consumer and the brand owner's investment.[110] Copyright law protects the branding content, whether such content is a photograph, collage, video game, software, or some combination thereof.[111] Enforcement costs

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[105] *See* Scott Scanlon, *The Ultimate List of Content Curation Tools and Platforms*, YOUBRAND, http://www.youbrandinc.com/ultimate-lists/ultimate-list-content-curation-tools-platform/ (last updated Nov. 2, 2012) (listing various online sources that facilitate curation of content to aid marketing strategy).

[106] *See, e.g.*, Elisha Hartwig, *The Art of the Branded Video*, MASHABLE (Nov. 29, 2013), http://mashable.com/2013/11/29/video-views-completion-metrics/#O0E4nxqL_aql (describing the importance of a video that resonates with the audience in building a brand); Liza Brown, *How to Add Logo to Video Quickly and Easily*, WONDERSHARE (Apr. 28, 2015, 8:29 PM), http://www.wondershare.com/video-editing-tips/add-logo-to-video.html ("[P]eople in today's world tend to distinguish themselves in various ways, including the video creation."); Mark Montgomery, *Branding with Bugs*, VIDEOMAKER (Mar. 1, 2010, 12:00 AM), http://www.videomaker.com/article/14602-branding-with-bugs (describing the importance of the addition of bugs, "graphical element[s] that usually display[ ] in or around a given corner of the viewable area of the video," to videos for branding purposes).

[107] *See* Steve Hicks, *Does the Video Game Industry Hold the Keys to the Future of Advertising? Engage Consumers via Brain Chemistry*, ADWEEK (Feb. 6, 2014, 11:04 AM), http://www.adweek.com/news/advertising-branding/engage-consumers-brain-chemistry-155531 ("The next generation of marketing innovation belongs, not to those who bring their advertising to the game, but to those who know how to bring the game to their advertising.").

[108] *See e.g.*, *Your Branding*, ANDROID DEVELOPERS, http://www.androiddocs.com/design/style/branding.html (last visited Jan. 1, 2016) (describing the different styles available for branding in an Android app).

[109] *See* BARNARD, *supra* note 20 ("Mobile advertising (by which we mean all internet ads delivered to smartphones and tablets, whether display, classified or search, and including in-app ads) has now only taken off and is growing six times faster than desktop internet.").

[110] *See* Sonia K. Katyal, *Trademark Intersectionality*, 57 UCLA L. REV. 1601, 1616 (2010) ("[T]rademark law protects a brand's proprietary, source-identifying function.").

[111] *See* Meghan L. Collins, *Still Standing, New Branding: Corporate Crossroads of Shaping a Modern Brand While Protecting Intellectual Property*, 17 DUQ. BUS. L.J. 197, 219 (2015) (stating that "copyright law protects creative works" of brand).

relating to brands under both trademark and copyright laws typically command a high monetary sum.[112]

V. TAX TREATMENT OF BRAND BUILDING AND ENFORCEMENT

A. GENERAL TAX FRAMEWORK

In business, one must spend money to make money. Tax rules recognize this, and permit deductions for certain outlays:

> The income tax is ostensibly a tax on net income. That is, it only attempts to tax the net increase in wealth generated by money making activities. This implies that we should be entitled to deduct the money we spend from the money we make before we apply the tax rates to the remainder. In general this is what the tax rules try to do.[113]

For the most part, the key rules for deducting expenses arising from money-making efforts are straightforward. Section 162 of the Internal Revenue Code (Code) authorizes the deduction of ordinary and necessary expenses arising from the carrying on of any trade or business.[114] Additionally, section 212 authorizes the deduction of ordinary and necessary expenses related to investment activities.[115] But there are some interesting complexities in

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[112] For trademark and copyright infringement cases, if the controversy is less than $1 million, the cost of litigation for each case is about $375,000. The cost will double if the controversy is above $1 million. AM. INTELL. PROP. L. ASS'N, *supra* note 81.

[113] *See* JOHN A. MILLER & JEFFREY A. MAINE, THE FUNDAMENTALS OF FEDERAL TAXATION: PROBLEMS AND MATERIALS 95 (3d ed. 2013). For example, a business that is conducted through the activities of its employees is entitled to deduct the reasonable salaries of those employees from its gross income in determining its taxable income. I.R.C. § 162(a)(1) (West Supp. 2015).

[114] I.R.C. § 162. Since the inception of the modern income tax, the Code has permitted a current deduction for ordinary and necessary business expenses. Revenue Act of 1913, ch. 16, § II(B), 38 Stat. 114, 167 ("[I]n computing net income for the purpose of the normal tax there shall be allowed as deductions: First, the necessary expenses actually paid in carrying on any business . . . .").

[115] I.R.C. § 212. The need for a separate provision addressing investment activities arose from an early Supreme Court decision in which the Court ruled that buying and selling stocks and other investment activities did not constitute a trade or business, and therefore, what is now section 162 did not apply to the expenses arising from those activities. Higgins

reaching a fair result with respect to business and investment deductions.[116] Most notably, since the inception of the modern income tax, the Code has precluded a current deduction for so-called "capital expenditures."[117]

A point of importance lies in understanding how deductible "expenses" differ from nondeductible "capital expenditures." In general, an immediately deductible expense is a cost that benefits the current year only.[118] A nondeductible capital expenditure is a cost that benefits more than the current year.[119] Thus, for example, when a business chooses to license trademark rights from a third party, the annual royalty paid can be deducted immediately since it only helps produce income in the current year.[120] On the other hand, when a business buys a trademark for use in its business, the cost of the trademark is a capital expenditure that cannot be deducted in the current year, because

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v. Comm'r, 312 U.S. 212, 218 (1941). Congress responded by enacting what is now section 212 to allow for the deduction of those expenses.

[116] This area is inherently complex. An area of continuing development and uncertainty is the meaning and application of the phrase "ordinary and necessary" as used in the statute. In *Welch v. Helvering*, 290 U.S. 111, 113–14 (1933), the seminal case interpreting that phrase, the Supreme Court held that to be "ordinary," the expense must be customary or expected in the life of the business. *See also* Deputy v. du Pont, 308 U.S. 488, 495 (1940) ("Ordinary has the connotation of normal, usual or customary."). The term "necessary" was interpreted by the Court in *Welch* to mean "appropriate and helpful." *Welch*, 290 U.S. at 113.

Neither the Code nor the Treasury Regulations define the term "trade or business." In considering the meaning of the term, the Supreme Court has generally concluded that to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity, and the taxpayer's primary purpose for engaging in the activity must be for income or profit. Comm'r v. Groetzinger, 480 U.S. 23, 35 (1987). Whether a taxpayer has engaged in the requisite scope of activities and has demonstrated the requisite profit motive are questions to be determined by the facts in each case. *Higgins*, 312 U.S. at 217.

[117] Revenue Act of 1913, ch. 16, § II(B), 38 Stat. 114, 167 (providing "[t]hat no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property"). For the current disallowance provisions, see I.R.C. § 263(a).

[118] *See* I.R.C. § 162(a) (stating that expenses "paid or incurred *during the taxable year*" are deductible (emphasis added)).

[119] *See Capital Asset Costs Are Not Deductible as Business Expenses*, BUSINESS OWNER'S TOOLKIT (Feb. 10, 2014), http://www.bizfilings.com/toolkit/sbg/tax-info/fed-taxes/cost-of-capital-assets-not-deductible-expense.aspx ("A capital asset is an asset that benefits your business for more than one year.").

[120] *See* I.R.C. § 162(a)(3) (including "other payments required to be made as a condition to the continued use of possession" as a deductible expense).

the trademark will help produce income over many years.[121] As illustrated, even an expenditure that is clearly for the purpose of making money may not be currently deductible if the expenditure will help produce income over a longer period of time than the current year.

Distinguishing immediately deductible expenses from nondeductible capital expenditures can be difficult. Throughout the years, the Supreme Court has attempted to clarify the law in this area, often creating further controversy and confusion in the process. In *Commissioner v. Lincoln Savings & Loan Ass'n*, the Supreme Court concluded that an expenditure that serves to create or enhance a separate and distinct asset must be capitalized.[122] The Court noted:

> [T]he presence of an ensuing benefit that may have some future aspect is not controlling; many expenses concededly deductible have prospective effect beyond the taxable year. What is important and controlling, we feel, is that the . . . payment serves to create or enhance for [the taxpayer] what is essentially a separate and distinct additional asset and that, as an inevitable consequence, the payment is capital in nature and not an expense. . . .[123]

In a later decision, *INDOPCO, Inc. v. Commissioner*, the Supreme Court minimized the importance of the separate-and-distinct-asset test of *Lincoln Savings* and expanded the test for

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[121] If the costs incurred to purchase a trademark were deductible in full in the current year, there would be a mismatching of income and expense that produced such income; income would be understated in the year of acquisition and overstated in later years. By prohibiting the immediate deduction of capital expenditures, this problem is avoided. It should be noted that the purchaser will recover its costs for the trademark over time through amortization deductions. I.R.C. § 197, discussed *infra* notes 140–44 and accompanying text.

[122] 403 U.S. 345, 354 (1971). *See generally* Alan Gunn, *The Requirement That a Capital Expenditure Create or Enhance an Asset*, 15 B.C. INDUS. & COM. L. REV. 443 (1974) (discussing the court's decision in *Lincoln Savings*).

[123] 403 U.S. at 354.

capitalization.[124] The Supreme Court used broad language to emphasize that any expenditure producing benefits beyond the current taxable year may require capitalization.[125] As noted above, the Supreme Court had previously held that an expenditure that serves to create or enhance a separate and distinct asset must be capitalized.[126] In *INDOPCO*, the Court held that, although the separate-and-distinct-asset standard is a sufficient condition for capitalization, it is not a necessary condition, and an expenditure giving rise to benefits may require capitalization, whether or not the expenditure gives rise to a separate and distinct asset.[127]

INDOPCO did not involve an expenditure relating to branding.[128] As most costs associated with branding produce benefits in current and future years, such costs would seemingly fall within the expansive thrust of *INDOPCO* and would be required to be capitalized.[129] Branding is inherently designed to

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[124] 503 U.S. 79, 86–90 (1992). The taxpayer in *INDOPCO*, a publicly-held corporation incurred expenses (various investment banker, legal, and consulting fees) in connection with a friendly merger offer from another company. The taxpayer sought to deduct the fees as current expenses. The Court held the fees were not currently deductible, but rather had to be capitalized under section 263. *Id.* at 90.

[125] The Supreme Court noted:

> Although the mere presence of an incidental future benefit . . . may not warrant capitalization, a taxpayer's *realization of benefits beyond the year in which the expenditure is incurred* is undeniably important in determining whether the appropriate tax treatment is immediate deduction or capitalization . . . . Indeed, the text of the Code's capitalization provision, §263(a)(1), which refers to "permanent improvements or betterments," itself envisions an inquiry into the *duration and extent of the benefits* realized by the taxpayer.

Id. at 87–88 (emphasis added) (citations omitted). The Court concluded that the transaction (merger) produced significant benefits that would be realized by the taxpayer, or by the merged entity, in future years. *Id.* at 88.

[126] *Lincoln Savings*, 403 U.S. at 354.

[127] *INDOPCO*, 503 U.S. at 87–88. "It by no means follows, however, that *only* expenditures that create or enhance separate and distinct assets are to be capitalized under section 263." *Id.* at 86–87.

[128] *INDOPCO* involved various investment banking, legal, and consulting expenditures related to the merger. *Id.* at 81–82.

[129] A number of pre-*INDOPCO* cases held that certain costs associated with trademarks and trade names should be capitalized, but *INDOPCO* seemingly required almost all costs associated with trademarks and trade names to be capitalized, including costs, such as ordinary brand advertising costs, that were previously viewed as deductible. *See, e.g.*, Georator Corp. v. United States, 485 F.2d 283, 286–87 (4th Cir. 1973) (holding that the costs of protecting a trademark from cancellation must be capitalized), *cert. denied*, 417 U.S.

produce future benefits for a business.[130] Costs of *developing* brands often produce benefits that give rise to distinctive intellectual property assets such as trade dress, trademarks, trade names, and copyrights that continue well beyond the current taxable year.[131] Legal costs of *enforcing* brands secure these benefits; specifically, such costs can increase the value of brands and make a taxpayer's interest in them more secure by eliminating the possibility of having the taxpayer's brand impaired by competitors and by deterring attempts to have the taxpayer's legal rights in brands challenged.[132]

If capitalization—in contrast to current expensing—is required for any costs associated with branding, the tax query would then shift to whether such costs may be recovered over time through tax depreciation deductions. In an economic sense, depreciation is the decline in value of an asset due to wear and tear and obsolescence.[133] In the tax sense, depreciation is a deduction from income to permit the taxpayer to recover the cost of that asset.[134] If we seek to match our capital expenditures against the revenues they helped produce, we must spread out the deduction over the useful life of the asset.[135] The problem with many intellectual property assets produced from branding activities, such as trademarks, trade names, and goodwill, is that they do not have a determinable useful life over which capitalized costs may be recovered. For this reason, trademarks, trade names, goodwill, and other intangible assets with indeterminate lives were viewed

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945 (1974); Danskin, Inc. v. Comm'r, 331 F.2d 360, 361 (2d Cir. 1964) (holding that the costs of trademark infringement litigation must be capitalized).

[130] *See generally* discussion *supra* Part II.

[131] *See generally* discussion *supra* Part III.

[132] *See, e.g.*, *supra* notes 83–88, 93 and accompanying text (illustrating how litigation intended to protect brands through various means can increase broad value).

[133] *See A Brief Overview of Tax Depreciation*, IRS, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/A-Brief-Overview-of-Depreciation (last visited Jan. 2, 2016) (stating that tax deductions for depreciation are an "annual allowance for the wear and tear, deterioration, or obsolescence of the property").

[134] *Id.* ("Depreciation is an income tax deduction that allows a taxpayer to rework the cost of other basis of certain property . . . for the wear and tear, deterioration, or obsolescence of the property.").

[135] Hertz Corp. v. United States, 364 U.S. 122, 126 (1960) ("[T]he purpose of depreciation accounting is to allocate the expense of using an asset to the various periods which are benefited by that asset.").

as nondepreciable assets at the time of the *INDOPCO* decision in 1992.[136]

On occasion, Congress has carved out limited statutory exceptions for trademarks and trade names (but not goodwill), permitting recovery of certain costs through annual deductions. Between 1956 and 1986, for instance, Congress amended the Internal Revenue Code to allow a taxpayer to elect to depreciate over five years certain costs incurred in connection with the acquisition, protection, expansion, registration, or defense of a trademark.[137] Between 1969 and 1993, Congress allowed the cost of certain acquired trademarks and trade names to be amortized over either ten or twenty-five years, depending on the circumstances.[138] Yet when these special depreciation rules were

[136] Under early tax depreciation rules, an intangible asset was subject to a depreciation allowance if it was "known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which may be estimated with reasonable accuracy. . . ." Treas. Reg. § 1.167(a)-3 (as amended in 2004). An intangible asset, the useful life of which was not determinable, was not subject to the allowance for depreciation. *Id.* Under this framework, patents and copyrights were considered depreciable, but trademarks, trade names, and goodwill were not. *See* Gen. Television, Inc. v. United States, 449 F. Supp. 609, 611 (D. Minn. 1978) ("Where the useful life of an intangible asset is clearly limited to a defined period as is the case with patents and copyrights, depreciation is available without question . . . ." (citing 26 C.F.R. § 1.17(a)–3)), *aff'd*, 598 F.2d 1148 (8th Cir. 1979).

[137] Congress enacted section 177 in 1956. Act of June 29, 1956, Pub. L. No. 84-629, § 4(a), 70 Stat. 404, 406 (1956). Before enactment of section 177, expenditures paid in connection with trademarks and trade names, such as legal fees, were not currently deductible and were not recoverable under early tax depreciation rules, because trademarks and trade names have indeterminable useful lives. S. REP. NO. 84-191, at 8 (1956). Certain large corporations, which had in-house legal staff handling trademark and trade name matters, avoided this result by deducting compensation with respect to these matters because of difficulties of identification. *Id.* Smaller companies, which could not afford to maintain their own legal staff, had to pay outside counsel or consultants to perform functions related to trademarks and trade names and were required to capitalize such expenses. *Id.* at 8–9. Section 177 was enacted as an attempt to eliminate the existing hardship and inequities facing small corporations. *Id.* Section 177 was repealed in 1986. Tax Reform Act of 1986, Pub. L. No. 99-514, § 241(a), 100 Stat. 2085, 2181 (1986). The tax rule for trademark and trade name expenditures was viewed as inappropriate for a number of reasons: the possibility that large companies were finding a way to deduct otherwise capital expenditures did not justify an amortization election for all; a five-year amortization only partially alleviated any unfairness; and there was no basis for a presumption that investment in trademarks and trade names produced social benefits that market forces might adequately reflect. S. REP. NO. 99-313, at 256 (1985).

[138] Section 1253, enacted in 1969, provided a new set of tax rules governing acquisitions of trademarks and trade names. Tax Reform Act of 1969, Pub. L. No. 91-172, § 1253, 83 Stat.

not in force or were inapplicable, capitalized trademark and trade name costs were not depreciable, as trademarks and trade names have indeterminate lives.[139]

In 1993, a year after *INDOPCO* was decided, Congress, in a major shift in tax policy, enacted section 197 to simplify the law and minimize disputes regarding the depreciation of intangibles.[140] Section 197 provides a single depreciation method (straight line depreciation) and a single recovery period (fifteen years) for the

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487, 647–48 (1969). Section 1253 provided that a trademark transferee could amortize a lump sum payment over the *lesser of* the term of the trademark agreement if the agreement had a limited term of ten years. *See* I.R.C. § 1253(d)(2) (1969) (providing for amortization of the cost of a trademark or trade name if, pursuant to section 1253(a), the transfer of the trademark was not treated as a sale or exchange of a capital asset). In 1989, Congress amended section 1253, limiting the ten-year amortization rule for lump sum amounts to transactions in which the lump sum amount paid did not exceed $100,000, and providing a new twenty-five year amortization period for fixed sum amounts exceeding $100,000. Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7622(a)-(c), 103 Stat. 2106, 2377–78.

[139] Mary LaFrance, *Days of Our Lives: The Impact of Section 197 on the Depreciation of Copyrights, Patents, and Related Property*, 24 HOFSTRA L. REV. 317, 321 (1995).

[140] *See id.* at 320 ("Congress enacted section 197 in order to simplify the rules for depreciating intangibles and to reduce the number of controversies arising from the need to determine which intangibles are depreciable and what their recovery periods should be."). One problem with the historic tax regime for intangibles was that it caused much litigation concerning the identification of intangible assets and their useful lives. *See id.* (stating that the vagueness of the standard for determining intangibles "led to frequent administrative appeals and litigation"). Of course, taxpayers who had the resources to litigate over the identification, valuation, and establishment of limited useful lives of intangibles were better off than those taxpayers who lacked resources. *See* STAFF OF JOINT COMM. ON TAXATION, 103D CONG., TECHNICAL EXPLANATION OF THE TAX SIMPLIFICATION ACT OF 1993, at 147 (Comm. Print 1993) (explaining that Congress created section 197 to eliminate considerable confusion over the federal tax treatment of amortizable intangible assets); *see also* Catherine L. Hammond, *The Amortization of Intangible Assets: § 197 of the Internal Revenue Code Settles the Confusion*, 27 CONN. L. REV. 915, 918 (1995) ("Because the determination of whether an intangible can be amortized was a question of fact, the outcome of such litigation varied widely according to the circumstances of each particular case."). Another problem stemmed from the fact that the rule for recovering costs of acquired intangible assets differed dramatically from the corresponding set of rules for recovering the costs of acquired tangible assets. This disparate treatment between intangible and tangible assets created distortions that were unfair to taxpayers. *See* Kevin R. Conzelmann, *Amortization of Intangibles*, 533-2d TAX MGMT. PORT. A-3 & n.7 (2001) (detailing the distortions caused by treating intangible and tangible assets differently); Allen Walburn, *Depreciation of Intangibles: An Area of the Tax Law in Need of Change*, 30 SAN DIEGO L. REV. 453, 454–56 (1993) (explaining that the inequity between similarly situated taxpayers resulted in noncompliance and much litigation, which unnecessarily burdened the administration of tax law).

capitalized costs associated with many types of intangible assets, including trademarks, trade names, and goodwill.[141] The fifteen-year recovery period was not based on any measure of actual usefulness of intangibles in a business but was chosen because it was the shortest period that would not have a negative revenue impact.[142] Although not all types of intangibles are subject to section 197,[143] fifteen-year amortization appears to be accepted by the government as the appropriate rule for most intangibles. Indeed, a decade after section 197's enactment, the Treasury Department established a fifteen-year safe harbor amortization period for intangibles that do not fall within the scope of section 197 and that do not have readily ascertainable lives.[144]

From a policy perspective, capitalizing and amortizing branding expenditures—as opposed to expensing such costs all at once—fulfills the government's goal of trying to match, for tax accounting

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[141] I.R.C. § 197(a). Although most self-created intangible assets are specifically excluded from the rule, self-created trademarks and trade names are included. *See id.* § 197(c)(2), (d)(1)(F) (including "any franchise, trademark, or trade name"); Treas. Reg. § 1.197-2(b)(10)(d)(2) (as worded in 2011) (same); *see also* H.R. REP. NO. 103-213, at 684 (1993), *reprinted in* 1993 U.S.C.C.A.N. 1088, 1373 (stating that "the capitalized costs incurred in connection with the development or registration of a trademark or trade name are to be amortized over the 14-year period"). For purposes of section 197, a trademark includes "any word, name, symbol, or device, or any combination thereof, adopted and used to identify goods or services and distinguish them from those provided by others." Treas. Reg. § 1.197–2(b)(10). A trade name includes "any name used to identify or designate a particular trade or business or the name or title used by a person or organization engaged in a trade or business." *Id.* A trademark or trade name includes "any trademark or trade name arising under statute or applicable common law, and any similar right obtained by contract." *Id.*

[142] *See* Gregory M. Beil, *Internal Revenue Code Section 197: A Cure for the Controversy Over the Amortization of Acquired Intangible Assets*, 49 U. MIAMI L. REV. 731, 733–34 (1995) (describing section 197 as a "simple solution" to the uncertainty of the prior regime). For an argument that the fifteen-year period is too short, see Calvin H. Johnson, *Extend the Life for Acquired Intangibles to 75 Years*, 135 TAX NOTES 1053, 1053–54 (2012).

[143] For example, section 197 does not apply to any interest in a patent, patent application, copyright, or computer software that is not acquired as part of a purchase of a trade or business. I.R.C. §§ 197(e)(3)(A)(ii), (e)(4); Treas. Reg. § 1.197-2(c)(7). The government has chosen different tax depreciation rules for these separately acquired intellectual property assets. *See* Treas. Reg. §§ 1.167(a)-4(a)–(b) (explaining treatment of computer software); Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752, 757 (2003) (defining computer software as property subject to section 197); JEFFREY A. MAINE & XUAN-THAO N. NGUYEN, INTELLECTUAL PROPERTY TAXATION: TRANSACTION AND LITIGATION ISSUES 5-27 to 5-41 (2d ed. 2014) (explaining the types of intellectual property covered under Section 197).

[144] Treas. Reg. § 1.167(a)-3(b).

purposes, the cost of an asset to the income stream that the asset produced.[145] Concededly, the pace of amortization chosen by the government—fifteen years—is arbitrary. To achieve accurate tax accounting, the pace of amortization would be the period of time that the asset produces income in the taxpayer's business.[146] The government, however, has historically abandoned the concept of determinable useful life in calculating the proper annual depreciation allowance to achieve goals other than sound accounting practice.[147] Fifteen-year amortization appears to be an accepted political compromise between a current deduction and no deductions at all.

Fifteen-year amortization applies only to branding costs that are chargeable to capital account and not otherwise currently deductible.[148] This brings us back to the initial question of whether branding costs should be capitalized in the first instance. The "significant future benefit" approach adopted in *INDOPCO* seemingly required the capitalization of branding expenditures, as most branding expenditures give rise to long-term future benefits. But since the Supreme Court's decision in 1992, there have been a number of government responses and tax cases carving out

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[145] *See* Massey Motors, Inc. v. United States, 364 U.S. 92, 104 (1960) ("It is the primary purpose of depreciation accounting to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use . . . of the asset to the periods to which it contributes.").

[146] *Id.* at 106–07 (concluding that "useful life" must be tied to the time the business is expected to use the asset, because such approach is "more likely to reflect correctly the actual cost").

[147] *See* Simon v. Comm'r, 68 F.3d 41, 45–46 (2d Cir. 1995) (explaining the government's abandonment of the useful life concept). It is also worth noting that in 1980, Congress developed a set of arbitrary recovery periods for tangible assets used in business. *See also* Economic Tax Recovery Act of 1981, Pub. L. No. 97-34, 95 Stat. 172, 207–19 (1981) (detailing the various recovery periods). The pre-set recovery periods eliminated the need for useful life and thus simplified the depreciation rules for tangible assets. *See Simon*, 68 F.3d at 45 (explaining that under the arbitrary recovery periods "the purpose served by the determinable useful life requirement . . . no longer exists"). These periods were usually shorter than the useful life of the tangible assets, encouraging investment in such assets and stimulating economic growth. *See id.* (explaining that the arbitrary recovery periods allow recovery of the cost of an asset over a period usually shorter than the asset's useful life, and that the accordingly simplified depreciation rules stimulated investment).

[148] *See* I.R.C. § 197(b) ("Except as provided in subsection (a), no depreciation or amortization deduction shall be allowable with respect to any amortizable Section 197 intangible."); Treas. Reg. § 1.197-2(a)(3).

INDOPCO exceptions for, and permitting expensing of, certain branding-related costs.[149] As noted in the sections below, current tax rules now permit expensing of many brand advertisement costs that produce long-term benefits; some brand advertisement costs, however, remain subject to capitalization. Surprisingly, the government has given little attention to the federal tax treatment of brand enforcement expenditures, leaving us a handful of pre-*INDOPCO* judicial opinions that have created seemingly incoherent tax distinctions for such costs.

B. TAX LAW ON BRAND ADVERTISEMENT

Companies today devote significant financial resources to advertise their brands. They utilize billboards along the highways to reach motorists. They hire experts to create commercials for broadcasting on television or airing via radio stations. They purchase keywords from Google to ensure that searchers can reach their websites with ease. They create multimedia programs and apps to attract the attention of users to their brands. They rely on traditional print media like newspapers and magazines to reach particular segments of potential customers. They roll out major advertisement campaigns to rejuvenate or remake their brands. Overall, they employ all available tactics and means to advertise their brands.

The tax treatment of costs associated with brand advertising has developed over the years. Shortly after the Supreme Court's *INDOPCO* decision, the Internal Revenue Service (IRS) issued an important administrative ruling impacting brand advertising costs. In Revenue Ruling 92-80, the IRS ruled that *INDOPCO* "would not affect the treatment of advertising costs as business expenses which are generally deductible under section 162 of the Code."[150] The IRS carved out an important exception: "Only in the

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[149] *See generally* Jezabel Llorente, *Nothing Left of INDOPCO: Let's Keep It That Way*, 29 FLA. ST. U. L. REV. 277 (2001).

[150] Rev. Rul. 92-80, 1992-2 C.B. 57, at *1 (1992). Current expensing of ordinary advertising has been administratively sanctioned since the 1960s. *See* Treas. Reg. § 1.162-20(a)(2) (allowing for expensing of expenditures for institutional or "good will" advertising); Denise Coal Co. v. Comm'r, 29 T.C. 528, 552–53 (1957), *aff'd and rev'd on other grounds*,

unusual circumstance where advertising is directed towards obtaining future benefits significantly beyond those traditionally associated with ordinary [product, institutional,] or goodwill advertising, must the costs . . . be capitalized."[151]

Branding is the process of "creating a unique name and image for a product in the consumers' mind, mainly through *advertising campaigns* with a consistent theme."[152] Advertising campaign expenditures often create intellectual property rights in trademarks and trade dress (the total image and overall appearance of a product),[153] as such rights are based on use in commerce;[154] campaign expenditures often encompass the costs of creating copyrightable advertising materials as well.[155] An interesting question is whether these long-term intellectual property benefits should serve as the basis for requiring capitalization of advertising campaign expenditures. In other words, do advertising campaigns aim to obtain future benefits beyond those traditionally associated with ordinary product, institutional, or goodwill advertising, which would require costs associated therewith to be capitalized under IRS guidelines?

The United States Tax Court addressed that question in a trade dress and copyright development case decided six years after the

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271 F.2d 930 (3d Cir. 1959) (holding that a political pamphlet advertisement was an ordinary and necessary business expense).

[151] Rev. Rul. 92-80, at *1 (emphasis added). The only example provided by the IRS was a case involving an electric company's advertisement to allay public fears about nuclear power. *See* Cleveland Elec. Illuminating Co. v. United States, 7 Cl. Ct. 220, 233 (1985) (holding that advertising expenditures related to construction of nuclear plant were not deductible as ordinary and necessary business expenses).

[152] *Branding*, BUS. DICTIONARY, http://www.businessdictionary.com/definition/branding.html (last visited Jan. 3, 2016) (emphasis added).

[153] *See Trade Dress*, INT'L TRADEMARK ASS'N (Nov. 2015), http://www.inta.org/TrademarkBasics/FactSheets/Pages/Trade-Dress.aspx ("Trade dress is the overall commercial image (look and feel) of a product that indicates or identifies the source of the product and distinguishes it from those of others.").

[154] *See* U.S. PATENT & TRADEMARK OFFICE, PROTECTING YOUR TRADEMARK: ENHANCING YOUR RIGHTS THROUGH FEDERAL REGISTRATION 6 (2014), http://www.uspto.gov/sites/default/files/trademarks/basics/BasicFacts.pdf (listing use in commerce as one possible basis for a grant of intellectual property rights in trademarks).

[155] *See, e.g.*, *Advertising Spending in the United States from 2011 to 2017, by Medium (in Billion U.S. Dollars)*, STATISTA, http://www.statista.com/statistics/272315/advertising-spending-in-the-US-by-medium/ (last visited Jan. 3, 2016) (breaking down media spending on copyrightable advertisements throughout the years).

Supreme Court's decision in *INDOPCO* and the IRS's issuance of Revenue Ruling 92-80.[156] In that case, the taxpayer incurred substantial costs in developing an advertising campaign—namely expenses related to the creation of graphic designs[157] and package designs[158] for the packaging of its cigarette products—and sought to deduct such campaign expenditures.[159] The taxpayer also sought to deduct the costs of executing the campaign.[160] Although the government conceded that the advertising execution expenditures were deductible, it argued that the advertising campaign expenditures should be capitalized.[161] The government's argument was that the campaign expenditures provided long-term benefits that were not traditionally associated with ordinary business advertising.[162] The graphic design and package design costs provided legal rights and economic interests of a long-term nature—the legal rights being the statutory rights and common-law trademark rights that attach to "trade dress," and the economic interests being the associated brand equity.[163] In addition, the taxpayer received long-term copyright protection for

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[156] RJR Nabisco, Inc. v. Comm'r, 76 T.C.M. (CCH) 71 (1998). The United States Tax Court is one of three courts that has original jurisdiction over tax cases. *Courts of Original Jurisdiction*, CCH GROUP, https://www.cchgroup.com/media/wk/taa/pdfs/accounting-firms/tax/understanding-judicial-systems-fact-sheet.pdf (last visited Jan. 3, 2016). It is the only forum in which a taxpayer may litigate a disputed tax claim without first having to pay the asserted deficiency. I.R.C. § 6213(a) (2012). While the Tax Court is based in Washington, D.C., the court hears cases in several locations throughout the United States. *See Places of Trial*, U.S. TAX COURT, http://www.ustaxcourt.gov/dpt_cities.htm (last visited Jan. 3, 2016) (listing the various places in which the court hears cases and listing its mailing address as being in Washington D.C.).

[157] "A 'graphic design' . . . is a combination of verbal information, styles of print, pictures or drawings, shapes, patterns, colors, spacing, and the like that make up an overall visual display." *RJR Nabisco*, 76 T.C.M. at 73. These designs "are developed for the following components of a cigarette product:" cartons, packages, flags, tipping, foils, cigarette papers, and closure seals. *Id.* at 74. They serve "to identify the product, convey information, and attract attention at the point of sale when the retailer displays the pack." *Id.*

[158] "The term 'package design' . . . refers to the design of the physical construction of a package." *Id.* at 73.

[159] *Id.*

[160] *Id.* at 80. Advertising execution expenditures were defined by the IRS as costs of executing the advertising campaign (e.g., costs of production of television commercials). *Id.*

[161] *Id.*

[162] *Id.*

[163] *Id.* at 83.

its copyrightable advertising materials.[164] The court rejected the government's argument and held that graphic and package design costs incurred by the taxpayer were not required to be capitalized but were deductible as ordinary product advertising.[165]

The government's immediate response to the Tax Court's treatment of advertising campaign expenditures was unsurprising. In an Action on Decision, the IRS did not acquiesce to the court's decision and announced that it would continue to litigate the treatment of package design costs where appropriate.[166] According to the IRS, "Rev. Rul. 92-80 should not be read as a concession that package design costs are advertising and, therefore, deductible."[167] Citing an earlier ruling, the IRS concluded that "package design

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[164] *Id.* at 84.

[165] *Id.* at 84–85. The court found that although the creation of graphic and package designs may contribute to the future patronage or goodwill of the taxpayer's business, Revenue Ruling 92-80 indicates that the costs are normally deductible. *Id.* at 82. Essentially, the court concluded that both advertising campaign and advertising execution expenditures account for at least some of the value of the typical trade dress, and since advertising execution expenses are ordinary business expenses, "the long-term benefit associated with trade dress is a benefit traditionally associated with ordinary business advertising." *Id.* at 84. Therefore, the court held that all graphic design and package design costs incurred by the taxpayer were not required to be capitalized but were deductible as ordinary and necessary business expenses under section 162. *Id.* at 84–85. As for the government's argument that copyright protection afforded to copyrightable advertising materials should serve as the basis for requiring the capitalization of advertising expenses, the court disagreed, concluding that the copyright protection, although long-term and for future business operation, was a traditional benefit associated with ordinary business advertising. *Id.* at 84.

[166] RJR Nabisco, Inc. v. Comm'r, 76 T.C.M. (CCH) 71 (1998), *action on dec.*, 1999-012, at *2 (Oct. 4, 1999) ("We disagree with the opinion and do not acquiesce. We will continue to litigate the treatment of package design costs where appropriate."). When the IRS loses a Tax Court case, the IRS will usually either acquiesce or nonacquiesce in the decision. A notice of acquiescence indicates that the IRS accepts the decision of the court, whereas a notice of nonacquiescence indicates that the IRS may continue to challenge other taxpayers with respect to the issue(s) presented in the case. RJR Nabisco, Inc. v. Comm'r, 76 T.C.M. (CCH) 71 (1998), *nonacq.* 1999-2- C.B. XVI, at *1.

[167] *RJR Nabisco*, 76 T.C.M. 71, *action on dec.*, 1998-012, at *1. For the IRS's position, see Rev. Proc. 2002-9, 2002-3 I.R.B. 327 (§ 3.01) (deeming package design costs to be capital expenditures under § 3, as opposed to mere advertising costs); Rev. Proc. 98-39, 1998-26 I.R.B. 36 (§ 2.03(2)) (noting that a package design may have an "ascertainable useful life that extends substantially beyond the end of the tax year in which the costs are incurred"); Rev. Proc. 97-35, 1997-2 C.B. 448 (§ 3.04) (implying that package design costs are deductible only in certain limited circumstances); Rev. Rul. 89-23, 1989-1 C.B. 85 (holding that package design costs are not deductible as ordinary and necessary business expenses and must be capitalized under § 263).

costs are capital expenditures . . . hav[ing] an indeterminate useful life," and are therefore distinguishable from advertising costs.[168]

Five years later, however, in a major shift in tax policy, the government reversed its position in a new set of regulations. In January 2004, the Treasury issued final regulations that provide comprehensive rules for capitalization of amounts paid to create or acquire intangible assets.[169] Interestingly, the regulations effectively repeal the "significant future benefit" standard of *INDOPCO* and revive the "separate-and-distinct asset" test of *Lincoln Savings* discussed above.[170] The reason given for using a separate-and-distinct asset standard was that "[a] 'significant future benefit' standard . . . does not provide the certainty and clarity necessary for compliance with, and sound administration of, the law."[171] The regulations identify categories of intangibles for which capitalization is required, including "separate and distinct intangible assets" created by the taxpayer.[172] However,

[168] *RJR Nabisco*, 76 T.C.M. 71, *action on dec.* 1998-012, at *1 (citing Davee v. United States, 444 F.2d 557 (Ct. Cl. 1971); Ala. Coca-Cola Bottling Co. v. Comm'r, 28 T.C.M. (CCH) 635, at *30–31 (1969); Cleveland Elec. Illuminating Co. v. United States, 7 Cl. Ct. 220, 223 (1985)).

[169] *See* Treas. Reg. § 1.263(a)-4 (providing "rules for applying section 263(a) to amounts paid to acquire or create intangibles").

[170] *See supra* notes 122–32 and accompanying text.

[171] Guidance Regarding Deduction and Capitalization of Expenditures, 67 Fed. Reg. 77,701, 77,702 (Dec. 19, 2002) (to be codified at 26 C.F.R. pt. 1).

[172] Treas. Reg. §§ 1.263(a)-4(b)(1)(i)–(iv). If an expenditure is not required to be capitalized by the final regulations (or by another provision of the Code), the IRS will not argue for capitalization on the ground that deduction of the expenditure does not clearly reflect income. Guidance Regarding Deduction and Capitalization of Expenditures, 69 Fed. Reg. 436, 437 (Jan. 5, 2004) (to be codified at 26 C.F.R. pt. 1) (describing how the final regulations interact with the "clear reflection of income" requirement of section 446(b)). The regulations also require capitalization of amounts paid to "*facilitate* the . . . creation of an intangible . . . if the amount[s are] paid in the process of investigating or otherwise pursuing the transaction." Treas. Reg. §§ 1.263(a)-4(b)(1)(v)–4(e)(1)(i) (emphasis added). But a taxpayer can elect to capitalize employee compensation, overhead, or de minimis costs. *Id.* § 1.263(a)-4(e)(4)(iv). A taxpayer might capitalize such costs for financial accounting purposes and prefer not to segregate such costs for federal income tax purposes. Guidance Regarding Deduction and Capitalization of Expenditures, 69 Fed. Reg. at 440.

The capitalization regulations adopt an exception termed the "12-month rule" applicable to most self-created intangibles. Treas. Reg. § 1.263(a)-4(f)(1). Under the twelve-month rule, a taxpayer is not required to capitalize amounts that provide benefits of a relatively brief duration. *Id.* Specifically, the regulations provide:

the regulations then limit application of the standard, specifically providing that an amount paid to create a package design is *not* treated as an amount that creates a separate and distinct intangible asset.[173] Thus, under the final regulations, the costs of creating a package design are deductible.

It should be noted that although a taxpayer can now expense the costs of developing a package design, the taxpayer must capitalize the costs of obtaining trademarks and copyrights on elements of the package design (i.e., the fees paid to a government agency to obtain trademark and copyright protection on certain elements of the package design).[174] For example, assume that a taxpayer who manufactures and markets personal care products pays a consultant $100,000 to develop a package design for the company's newest product, Product A. Assume also that the taxpayer pays a fee to a government agency to obtain trademark and copyright protection on certain elements of the package design and pays its outside legal counsel $10,000 for services rendered in preparing the filing, prosecuting trademark and copyright applications, and for other services rendered in securing the trademark and copyright protection. The taxpayer is not required to capitalize the $100,000 payment because amounts paid to develop a package design are treated as amounts that do not create a separate and distinct intangible asset. However, the taxpayer must capitalize the amounts paid to the government agency to obtain trademark and copyright protection. In addition,

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> A taxpayer is not required to capitalize . . . amounts paid to create . . . any right or benefit for the taxpayer that does not extend beyond the earlier of—
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> (1) 12 months after the first date on which taxpayer realizes the right or benefit; or
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> (2) The end of the taxable year following the taxable year in which the payment is made.

Id.

[173] Treas. Reg. § 1.263(a)-4(b)(3)(v) (describing the term *package design* as "the specific graphic arrangement or design of shapes, colors, words, pictures, lettering, and other elements on a given product, package, or the design of a container with respect to its shape or function").

[174] *Id.* § 1.263(a)-4(d)(5). This result (capitalization of costs of obtaining federal trademark registrations) was the result under early case law. *See, e.g.*, Deusenberg, Inc. Del. v. Comm'r, 31 B.T.A. 922, 924–26 (1934) (finding that the fees to register a trademark were a capital expenditure), *aff'd on other grounds*, 84 F.2d 921 (7th Cir. 1936).

the $10,000 paid by the taxpayer to its outside counsel is an amount paid to facilitate the creation of the trademark and copyright and must therefore be capitalized as well.[175]

Likewise, a taxpayer must capitalize the cost of tangible assets associated with advertising. In Revenue Ruling 92-80 (the post-*INDOPCO* ruling that confirmed the deductibility of ordinary product advertising), the IRS ruled that "expenditures for billboards, signs, and other tangible assets associated with advertising remain subject to the usual rules with respect to capitalization."[176]

In short, although capitalization is the norm in tax theory, expensing is the reality when it comes to brand advertising investments,[177] with the exception of trademark and copyright registration fees and tangible assets associated with advertising. This approach adopted by the government is critiqued later in this Article.[178]

C. TAX LAW ON BRAND ENFORCEMENT

As part of brand enforcement, taxpayers resort to litigation against infringing activities, e.g., the unauthorized use of the taxpayer's trademark.[179] In trademark litigation, the owner

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[175] Treas. Reg. § 1.263(a)-4(l), Example 9.

[176] RJR Nabisco, Inc. v. Comm'r, 76 T.C.M. (CCH) 71, 82 (1998), *action on dec.*, 1999-012 (Oct. 4, 1999). Final Treasury Regulations issued in 2013 dealing with capitalization of tangible assets confirm this result. Treas. Reg. § 1.263(a)-2(d)(1) (requiring capitalization of amounts paid to produce or acquire a unit of real or personal property other than materials and supplies). For an early case, see Best Lock Corp. v. Comm'r, 31 T.C. 1217, 1238 (1959) ("[A]mounts paid . . . to produce [a sale catalog] were capital items contributing to earning income for several years in the future and not ordinary and necessary expenses of doing business . . . .").

[177] Deductible advertising must meet requirements applicable to all business expenses. *See supra* note 114 (noting the Code's allowance of deductions for "ordinary and necessary" business expenses). Thus, deductible advertising must relate to an existing trade or business (or expansion) and must be reasonable in amount, especially in relation to the amount of the benefit expended. *See, e.g.*, Menard, Inc. v. Comm'r, 88 T.C.M. (CCH) 229, 247 (2004) ("[T]o the extent the expenditures are reasonable in amount, the taxpayer may deduct them as ordinary and necessary business expenses attributable to advertising."), *rev'd on other grounds*, 560 F.3d 620 (7th Cir. 2009); Schlafer v. Comm'r, 58 T.C.M. (CCH) 1374 (1990) (holding claimed deductions for sponsoring a race car were not reasonable).

[178] *See infra* Part VI.

[179] *See, e.g.*, U.S. Structures, Inc. v. J.D. Structures, Inc., 130 F.3d 1185, 1188 (6th Cir. 1997) (arguing that defendant's use of the Archadeck trademark was unauthorized).

desires to enjoin the illegal conduct and seeks compensatory damages, defendant's profits, and in some instances, enhanced damages and attorney's fees.[180] In such litigation, the owner often faces affirmative defenses, such as assertions that the trademark at issue is invalid because it has become generic, is descriptive without secondary meaning established, or has been abandoned through naked licensing or extensive unauthorized use.[181] Consequently, the owner will incur litigation costs, including the costs to overcome those affirmative defenses threatening to cancel or invalidate the property rights held by the owner.

There are no intellectual property-specific Code provisions pertaining directly to brand enforcement legal costs. Thus, we apply general tax principles discussed above: ordinary and necessary business and investment expenses are currently deductible while capital expenditures are not. The "norm" is capitalization.[182] With respect to litigation costs, courts generally considered whether the taxpayer's primary purpose in initiating or defending the litigation should be controlling, or whether the outcome of the litigation should be a factor. It is now well settled that the origin and character of the claim with respect to which the costs of litigation are incurred is the controlling test.[183]

Generally, to be currently deductible, litigation costs cannot originate in the acquisition or disposition of a capital asset.[184] This

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[180] *See id.* at 1188 ("U.S. Structures prayed for an accounting, delivery of phone numbers and other materials associated with the Archadeck name, damages, treble damages, injunctive relief and attorneys' fees and costs.").

[181] *See, e.g.*, Barnes Grp. Inc. v. Connell Ltd. P'ship, 793 F. Supp. 1277, 1297, 1305 (D. Del. 1992) (arguing that the trademark became generic, a common descriptive feature, and had been abandoned).

[182] INDOPCO, Inc. v. Comm'r, 503 U.S. 79, 84 (1992) ("The notion that deductions are exceptions to the norm of capitalization finds support in various aspects of the Code.").

[183] *See* United States v. Gilmore, 372 U.S. 39, 49 (1963) (holding that "the origin and character of the claim with respect to which an expense was incurred . . . is the controlling basic test of . . . whether [the expense] is deductible"); I.R.S. Priv. Ltr. Rul. 108360-10 (July 29, 2010), https://www.irs.gov/pub/irs-wd/1045005.pdf ("The controlling test to distinguish business expenses from personal or capital expenditures is the 'origin of claim' test." (citing Anchor Coupling Co. v. United States, 427 F.2d 429, 433 (7th Cir. 1970)).

[184] *See* Woodward v. Comm'r, 397 U.S. 572, 575–76 (1970) ("[C]osts incurred in the acquisition of a capital asset are to be treated as capital expenditures."); United States v. Hilton Hotels Corp., 397 U.S. 580, 583 (1970) ("[T]he expenses of litigation that arise out of the acquisition of a capital asset are capital expenses."); *Gilmore*, 372 U.S. at 49–50 ("[I]t

is also known as the "origin-of-the-claim" test, a factually specific inquiry wherein consideration must be given to "the issues involved, the nature and objectives of the suit in which the expenditures were made, the defenses asserted, the purpose for which the claimed deductions were expended, the background of the litigation, and all facts pertaining to the entire controversy."[185] The corollary to the origin-of-the-claim principle is that the cost of defending or perfecting title to property is inherently a capital expenditure.[186] Thus, the tax treatment of litigation costs varies depending on the nature of the litigation. To be immediately deductible, litigation must not relate to title of property, but rather to income from it. When litigation is conducted both to defend or

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was manifestly Congress' purpose with respect to deductibility to place all income-producing activities on an equal footing.").

[185] Estate of Morgan v. Comm'r, 332 F.2d 144, 151 (5th Cir. 1964), *acq.*, 1966-2 C.B. 3. The "origin-of-the-claim" test was originally created by the Supreme Court in *United States v. Gilmore* and was used to determine whether litigation costs were incurred in a business or profit-seeking context or whether the costs were personal. 372 U.S. 49. In *Gilmore*, the taxpayer attempted to deduct a portion of the legal fees he paid in a divorce proceeding—specifically, that portion attributable to his attorney's efforts to protect his ownership of certain closely held stock (income-producing property) that his spouse had demanded in the divorce. *Id.* at 41–42. The Court held that the divorce proceeding and the costs thereof "stemmed entirely from the marital relationship" and were thus nondeductible personal expenses. *Id.* at 51–52.

The origin-of-the-claim standard has also been used to determine whether litigation costs—even if incurred in a business or profit-seeking activity—are nondeductible capital expenditures. In *Woodward v. Commissioner*, taxpayers who owned a majority interest in a corporation paid legal fees in an appraisal proceeding that arose in connection with the required purchase of a dissenting minority shareholder's stock. 397 U.S. 572, 573–74 (1970). Relying on its decision in *Gilmore*, the Supreme Court held that the origin of the claim that gave rise to the legal fees was the acquisition of stock and that the fees should therefore be capitalized. *Id.* at 578–79.

[186] Treas. Reg. §§ 1.263(a)-4(d)(9)–4(e)(5), Example 6 (requiring capitalization of litigation expenses incurred in defense of title to intangible property); I.R.S. Field Serv. Adv. 199925012, 1999 WL 424839, at *3 (June 25, 1999) (citing former Treas. Reg. § 1.263(a)-2); Ca. & Hawaiian Sugar Ref. Corp. v. United States, 311 F.2d 235, 242 (Ct. Cl. 1962) ("[T]he Code and the regulations require that, before the expenditures can be deductible, they must be . . . other than permanent improvements or betterments made to increase the value of any property or estate, including expenditures incurred in defending or perfecting title to property." (internal quotations and citations omitted)). The costs incurred in defending or perfecting title to property are considered to be part of the cost of the property, and they must be capitalized. *Ca. & Hawaiian Sugar Ref. Corp.*, 311 F.2d at 241–42. This rule is functionally equivalent to the general rule requiring acquisition costs to be capitalized.

perfect title (capital) and to preserve or collect income (deductible), an allocation between the two categories is appropriate.[187]

Judicial precedents pertaining to the tax treatment of brand enforcement legal costs are extremely limited. The well-settled case relates to the tax treatment of legal costs of defending trademark registrations in cancellation proceedings. In *Georator Corp. v. United States*,[188] the taxpayer incurred litigation expenses in defending its trademark registration in a cancellation proceeding.[189] The ground for cancellation was that the taxpayer's trademark had become the common name for certain types of products; the cancellation proceeding was later dismissed because of failure to present substantial evidence to refute the validity presumption afforded the trademark at issue by virtue of its registration.[190] The Fourth Circuit first observed that federal registration of a trademark confers several benefits upon the holder of a trademark. The benefits, which are of long-term duration, include: (1) constructive notice of ownership in the trademark; (2) prima facie evidence of trademark validity, registrant's ownership, and exclusive right to use the trademark in commerce; (3) the possibility that the registration will become incontestable after five years of continuous use and constitute conclusive evidence of the registrant's right to use the trademark; (4) the registrant's right to request customs officials to bar the importation of goods bearing marks similar to the registered trademark; and (5) registration effective for the initial period of twenty years and possible subsequent renewal.[191] Because the benefits of federal registration are of indeterminate duration, the costs of obtaining trademark registration must be capitalized.[192] Because the costs of obtaining federal trademark registrations are capital expenditures, the costs of litigation defending the federal

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[187] Treas. Reg. § 1.212-1(k) ("Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents.").

[188] 485 F.2d 283 (4th Cir. 1973).

[189] *Id.* at 284.

[190] *Id.*

[191] *Id.* at 285.

[192] This is the result on current regulations discussed above. *See supra* notes 174–76 and accompanying text.

trademark registrations from cancellations are also capital expenditures. Indeed, the Fourth Circuit in *Georator* noted that "successful opposition to a cancellation proceeding secures the benefits of registration as much as does the original registration of the trademark."[193]

The less-settled case relates to the tax treatment of legal costs incurred in trademark infringement actions. In trademark infringement actions, trademark owners often seek damages as well as an injunction restraining the defendant from using a confusing mark.[194] Consequently, the question arises whether the litigation relates to the recovery of lost income from the trademark (in which cases costs are deductible) or to perfecting or preserving rights to the trademark (in which case costs must be capitalized as in *Georator*). In patent infringement cases, courts have held that litigation costs are currently deductible.[195] The reason is that patent infringement litigation is viewed as a "far cry from removing a cloud of title, or defending ownership of property."[196] Rather, patent infringement cases are aimed at recovering a taxpayer's lost profits.[197] Thus, legal costs in a patent infringement action—for the purpose of protecting royalties previously derived as well as those to be derived in the future—are deductible as ordinary and necessary business expenses regardless of whether the taxpayer is successful or unsuccessful in the

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[193] 485 F.2d at 285.

[194] *See, e.g.*, Urquhart v. Comm'r, 215 F.2d 17 (3d Cir. 1954) (seeking an injunction and damages in trademark action).

[195] *See id.* (finding litigation costs to be ordinary and necessary expenses).

[196] *Id.* at 20. In patent infringement actions, the defense of invalidity of patent claims is normally raised and disposed of first. But courts have held that litigation costs are nevertheless deductible when the original claim was commonplace patent infringement. *Id.* at 19.

[197] *Id.* at 20 ("In patent nomenclature what the infringer makes is 'profits,' what the owner of the patent loses by such infringement is 'damages.' And usually, although not always, what a patent owner loses from infringement is the acquisition of 'a just and deserved gain' from the exploitation of the invention embodied in his patent. Therefore an award of damages in patent litigation is ordinarily an award of compensation for gains or profits lost by the patent owner and hence is taxable to him as income in the year received." (citations omitted) (quoting Mathey v. Comm'r, 177 F.2d 259, 262 (1st Cir. 1949)) (internal quotation marks omitted)).

infringement action.[198] It appears legal costs in copyright infringement actions receive the same tax treatment as legal costs in patent infringement actions.[199]

In contrast to patent and copyright infringement cases, trademark infringement cases "are of peculiar pedigree."[200] In two cases, the Second Circuit and Tenth Circuit adopted similar reasoning in requiring capitalization of attorney's fees and other litigation costs in trademark infringement suits. In *Danskin, Inc. v. Commissioner*,[201] the Second Circuit analyzed the purpose and effect of the legal expenses in the underlying trademark infringement case.[202] Although the complaint for infringement included a plea for damages, the Second Circuit observed that the legal expenses increased the value of the taxpayer's trademark, secured the property right of the taxpayer in the trademark, and eliminated future infringement by the use of a similar

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[198] *Id.* at 20–21; *see also* I.R.S. Gen. Couns. Mem. 38,490, 1980 WL 131296 (Aug. 27, 1980) (stating that legal expenses associated with preventing patent infringement incurred by an inventor who is in the business of inventing and licensing patents are deductible as ordinary and necessary business expenses under section 162).

[199] *See* Saltzman v. Comm'r, 68 T.C.M. (CCH) 1544, 1569 (1994) (holding that a portion of the litigation costs in a copyright infringement action were to recover lost income and hence deductible as ordinary and necessary business expenses); I.R.S. Field Serv. Adv. Mem. 199925012, 1999 WL 424839, at *2 (June 25, 1999) (noting an apt comparison exists between patents and copyrights in addressing "[w]hether costs incurred in the pursuit and settlement of a copyright infringement action instituted by the Taxpayer may be deducted as ordinary and necessary trade or business expenses or, instead, must be capitalized").

[200] I.R.S. Field Serv. Adv. Mem. 199925012, at *3 (summarizing tax cases involving trademark infringement costs).

[201] 331 F.2d 360, 360 (2d Cir. 1964), *aff'g*, 40 T.C. 318 (1963). For further discussion of the deductibility of legal expenses in the context of intellectual property litigation, see I.R.S. Tech. Adv. Mem. 8831001 (Apr. 8, 1988); Tech. Adv. Mem. 8022002 (1980).

[202] In *Danskin*, the taxpayer owned the federally registered DANSKIN trademark and used the trademark in connection with manufacturing and marketing ladies' and children's leotards, tights, and related items. Danskin, Inc. v. Comm'r, 40 T.C. 318, 319 (1963), *aff'd*, 331 F.2d 360 (2d Cir. 1964). In the U.S. District Court for the Eastern District of Pennsylvania, the taxpayer asserted a trademark infringement action against a competitor for using the GAMSKIN trademark. *Id.* at 319–20. The court granted the taxpayer's request for a temporary restraining order, and the parties later settled the litigation. *Id.* at 320. The defendant agreed to stop using the GAMSKIN trademark and to pay all court costs and damages in the amount of $7,000 if it ever breached any provision of the settlement. *Id.* The taxpayer incurred $4,666 in connection with the litigation and subsequent settlement. *Id.* The taxpayer sought to deduct the costs as ordinary and necessary business expenses under section 162 of the Code. *Id.* The IRS disallowed the claimed deductions, and the Tax Court sustained the IRS's determination. *Id.* at 319–22.

trademark.[203] Thus, the taxpayer enjoyed a financial gain that would endure "for many years to come; and therefore the pattern of the revenue laws of accurately matching income and expenses within annual accounting periods requires that these legal expenses be classified as capital outlays."[204] According to the court, the costs of removing the infringing threat to a trademark resemble the costs of perfecting or preserving title to property.[205] Such costs are well established as capital expenditures, not currently deductible business expenses.[206] The Tenth Circuit, in *Medco Products Co. v. Commissioner*,[207] later relied in part upon *Danskin* in holding that litigation costs incurred in a trademark infringement action were not deductible expenses.[208]

In at least one case, however, the Tax Court allowed the deduction of legal costs incurred by a taxpayer who had a trademark registration and unsuccessfully alleged trademark infringement against a defendant. In *J.R. Wood & Sons, Inc. v. Commissioner*,[209] the IRS disallowed the taxpayer's claimed deductions, arguing that the litigation was to defend or perfect title to the taxpayer's trademark, as supported by the mere fact that in the trademark litigation the defendant raised a defense of trademark abandonment.[210] The Tax Court rejected the IRS's argument as without support because the court in the trademark infringement suit did not address the abandonment issue.[211] The Tax Court found that the taxpayer "did not seek to gain, protect or improve title to any capital asset and, although the litigation was unsuccessful, [the taxpayer] lost nothing of a capital nature in that

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203 331 F.2d at 361.

204 *Id.*

205 *Id.*

206 *Id.*

207 523 F.2d 137 (10th Cir. 1975), *aff'g* 62 T.C. 509 (1974).

208 *Id.* at 139. For an earlier case than *Danskin* or *Medco*, see Food Fair of Va., Inc. v. Comm'r, 14 T.C. 1089, 1089 (1950) (holding that litigation expenses incurred by the taxpayer, who used the trade name "Food Fair" in connection with its retail grocery business, in a suit against a competitor for using the same name were not deductible because the suit was to defend the taxpayer's title or right in the trade name).

209 21 T.C.M. (CCH) 1038 (Aug. 7, 1962).

210 *Id.* at *2.

211 *Id.*

litigation."[212] Accordingly, the litigation costs were incurred in the ordinary conduct of the taxpayer's business in an effort to protect its income and were thus allowable for deduction.[213]

J.R. Wood is perhaps an isolated aberration of the Tax Court. Indeed, the case was expressly questioned and rejected by the IRS years later after the *Danskin* and *Medco* decisions.[214] The purpose of a trademark infringement action, even if it is unsuccessful, is to secure benefits in the trademark, such as the exclusive right to use the trademark in commerce.[215] Such benefits have a life beyond the taxable year, as noted by the Second Circuit in *Danskin* and the Tenth Circuit in *Medco*.[216] Since there was no infringement of the taxpayer's trademark in *J.R. Wood*, the taxpayer continued to benefit from all the exclusive rights in the trademark.

In trademark litigation, the trademark owner often asserts both trademark infringement and unfair competition claims.[217] The unfair competition claim under section 43(a) of the Lanham Act is a very broad claim that encompasses a defendant's use of a trademark or trade dress in commerce that causes a likelihood of consumer confusion as to the source of the defendant's trademark or trade dress and the plaintiff's trademark or trade dress.[218] Both unfair competition claims and trademark infringement claims reach the same likelihood-of-consumer confusion test; most courts analyze the test and reach the same conclusion to both claims.[219] As such, monetary damages are available for both claims under the Lanham Act. The question then becomes whether these claims should be treated the same for tax purposes.

At least one case did not treat trademark and unfair competition claims similarly for tax purposes and ruled that litigation costs incurred in connection with an unfair competition

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[212] *Id.*

[213] *Id.*

[214] I.R.S. Gen. Couns. Mem. 38490, 1980 WL 131296, at *2 n.1 (Aug. 27, 1980); *see also* I.R.S. Field Serv. Adv. 199925012, 1999 WL 424839, at *3 n.1 (June 25, 1999) ("*Wood* was expressly questioned in [Gen. Couns. Mem.] 38490, and its result was rejected.").

[215] *See supra* note 191 and accompanying text.

[216] Medco Products Co. v. Comm'r, 523 F.2d 137, 139 (10th Cir. 1975); Danskin, Inc. v. Comm'r, 40 T.C. 318, 323 (1963).

[217] *See supra* note 73 and accompanying text.

[218] 15 U.S.C. § 1125(a) (2012).

[219] *See supra* note 74 and accompanying text.

claim were currently deductible. In *Rust-Oleum Corp. v. United States*, the taxpayer-plaintiff brought a suit against the defendant in federal court for trademark infringement and unfair competition.[220] The defendant then filed an opposition proceeding in the Patent and Trademark Office against the taxpayer-plaintiff's trademark registration.[221] In the early stages of litigation, the taxpayer-plaintiff commissioned a trademark recognition survey for purposes of using the survey to demonstrate that its trademark was valid.[222] The taxpayer-plaintiff did not have an opportunity to use the survey, because the litigation was settled and the opposition proceeding was terminated.[223] But the taxpayer-plaintiff later used the trademark recognition survey for its advertising purposes.[224]

The taxpayer sought to deduct its legal costs, as well as the costs of the trademark recognition survey.[225] Strangely, the court divided the litigation expenses equally between the unfair competition and trademark infringement claims.[226] The court observed that the trademark infringement claim sought judicial determination that the plaintiff had a property right in the trademark, while the unfair competition claim sought money damages for the alleged unfair competition.[227] Accordingly, litigation expenses associated with the trademark infringement claim were not deductible because they were incurred for the purpose of protecting or perfecting title in property.[228] Expenses associated with the unfair competition claim, however, were deductible.[229]

In addition, the court divided the survey costs "equally between those properly deductible and those not so deductible."[230] The court found that the consumer recognition survey was conducted

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220 280 F. Supp. 796 (N.D. Ill. 1967).

221 *Id.* at 798.

222 *Id.*

223 *Id.*

224 *Id.*

225 *Id.* at 796.

226 *Id.* at 801.

227 *Id.*

228 *Id.*

229 *Id.*

230 *Id.*

for contemplated use of supporting both the trademark infringement and unfair competition claims.[231] Accordingly, half of the survey costs would be deductible, as such costs contributed to the unfair competition claim.[232] The other half would be treated as capital expenditures and not deductible in the year incurred.[233] The taxpayer unsuccessfully attempted to have the total costs of the consumer recognition survey deducted as costs for advertising purposes.[234] Though the taxpayer-plaintiff indeed used the survey results for advertising purposes, such use was subsequent to the settlement of the litigation, which occurred at an early stage.[235] The court thus determined that such use could "hardly be given retroactive significance as the primary purpose for which [the surveys] were secured."[236]

VI. CRITIQUE OF CURRENT APPROACHES AND PROPOSALS

A business must both use a trademark in commerce and defend it if necessary, or risk losing it under intellectual property laws.[237] As described in Part V, the federal income tax treatment of use (advertising costs) and enforcement (litigation costs) varies greatly. Advertising dollars spent to build up the goodwill value of a trademark are expensed (with the exception of the costs of tangible assets associated with advertising).[238] In contrast, litigation costs incurred to protect that enhancement of value must be capitalized (with the exception of legal costs in unfair competition claims).[239] These tax distinctions for branding

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[231] *Id.* at 797, 801.

[232] *Id.* at 801.

[233] *Id.* at 801–02.

[234] *Id.* Recall from above that ordinary product and institutional goodwill advertising costs are deductible under section 162. *See supra* note 150 and accompanying text.

[235] *Id.* at 796–97.

[236] *Id.* at 801.

[237] *See Loss of Trademark Rights*, INT'L TRADEMARK ASS'N (May 2015), http://www.inta.org/TrademarkBasics/FactSheets/Pages/LossofTrademarkRightsFactSheet.aspx ("The most common way to lose rights in a mark is to stop using the mark with no intention to use it again . . . . Trademark rights may also be lost when . . . the owner does little or nothing to police its mark, [as] the mark is likely to lose some or all of its value as a source identifier in the marketplace.").

[238] *See supra* notes 150–51 and accompanying text.

[239] *See supra* Part V.C.

activities raise important policy questions. If these tax distinctions lack theoretical justification, legislative or administrative changes may be warranted.

A. IDENTIFYING AN APPROPRIATE FRAMEWORK FOR BRAND ADVERTISING EXPENDITURES

Regarding the deductibility of business and investment expenses, the "norm" is capitalization and therefore depreciation/amortization.[240] As described in Part V, however, wide exemptions from normative capitalization have been established for brand development expenditures. Under current law, costs of *usual* brand advertising are currently deductible.[241] This includes, for example, the costs of using social media, maintaining a website, purchasing keywords, embedding keywords in a website, placing an ad in the newspaper, bundling inserts of ad pages with newspapers, distributing flyers, and sending logos in e-mails. In addition, the costs of *unusual* brand advertising are currently deductible.[242] This includes, for example, advertising campaign costs and graphic and package design costs.[243] The favorable treatment of advertising suggests that the government views advertising expenses as part of a "normal" income tax system; indeed, "neither the Joint Committee on Taxation nor the Office of Management and Budget (OMB) treats advertising deductions as a 'tax expenditure' " for the government.[244]

In stark contrast to the current tax regime (expensing), arguments could be made for the uniform capitalization of *all* advertising costs.[245] It could be argued, for instance, that advertising—campaigns and executions—should not be viewed as

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[240] INDOPCO, Inc. v. Comm'r, 503 U.S. 79, 84 (1992).

[241] *See supra* note 150 and accompanying text.

[242] *See supra* notes 169–77.

[243] *See supra* notes 169–77.

[244] Annette Nellen, *Advertising Expense and Tax Reform: How Not to Broaden the Tax Base*, AICPA (July 31, 2014), http://www.cpa2biz.com/Content/media/PRODUCER_CONTENT/Newsletters/Articles_2014/CorpTax/BroadenTaxBase.jsp.

[245] *See* Mona L. Hymel, *Consumerism, Advertising, and the Role of Tax Policy*, 20 VA. TAX REV. 347, 444 (2000) (questioning the tax deduction for advertising on the basis of public welfare concerns); Lily Kahng, *The Taxation of Intellectual Capital*, 66 FLA. L. REV. 2229, 2266–67 (2014) (arguing that tax law should require capitalization of investments in self-created intellectual capital, including branding).

part of a "normal" income tax system; rather, advertising is an unusual cost that invariably produces unique, long-term benefits, which, alone, justifies capitalization. *Advertising campaign expenditures* typically result in statutory and common law trademark rights that attach to trade dress, copyright protections, and economic interests associated with brand equity.[246] These intangible benefits are not realized in the current year alone, but endure over the economic life of the brands. As with advertising campaign expenditures, *advertising execution expenditures* often provide benefits that endure for many years.[247] For example, a communication to the general public for the purpose of promoting a business or its products—whether in the form of website display, multimedia program, video segments to go viral on YouTube, e-mail communication, radio broadcast, or newspaper publication—has the potential to yield benefits for the business that extend beyond the current year, as a memorable communication, transmitted only once, may have a lingering impact on a particular consumer. Case law has recognized the similar benefits produced by both campaign and execution expenditures to justify similar tax treatment, i.e., current deduction for both.[248] But these similar benefits are of a long-term nature, justifying a different outcome, i.e., capitalization for both.

The uniform capitalization of advertising costs would broaden the tax base and raise necessary revenue for the government in a climate of serious budget deficits. Legislative proposals have been made to restrict the tax deduction for advertising. Most recently, in 2014, Representative David Camp introduced legislation that would require large businesses to capitalize most advertising expenses and then amortize such expenses over ten years.[249] A

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[246] RJR Nabisco Inc. v. Comm'r, 76 T.C.M. (CCH) 71, 82 (1998).

[247] *Id.* at 84.

[248] *See supra* notes 156–65 and accompanying text.

[249] Tax Reform Act of 2014, H.R. 1, 113th Cong. (2014), https://www.govtrack.us/congress/bills/113/hr1. Camp's proposal, which would be phased-in until 2018, would add Section 177 to the Code and allow an immediate tax deduction for advertising expenses in any taxable year that do not exceed $1 million. *Id.* § 3110(b) (providing that the exemption is phased out for otherwise deductible advertising expenses in any year exceeding $1.5 million). Then, fifty percent of "specified advertising expenses" would be charged to a capital account and allowed an amortization deduction ratably over the ten-year period, beginning with the midpoint of the taxable year in which such expenses are paid or

similar bill was proposed in 2013 by Senator Max Baucus that would have required advertisers to deduct only fifty percent of all advertising expenses and amortize the remainder over the next five years.[250] These proposals, which would raise revenue without raising income tax rates, have been criticized and do not appear to be gaining support.[251] Critics contend that capitalization is unwarranted and "would deny businesses the ability to deduct their expenses and thus overstate their taxable income"; indeed, it was suggested that Camp's proposal "would increase business taxes by $169 billion over ten years."[252] The advertising industry, particularly, the Association of National Advertising, has criticized any legislation, arguing that such action would have a profound impact on both the advertising industry and the economy more broadly by increasing the cost of advertising and causing a "substantial disincentive for companies to spend additional advertising dollars."[253] According to the advertising industry, advertising drives sales and jobs, stimulates new economic activity, and in 2012, it accounted for $5.6 trillion of U.S. output and supported 21.1 million—nearly 16%—of the 136.2 million U.S. jobs.[254] It was estimated that if Camp's proposal were

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incurred. *Id.* "Specified advertising expenses" include advertising expenses paid or incurred for the development, production, or placement of any communication to the general public which is intended to promote the taxpayer or a trade or business; specified advertising expenses do *not* include discounts or coupons, creation of logos, trade names, package design, or market research. *Id.* § 3110(d)(2).

[250] JOINT COMM. ON TAXATION, TECHNICAL EXPLANATION OF THE SENATE COMMITTEE ON FINANCE CHAIRMAN'S STAFF DISCUSSION DRAFT TO REFORM CERTAIN BUSINESS PROVISIONS 46 (JCX-19-13) (Comm. Point 2013), http://www.finance.senate.gov (click search tool at top right corner; search "Final SFC Business TE 11-19-13"); *see also* Press Release, Sen. Comm. on Fin., Baucus Works to Overhaul Outdated Tax Code (Nov. 21, 2013), http://www.finance.senate.gov/newsroom/chairman/release/?id=536eefeb-2ae2-453f-af96-946c305d5c93.

[251] *See, e.g.*, Nellen, *supra* note 244 (critiquing Rep. Camp's proposal based on its complexity, predictability, accounting principles, economic efficiency, and competitiveness). *But see* Kahng, *supra* note 245, at 2275 ("[R]ecent legislative proposals of 50% seem reasonable in view of empirical estimates.").

[252] Curtis S. Dubay & David R. Burton, *Chairman Camp's Tax Reform Plan Keeps Debate Alive Despite Flaws*, HERITAGE FOUND. (Mar. 14, 2014), http://www.heritage.org/research/reports/2014/03/chairman-camps-tax-reform-plan-keeps-debate-alive-despite-flaws.

[253] Press Release, Ass'n of Nat'l Advertisers, Potential Changes in Deductibility of Advertising Expenses Within Tax Reform Legislation Would Only Serve to Stifle Economic Activity (Nov. 21, 2013), http://www.ana.net/content/show/id/28593.

[254] *Id.*

implemented, "more than 1.7 million jobs and $456 billion in sales would be jeopardized."[255] The advertising industry, however, is not the only group to show the persuasive forces of advertising.[256] In a recent non-industry sponsored study, the Centre for Economic Performance studied the effect of advertising expenditures of firms and consumer prices across industries and found that advertising tends to lower consumer prices across the board.[257]

Criticism of legislative proposals to change the current advertising deduction illustrates the difficulty policymakers would have in moving toward a uniform capitalization rule for *all* advertising costs. As noted by Professor Johnson, a strong proponent of capitalization in general,

> [E]xpensing of various investments has crept into the income tax system over the years. . . . Part of it is a "tragedy of the commons" in politics, under which the special exemptions systematically triumph over the common good. The public cannot be organized to protect the general welfare because the interest of each member of the public in a fair and uniform tax

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[255] Press Release, Ass'n of Nat'l Advertisers, Advertising Deduction Wrongly Targeted in Chairman Camp's Proposed Tax Reform Legislation; Provision Would Stifle Economic Activity (Feb. 26, 2014), http://www.ana.net/content/show/id/29628.

[256] *See, e.g.*, Mark Bartholomew, *Advertising and the Transformation of Trademark Law*, 38 N.M. L. REV. 1, 20 (2008) ("Courts also accepted that advertising played a positive role in the national economy."); Jerrold L. Walden, *Antitrust in the Positive State: II*, 42 TEX. L. REV. 603, 614–16 (1964) ("Advertising expenditures in this country have constantly escalated over the last decade, and it is now confidently predicted that they will attain the phenomenal annual total of 25 billion dollars ten years hence. This fact is indicative of the indispensable role played by advertising in conjunction with mass communication media in the economy of the positive state.").

[257] Ferdinand Rauch, *Advertising Expenditure and Consumer Prices*, CTR. FOR ECON. PERFORMANCE (Aug. 2011), http://cep.lse.ac.uk/pubs/download/dp1093.pdf; *see also* Brad Plumer, *Does Advertising Help or Harm the Economy?*, WASH. POST (Nov. 27, 2012), http://www.washingtonpost.com/news/wonkblog/wp/2012/11/27/does-advertising-help-or-harm-the-economy/ (discussing the Centre's findings). For a study conducted by Global Insight, Inc., an economics organization, see IHS GLOBAL INSIGHT, INC., THE ECONOMIC IMPACT OF ADVERTISING EXPENDITURES IN THE UNITED STATES 2012–2017, https://www.ana.net/getfile/20391.

> system is too low, and the interest of those seeking a special exemption is so intense.[258]

But it has been argued that the current advertising deduction

> has never been a tax preference item, 'loophole' or special interest benefit. Rather, it provides an opportunity for every company in every industry throughout the U.S. to communicate efficiently with consumers about products and services. . . . [They] always have been . . . treated no differently than any other ordinary and necessary business expense.[259]

In sum, while uniform capitalization for all advertising would contribute to a sound tax base, it would increase the cost of advertising for firms and perhaps be too hard for businesses to accept and policymakers to defend.

Although capitalization is the norm in our income tax system, in practice it is not. In numerous instances, the government has justified exemptions that deliberately drive economic decisionmaking. For example, to encourage research activity and to stimulate economic growth and technological development, Congress permits taxpayers to expense research and development expenditures that might otherwise have to be capitalized.[260] As a

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[258] Calvin H. Johnson, *Omnibus Capitalization Proposals*, 124 TAX NOTES 1121, 1122 (2009).

[259] Press Release, Ass'n of Nat'l Advertisers, *supra* note 255.

[260] *See* I.R.C. § 174(a) (2012) (allowing taxpayers to treat research and experimental expenditures as expenses not chargeable to capital account); *id.* § 263(a)(1)(B) (providing that the capitalization rules under section 263(a) do not apply to research and experimental expenditures deductible under section 174(a)). For the statute's legislative history, see H.R. REP. NO. 1337, at 4262–64 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4017, 4053; 100 CONG. REC. 3,425 (1954) (statement of Chairman Reed: "This provision will greatly stimulate the search for new products and new inventions upon which the future economic and military strength of our Nation depends. It will be particularly valuable to small and growing businesses."). *See also* Donald C. Alexander, *Research and Experimental Expenditures Under the 1954 Code*, 10 TAX L. REV. 549, 549 (1955) (noting a primary reason for enacting section 174 was to create an incentive for new products and inventions through federal subsidy of research and development start-ups); William Natbony, *The Tax Incentives for Research and Development: An Analysis and a Proposal*, 76 GEO. L.J. 347, 349 (1987) (explaining that Congress decided to provide taxpayers with the option of an immediate deduction in order to encourage new research and development); Richard L. Parker, *The*

further example, to encourage investment in productive, depreciable, tangible personal property and to encourage economic activity, Congress allows taxpayers to immediately expense the acquisition cost of such property, subject to certain limitations.[261] The relevant inquiry here is whether the law's current exemptions for both usual advertising (ordinary product, institutional, or goodwill advertising) and unusual advertising (advertising campaigns) are sound. We argue below that, when evaluated under normative tax policy criteria, expensing makes sense for the former category, but capitalization should apply for the latter.

1. Expensing Usual Advertising Expenditures. Tax law's current treatment (expensing) of ordinary brand advertising serves legitimate goals. Most notably, advertising stimulates economic growth and thus produces positive externalities. In a recent study analyzing the total economic impact of advertising expenditures across sixteen industries and the government, researchers determined that each dollar spent on advertising expenses generates nearly $22 of economic output that would not have otherwise existed.[262] Additionally, every $1 million spent on annual advertising expenses supports eighty-one American jobs.[263] The study projected that "[b]y 2017, advertising will directly and indirectly foster $6.5 trillion in U.S. economic activity (sales) and help support 22.1 million U.S. jobs."[264] Thus, while it is important to the economy to stimulate the search for new products and new inventions, it is equally important to support the dissemination of

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Innocent Civilians in the War Against NOL Trafficking: Section 382 and High-Tech Start-Up Companies, 9 VA. TAX REV. 625, 694 (1990) ("The deduction election under section 174(a) is intended to encourage research and development activities by allowing the cost of such activities to be used to offset the income earned in the business at the earliest possible date.").

[261] *See* I.R.C. § 179(a) (allowing taxpayers to elect to write off the cost of acquisition of "section 179 property" as an expense "not chargeable to capital account"). Section 179 property is tangible property or off-the-shelf computer software, which is personal property and is purchased for the active conduct of a trade or business. *Id.* § 179(d)(1). There are limits on the amount that can be expensed in any given year. *Id.* § 179(b).

[262] Press Release, Ass'n of Nat'l Advertisers, New Study Underscores Advertising's Role as a Critical Driver of the U.S. Economy (Jan. 14, 2014), http://www.ana.net/content/show/id/29212. Economists and other research groups have also studied the persuasive effects of advertising. *See* Rauch, *supra* note 257; IHS GLOBAL INSIGHT, INC., *supra* note 257.

[263] Press Release, Ass'n of Nat'l Advertisers, *supra* note 262.

[264] *Id.*

those products through marketing.[265] If policymakers wish not to subsidize the marketing of "bad" products (e.g., alcohol or tobacco products) out of social welfare concerns, then special capitalization rules could be carved out for advertising investments associated with those products.[266]

Current expensing of usual advertising costs furthers administrative efficiency.[267] In contrast, a capitalization rule for such costs would necessarily add complexity to the current tax system. For example, a default capitalization rule for advertising would have to define "advertising" to avoid ambiguities and provide clarity of tax result, a seemingly impossible task.[268] Advertising would surely include fees paid to an outside marketing firm. But would advertising include salaries paid to employees in a company's marketing or public relations department, which otherwise are expensed under current law? Would advertising include wages paid to in-house counsel or fees to outside counsel to

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[265] *But see* Kahng, *supra* note 245, at 2266 ("[I]t is hard to justify a deduction for advertising to promote a brand on the grounds that it provides socially valuable spillover effects.").

[266] *See* Hymel, *supra* note 245, at 444–61 (noting such past legislative and scholarly proposals to amend the advertising tax deduction).

[267] Expensing is sometimes used by the government to eliminate uncertainties caused by the capitalization principle. Section 174, for example, allows taxpayers to elect to immediately deduct qualified research and development expenditures that would otherwise be capitalized. *See supra* note 260 and accompanying text. While the primary justification for the special deduction was to encourage new research and development activity and stimulate economic growth and technological development, as noted *supra* note 260, another justification was to reduce uncertainties caused by applying the asset capitalization rules to research and development activities. *See* David S. Hudson, *The Tax Concept of Research or Experimentation*, 45 TAX LAW. 85, 88–89 (1991) (discussing the problems associated with the capitalization rules); George Mundstock, *Taxation of Business Intangible Capital*, 135 U. PA. L. REV. 1179, 1258–59 (1987) ("Besides reducing uncertainty, section 174 was intended to encourage R&D and to ensure that start-up businesses can deduct R&D that would be deductible by an ongoing concern.").

[268] The current capitalization rules for costs of improvements to tangible property has been plagued by similar problems. For instance, the costs of improvements (as opposed to repairs) to property must be capitalized. I.R.C. § 263(a) (2012). But what is an improvement? Although the regulations under section 263 have existed for some time, they have long been considered vague, subjective, and the source of much litigation. *See, e.g.*, Otis v. Comm'r, 73 T.C. 671, 674–75 (1980) (holding that the replacement of carpets, draperies, refrigerators, and dishwashers "was more than mere incidental repair" and would thus need to be capitalized). As a result, the Treasury has recently issued new regulations expanding and clarifying the rules surrounding improvements. Treas. Reg. § 1.263(a)-1, -2, -3 (2014).

ensure compliance with advertising laws?[269] If the government excluded employee compensation from the definition of advertising to resolve controversies and eliminate the burden on taxpayers of allocating transaction costs,[270] inequities would emerge. Large firms with in-house marketing staff and legal staff handling advertising matters would be permitted to deduct compensation related to advertising, whereas small firms that have to pay outside marketing firms and consultants to perform functions related to advertising would be required to capitalize such expenses.

A capitalization rule for usual brand advertising would also necessarily contain various limitations and exceptions difficult for taxpayers to apply and for the government to administer. As an example, a default capitalization rule would most likely contain an exception for usual brand advertising that produced only short-term benefits (say twelve months or less), which would lead to controversies between taxpayers and the government over the duration of benefits.[271] Assume a business pays a fee to a radio

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[269] Professor Nellen raised these excellent points in her criticism of Rep. David Camp's proposal to capitalize advertising expenses. Nellen, *supra* note 244.

[270] Under current law, there is an assumption that employee compensation and overhead costs do not facilitate the acquisition, creation, or enhancement of an intangible asset, regardless of the percentage of time that is allocable to capital transactions. *See Guidelines for Intangibles Under IRC § 263(a)*, IRS (Oct. 27, 2015), https://www.irs.gov/businesses/guidelines-for-intangibles-under-irc-section-263-a ("[U]ntil further guidance is finalized, capitalization will not be asserted under § 263(a) for employee compensation . . ., fixed overhead, or de minimus costs related to the acquisition, creation, or enhancement of intangible assets or benefits."). Employee compensation, which is not subject to capitalization under the simplifying convention, includes salary, bonuses, and commissions paid to an employee of the taxpayer. Treas. Reg. § 1.263(a)-4(e)(4)(ii). The employee simplifying convention is extended to amounts paid to so-called independent contractors and outside contractors for secretarial, clerical, and similar administrative services. *Id.*

[271] Such an exception exists in current regulations governing the capitalization of certain intangible assets. Under the so-called "12-month rule," applicable to most self-created intangibles, a taxpayer is not required to capitalize amounts that provide benefits of a relatively brief duration. Treas. Reg. §§ 1.263(a)-4(f)(1)(i)–(ii). Specifically, the regulations provide that a taxpayer is not required to capitalize amounts paid to create any right or benefit for the taxpayer that does not extend beyond the earlier of: (1) twelve months after the taxpayer first realizes the right or benefit; or (2) the end of the taxable year that follows the taxable year in which the payment is made. *Id.* The purpose of the twelve-month rule was to reduce the administrative and compliance costs inherent in applying section 263(a) to amounts paid to create intangible assets. Guidance Regarding Deduction and Capitalization of Expenditures, 67 Fed. Reg. 77,701, 77,708 (Dec. 19, 2002) (to be codified at

station to play a jingle on the radio during November of Year One, but potential consumers continue to sing the jingle while showering and driving in their cars throughout Years Two and Three. Would the fee fall within the short-term-benefits exemption and be expensed because the contract with the radio station was for one month, or would the fee be capitalized under the default rule because the advertising investment really didn't expire by the end of Year One? Expensing, rather than capitalization, of usual advertising would avoid the need to make determinations like this and provide certainty and clarity to minimize costs of compliance and administration.

In addition to the economic and administrative efficiencies achieved under the current system (via tax expensing of ordinary brand advertising), expensing ordinary product advertising also creates an even playing field between (1) businesses that spend money to advertise and build up the goodwill value in their own trademarks and (2) businesses that choose, instead, to license from others the right to use well-known trademarks in connection with the products they manufacture and sell. While expensing of the former has long been allowed, the deductibility of the latter (sales-based royalty payments) has been the subject of litigation and regulation. It is now settled that if a taxpayer obtains a license to use well-known trademarks in connection with certain products manufactured and distributed by the taxpayer and agrees to pay royalties to the licensor based on a percentage of net sales of the products bearing the licensor's trademarks, the royalty payments can be expensed, rather than capitalized, to the products produced.[272] Treating equally those taxpayers who spend money to

26 C.F.R. pt. 1). The rule is easily applied with respect to pre-paid expenses and contract rights. Such a rule might prove more difficult to apply with respect to benefits of usual advertising, the duration of which is not easily determined.

[272] The IRS's initial position on the deductibility of sales-based trademark royalties was tested in *Robinson Knife Mfg. Co. v. Comm'r*, 97 T.C.M. (CCH) 1037, T.C. Mem. 2009-9 (Jan. 14, 2009), *rev'd*, 600 F.3d 121 (2d Cir. 2010). The taxpayer, a kitchen tool manufacturing company, licensed the rights to use well-known trademarks in connection with some of the kitchen tools it produced and sold, agreeing to pay royalties to licensors based on a percentage of net sales of the tools bearing the licensors' trademarks. *Robinson Knife*, 600 F.3d at 123. The taxpayer deducted the royalty payments as ordinary and necessary business expenses. *Id.* at 124. The IRS determined that the royalties paid should be capitalized as indirect costs allocable to products (kitchen tools) produced. *Id.*

build up the value of their own marks and those taxpayers who spend money to license already-valuable marks achieves fairness—an important goal of tax policy.[273]

Although expensing is permitted for usual brand advertising, there is an important exception. A taxpayer must capitalize the cost of tangible assets associated with advertising; specifically, "expenditures for billboards, signs, and other tangible assets associated with advertising remain subject to the usual rules with respect to capitalization."[274] By creating a tax distinction between the cost of intangibles associated with brand advertising (expensed) and the cost of tangible assets associated with brand

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The Second Circuit ruled in favor of the taxpayer. *Id.* at 122–23. Although the Second Circuit rejected the taxpayer's argument that the royalty payments were deductible as marketing, selling, advertising, or distribution costs, it was persuaded by the taxpayer's argument that the royalty payments were not "properly allocable to property produced" within the meaning of Treas. Reg. § 1.263A-1(e): "We hold that where, as here, a producer's royalty payments (1) are calculated as a percentage of sales revenue from inventory and (2) are incurred only upon the sale of that inventory, they are immediately deductible as a matter of law because they are not 'properly allocable to property produced.'" *Robinson Knife*, 600 F.3d at 122–23. After the Second Circuit's decision in *Robinson Knife*, the Treasury Department issued proposed regulations on sales-based royalties. Sales-Based Royalties and Vendor Allowances, 75 Fed. Reg. 78,940, 78,940–44 (Dec. 17, 2010) (to be codified at 26 C.F.R. pt. 1). The proposed regulations provide a taxpayer-favorable result similar to that reached by the Second Circuit. Technically, the proposed regulations provide that sales-based royalties may be capitalizable to property produced by a taxpayer. Prop. Treas. Reg. § 1.263A-1(e)(3)(i)(A), 75 Fed. Reg. 78,940, 78,943 (Dec. 17, 2010). The proposed regulations also provide a broad relief provision that such royalties required to be capitalized are allocable only to costs of goods sold (and not ending inventory). Prop. Treas. Reg. § 1.263A-1(e)(3)(ii)(U)(2), 75 Fed. Reg. 78,940, 78,943 (Dec. 17, 2010). So, although the regulations do not say that sales-based royalty costs are inherently non-capitalizable, they do provide that otherwise capitalizable sales-based royalties are properly allocable to property sold during the year. In short, the proposed regulations achieve a similar result to that produced in *Robinson Knife*. Most taxpayers will not have to capitalize their sales-based royalties into ending inventory.

[273] *See* Xuan-Thao Nguyen & Jeffrey A. Maine, *Equity and Efficiency in Intellectual Property Taxation*, 76 BROOK. L. REV. 1, 3–4 (2010) ("[T]ax fairness . . . is usually described in terms of horizontal equity. Horizontal equity requires that persons who are similarly situated should be taxed in a similar fashion. A related concept of equity is that economically equivalent activities should be taxed in the same manner even if they differ in form. Horizontal equity was once considered the primary goal of tax policy, and even if no longer held in quite this same regard, it nonetheless remains an important principle of tax theory.").

[274] RJR Nabisco, Inc. v. Comm'r, 76 T.C.M. (CCH) 71, 83 (1995). Final Treasury Regulations issued in 2013 dealing with the capitalization of tangible assets confirm this result. Treas. Reg. § 1.263(a)-2(d)(1).

advertising (capitalized), tax considerations potentially distort a taxpayer's brand strategy. Tax rules should embrace the principle of efficiency and minimize the social costs of taxation.[275] Specifically, tax rules for branding expenditures should be neutral—they should not interfere with a taxpayer's economic behavior and should avoid deadweight losses caused by restructuring of branding activities to minimize taxes.[276] Over the past half century, the principle of neutrality has lost ground to what might be termed "social engineering," and there now exist many tax rules in place that deliberately attempt to drive economic decisionmaking.[277] It is questionable, however, whether neutrality violations in the branding context represent sound tax policy. For example, why should a business be permitted to deduct the cost of Facebook advertising or television advertising, but not the cost of an advertising sign or billboard? Does the former achieve a more important social engineering policy or advance the public interest more so than the latter? Such a tax distinction is also difficult to reconcile because intellectual property produced

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[275] "[A] criterion of sound tax policy—efficiency—has been measured by contradictory standards and means various things in various contexts." Nguyen & Maine, *supra* note 273, at 5. Efficiency can be viewed as a utilitarian concept that seeks a balance between maximizing tax revenues and minimizing the social costs of taxation. *See* Herman P. Ayayo, *Tax Expenditures: Useful Economic Concept or Budgetary Dinosaur?*, 93 TAX NOTES 1152, 1153 (2001) (describing tax policies that "spend[ ] much less on a per capita basis" as sufficient); Edward A. Zelinsky, *Efficiency and Income Taxes: The Rehabilitation of Tax Incentives*, 64 TEX. L. REV. 973, 978–1012 (1986) (describing the impact of tax incentives under different definitions of efficiency); Eric M. Zolt, *The Uneasy Case for Uniform Taxation*, 16 VA. TAX REV. 39, 63 (1996) (describing three forms of taxes that create distortions and stating that "[e]fficient taxes distort as little as possible").

[276] *See* MICHAEL J. GRAETZ & DEBORAH H. SCHENK, FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 29 (6th ed. 2009) (stating that efficiency requires that a tax interfere as little as possible with people's economic behavior); David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y REV. 43, 47 (2006) (stating that efficient taxes minimize deadweight losses caused by taxpayer actions to reduce tax burdens by choosing courses of action that minimize tax).

[277] Many of the special tax provisions governing patents and copyrights, for example, were a deliberate attempt to support the social-utility mandate of patent and copyright laws. Xuan-Thao Nguyen & Jeffrey A. Maine, *The History of Intellectual Property Taxation: Promoting Innovation and Other Intellectual Property Goals?*, 64 SMU L. REV. 795, 831 (2011). Tax expenditures in the form of deductions and credit for certain research and development, and short write-off periods for certain intellectual property acquisitions, were deliberately designed to drive economic decisionmaking to achieve more important intellectual property social policies. *Id.* at 831–33.

from ordinary brand advertising (copyrights, trade dress, trademarks) generally depends on tangible forms for their creative existence.

2. *Capitalizing Unusual Advertising Expenditures.* Although sound policy arguments can be made for expensing ordinary brand advertising expenditures, arguments can be made for capitalizing advertising campaign expenditures (specifically, costs of graphic designs and package designs). Historically, advertising campaign costs were charged to capital accounts, but as a result of a significant, unexplained change in tax policy in 2004, they are now expensed.[278] We believe this policy shift was inappropriate and that no circumstances justify divergence from the norm when it comes to campaign costs.[279] We argue below that ordinary brand advertising expenses should be equated with deductible repairs to tangible property, whereas advertising campaign expenditures should be equated with capitalized improvements to tangible property. Such a standard would be superior to historic standards that were used in distinguishing between deductible and nondeductible advertising.

Much of the historic uncertainty over the proper tax treatment of package design costs resulted from a lack of clarity over the proper standard to apply. In *Commissioner v. Lincoln Savings & Loan Ass'n*, the Supreme Court concluded that an expenditure that serves to create or enhance a separate and distinct asset must be capitalized.[280] Later in *INDOPCO, Inc. v. Commissioner*, the Supreme Court minimized the importance of the separate-and-

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[278] *See supra* notes 168–73 and accompanying text. Before final regulations were issued in 2004, the IRS took the position that the costs of creating a package design must be capitalized, because package designs do not have ascertainable useful lives. Rev. Proc. 2002-9, 2002-3 C.B. 327 (§ 3.01); Rev. Proc. 97-35, 1997-2 C.B. 448 (§ 5); Rev. Rul. 89-23, 1989-1 C.B. 85 (1989).

[279] Professor Johnson has argued for the capitalization of package design costs. *See* Johnson, *supra* note 258, at 1127 ("Package design costs are not meritorious enough to be subsidized by the tax system by way of expensing or with an artificially short life."). Professor Johnson states that product design costs are capitalized, and that "no viable distinction can be made between good design for the product being sold and good design for the package it comes in." *Id.* We do not understand Professor Johnson's rationale, as product design costs may be expensed under section 174 of the Code. Nevertheless, we agree with his conclusion and adopt an alternative rationale for capitalization.

[280] 403 U.S. 345, 354 (1971); *see also supra* notes 122–23.

distinct-asset test of *Lincoln Savings* and adopted a broad future benefits standard for capitalization.[281] But, final regulations providing comprehensive rules for capitalization of intangibles effectively repealed the significant future benefits standard of *INDOPCO* and revived the separate-and-distinct asset test of *Lincoln Savings*.[282]

The current intangibles regulations allow package design costs to be expensed rather than capitalized; specifically, they provide that a package design is *not* a separate and distinct asset, the cost of which must be capitalized.[283] The regulation adopted the result in *RJR Nabisco, Inc. v. Commissioner*.[284] In *RJR Nabisco*, an important trade dress and copyright development case, the Tax Court did not accept that there existed a distinction between the benefits of advertising campaign expenditures and advertising execution expenditures to justify differing tax treatment.[285] The government argued that advertising campaign expenditures provide long-term benefits, whereas advertising execution expenditures give rise to short-term benefits; thus, the former should be capitalized, while the latter may be expensed.[286] But the court did not accept the long-term, short-term distinction and instead found that trade dress is a product of both advertising campaign and execution expenditures.[287] The court then concluded that the long-term benefit associated with trade dress must be a benefit traditionally associated with ordinary business advertising and cannot serve as a basis to require capitalization of advertising campaign expenditures.[288]

The court's reasoning in *RJR Nabisco* is fundamentally flawed. It is indeed strange to conclude that advertising campaign expenditures (which historically have been charged to capital accounts) should be expensed on the basis that advertising execution expenditures (which historically have been deductible)

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281 503 U.S. 79, 86–90; *see also supra* note 124 and accompanying text.

282 *See supra* notes 169–73 and accompanying text.

283 Treas. Reg. § 1.263(a)-4(b)(3)(v).

284 76 T.C.M. (CCH) 71 (1998).

285 *Id.* at 84–85.

286 *Id.* at 83.

287 *Id.* at 84.

288 *Id.*

produce some of the same benefits as the campaign expenditures. This would be tantamount to arguing that the cost of replacing a leaking roof should be expensed on the basis that a repair of some shingles on the roof (appropriately expensed under current law) would produce the same benefit—fixing the leak.

Neither standard—the future benefits approach under *INDOPCO* or the separate-and-distinct asset test in *Lincoln Savings* and the current intangibles regulations—truly provides the certainty and clarity necessary for distinguishing between deductible and non-deductible advertising expenditures. As noted in *RJR Nabisco*, both advertising campaign expenditures and advertising execution expenditures contribute to trade dress—a separate and distinct asset by most non-tax law definitions of property.[289] Trade dress is the packaging of a product or service, the overall image, or total look and feel of a product or service.[290] Trade dress can be the décor and ambience of a restaurant, the packaging designs of cigars, and the look of and feel of a website.[291] Trade dress is entitled to registration with the United States Patent and Trademark Office.[292] Trade dress enjoys all protection accorded trademarks under the Lanham Act.[293] Likewise, both advertising campaign expenditures and advertising execution expenditures produce long-term benefits; indeed, trade dress, a

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[289] The intangibles regulations define a separate and distinct intangible asset as:

> a property interest of ascertainable and measurable value in money's worth that is subject to protection under applicable [s]tate, [f]ederal, or foreign law and the possession and control of which is intrinsically capable of being sold, transferred, or pledged (ignoring any restrictions imposed on assignability) separate and apart from a trade or business.

Treas. Reg. § 1.263(a)-4(b)(3)(i) (2014). Then however, the regulations state that an amount paid to create a package design is not treated as an amount that creates a separate and distinct intangible asset. *Id.* § 1.263(a)-4(b)(3)(v).

[290] *See Trade Dress*, INT'L TRADEMARK ASS'N (Nov. 2015), http://www.inta.org/TrademarkBasics/FactSheets/Pages/Trade-Dress.aspx ("Trade dress is the overall commercial image (look and feel) of a product that indicates or identifies the source of the product and distinguishes it from those of others.").

[291] *See, e.g.*, Two Pesos, Inc. v. Taco Cabana, Inc. 505 U.S. 763, 766–67 (1992) (finding a restaurant's trade dress to be inherently distinctive); *RJR Nabisco*, 76 T.C.M. (CCH) at 73 (finding the packaging for cigarettes to constitute trade dress).

[292] *See Trade Dress*, *supra* note 290 (delineating requirements to register trade dress with the United States Patent and Trademark Office).

[293] *See id.* ("[T]rade dress like a trademark, is protected under the Federal Trademark Act (Lanham Act).").

product of both marketing campaigns and executions thereof, provides long-term benefits over the life of the brand.[294] Thus, neither a "separate asset" test nor a "benefits" test provides a useful framework for tax distinctions involving advertising.

The regulatory rules on tax treatment of repairs and improvements to tangible property present a better framework for determining the appropriate tax treatment of advertising. We believe advertising campaign expenditures to build brand equity can be analogized to costs of improvements to tangible property, which have long been considered capital expenditures.[295]

A business's valuable assets can be broken down into two categories—tangible property and intangible property. The cost to initially acquire tangible or intangible property must be capitalized. For example, the cost to construct or purchase a business building must be capitalized.[296] Likewise, the fees paid to obtain initial registration of a trademark or to purchase another's trademark must be capitalized.[297] After acquisition, a business spends money to maintain and enhance the value of both its tangible and intangible assets. For example, a business regularly spends money to maintain its building to keep it in an efficient operating condition. A business also sometimes spends substantial sums to materially improve its building (e.g., a major renovation or refurbishing of the building). Similarly, a business regularly spends money to advertise its trademark though various materials and techniques. On occasion a business spends substantial sums on marketing campaigns introducing new marketing concepts, themes, imagery, slogans, and the like.

It has long been the rule that expenditures for *repairs and maintenance* to tangible property (incidental repairs that neither materially add to the value of the tangible property nor appreciably prolong its original life, but keep it in an ordinarily

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[294] *See supra* notes 287–88 and accompanying text.

[295] I.R.C. § 263(a) (2012).

[296] Treas. Reg. § 1.263(a)-2(d)(1) (requiring capitalization of amounts paid to acquire or produce "a unit of real or personal property"). Capitalized acquisition costs include related transactions costs such as appraisal fees, commissions, and accounting and legal fees. *Id.* § 1.263(a)-2(f).

[297] *Id.* § 1.263(a)-4(1), Example 9.

efficient operating condition) may be deducted currently.[298] In contrast, expenditures for *improvements* (that add to the value, or substantially prolong the useful life, of tangible property or that adapt property to a new or different use) must be capitalized.[299] As with the problem of distinguishing between deductible and nondeductible advertising, distinguishing between deductible repairs and nondeductible improvements can be difficult under either a separate asset test or future benefits test. Neither repairs nor improvements to tangible property necessarily result in a separate and distinct tangible asset. Both, however, arguably produce benefits for the tangible property extending beyond the current year.

Due to the difficulties of applying a generic separate-and-distinct asset or future benefits test to distinguish deductible repairs from capital improvements, the Treasury Department issued a new regulatory framework in 2013.[300] Generally, amounts paid for repairs and maintenance to tangible property are deducible unless they result in an "improvement" to property.[301] Tangible property is deemed to be improved in three situations: (1) betterments, (2) restorations, and (3) adaptations to new or different uses.[302]

First, expenditures for betterments to tangible property must be capitalized.[303] "Betterments" are changes to the property that are a material addition to the property or are "reasonably expected to materially increase the productivity, efficiency, strength, quality, or output of the unit of property."[304] Second, expenditures for restoration, like expenditures for betterments, must be capitalized.[305] A restoration occurs in a variety of situations but typically involves a major renovation or refurbishing of a tangible

298 *See infra* notes 300–07.

299 *See infra* notes 300–07.

300 Treas. Reg. §§ 1.263(a)-1, -2, -3 (2014); *see also supra* note 268.

301 *See* Treas. Reg. § 1.162-4 ("A taxpayer may deduct amounts paid for repairs and maintenance to tangible property if the amounts paid are not otherwise required to be capitalized.").

302 *Id.* § 1.263(a)-3(d).

303 *Id.* § 1.263(a)-3(j)(1).

304 *Id.* § (j)(1)(iii).

305 *Id.* § 1.263(a)-3(k)(1).

asset.[306] Finally, expenditures that adapt tangible property to a new or different use ("if the adaption is not consistent with the taxpayer's ordinary use . . . at the time originally placed in service by the taxpayer") must also be capitalized.[307]

The new regulatory framework for distinguishing deductible repairs from capital improvements does not look to whether any new asset was created or whether benefits last beyond the current year. Rather, it focuses on the nature of the activities giving rise to the expenditures. This approach is presently used by the government in determining whether research and development expenditures can be expensed under section 174 of the Code.[308] Under the regulations, in determining whether research and development costs can be deducted, the nature of the product being developed is irrelevant; instead, the focus is on the "nature of the activity to which the expenditures relate."[309] Such an approach would be well suited in similarly distinguishing deductible advertising from nondeductible advertising.

A marketing campaign's impact on a company's valuable intangible assets is similar to the impact of capital improvements to a company's tangible property. A marketing campaign does not sell anything, but rather prescribes an intangible marketing concept (usually long-term) characterized by an image, theme, slogan, or message.[310] It can be equated to betterments to tangible property if the advertising campaign is expected to *materially increase the strength of a brand.* Alternatively, an advertising campaign can be equated to a restoration if the campaign is expected to *rejuvenate an existing trademark.* To the extent a campaign *adapts an existing trademark to new products, new times, or new media,* it could be equated to an adaptation to a

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[306] *Id.*

[307] *Id.* § 1.263(a)-3(l)(1).

[308] *Id.* § 1.14-2(a)(l).

[309] *Id.* Deductible research expenses are broadly defined as "expenditures incurred in connection with the taxpayer's trade or business which represent research and development costs in the experimental or laboratory sense." *Id.* The regulations require that such expenditures be incurred in "activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product." *Id.*

[310] *See Marketing Campaign*, INVESTOPEDIA, http://www.investopedia.com/terms/m/marketing-campaign.asp (defining "marketing campaign" as "a coordinated series of steps through different mediums" to "promote a product, service or business").

different use. In any of these scenarios, the campaign expenditures should be capitalized.

Moreover, a marketing campaign enhances the existing trademark's reputation, translating into an increase in the distinctiveness of the trademark in the mind of the consuming public. As public awareness or perception of the trademark rises, the level of protection under trademark law increases. If the trademark attains famous status, the trademark owner can gain a unique, property-like status in the famous trademark.[311] That means the trademark owner can assert action against many new entrants using similar marks, even absent a likelihood of consumer confusion between the famous mark and the new entrant's mark.[312] Essentially, a marketing campaign can lift the status of the trademark to a higher level of protection that is not available to the majority of trademarks.

Later individual executions of a campaign, in contrast, focus more on the sale of a product and typically involve routine changes to advertising materials or techniques to maintain customer interest in the original marketing concept. The taxpayer incurs institutional or goodwill advertising costs to keep its name before consumers. These advertising executions do not resemble betterments, restorations, or adaptations to different use in the regulations governing tangible property and thus should be expensed.

Requiring the capitalization of advertising campaign expenditures (specifically graphic design and package design costs), which resemble improvement costs to tangible property, would go toward reconciling the tax treatment of tangible and intangible assets. This is something the government has attempted to achieve in the past, at least with respect to tax depreciation rules.[313] Capitalization of campaign expenditures

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[311] *See, e.g.*, Xuan-Thao Nguyen, *Fame Law: Requiring Proof of National Fame in Trademark Law*, 33 CARDOZO L. REV. 89, 99–101 (2011) (discussing trademark dilution law and how famous trademarks with national fame obtain property-like protection).

[312] *See id.* at 95 ("The owner of the 'famous' name . . . can enjoy the right to exclude even without proof of likelihood of confusion caused by use of the famous name by others on noncompeting goods.").

[313] At one point in tax history, the rules for depreciating intangible intellectual property assets differed dramatically from the corresponding set of rules for depreciating tangible

would likewise go toward reconciling the tax treatment of brand development with brand enforcement, both of which are necessary under intellectual property law. Such a regime would require capitalization of salaries paid to employees primarily engaged in developing package designs. It would also continue to require the capitalization of fees paid to a governmental agency to obtain or renew a trademark, trade name, copyright, or other similar right granted by that governmental agency.

Under current law, capitalized advertising expenditures would be amortized over fifteen years. As noted earlier, fifteen years seems to be accepted by the government as the appropriate recovery period for intangibles.[314] There is limited empirical data,

assets. Over time, Congress enacted a detailed set of arbitrary depreciation rules for all tangible assets. These Code provisions provided arbitrary conventions and methods for depreciating costs of tangible assets, and more importantly, they provided artificially low recovery periods (e.g., three, five, and seven years) for many tangible assets that arguably have longer useful lives. I.R.C. §§ 167–168 (2012). This disparate treatment between intellectual property assets and tangible assets created distortions that were unfair to taxpayers. *See* Walburn, *supra* note 140, at 454–56 (explaining that the inequity between similarly situated taxpayers resulted in noncompliance and much litigation, which unnecessarily burdened the administration of tax law). For example, taxpayers who acquired businesses with mostly tangible assets fared better than taxpayers who acquired businesses with mostly intangible assets. This problem worsened as more and more valuable business assets took the form of intangible assets. *See Tax Treatment of Intangible Assets: Hearing Before the Comm. on Ways & Means*, 102d Cong. 23 (1991) (Statement of Hon. Guy Vander Jagt) ("Taxpayers now spending considerable efforts and costs to prepare detailed appraisals solely for the sake of distinguishing between intangible assets that are amortizable as compared with those that are nonamortaizable. . . . [E]ven greater expenses are incurred when the I.R.S. challenges the treatment of these assets on audit and through litigation."); *id.* at 30 (Statement of Hon. Kenneth W. Gideon, Assistant Sec'y for Tax Policy, Dep't of Treasury) (describing the rise of intangible assets in the market and the consequent necessity of a law that provides certainty on the taxation of such assets). Seeking to mitigate these distortions, many saw the need to reconcile the treatment of acquired intangible assets with the treatment of acquired tangible assets. *See* DAVID W. BRAZELL ET AL., OFFICE OF TAX ANALYSIS, A HISTORY OF FEDERAL TAX DEPRECIATION POLICY 4, 12 (1989), http://www.treasury.gov/resource-center/tax-policy/tax-analysis/documents/ota64.pdf (explaining that "the first income tax regulations denied depreciation allowances for goodwill . . . and other intangibles"). In 1993, Congress responded with section 197, which prescribes an arbitrary fifteen-year recovery period for many intangibles. *See* LaFrance, *supra* note 139, at 320 ("Congress enacted Section 197 in order to simplify the rules for depreciating intangibles and to reduce the number of controversies arising from the need to determine which intangibles are depreciable . . . . The statute achieves these goals by imposing the fifteen-year straight-line method on most acquired intangibles.").

[314] *See supra* notes 143–44 and accompanying text.

however, suggesting that the life of a brand is much less, and therefore, a shorter recovery may be justified.[315]

B. IDENTIFYING AN APPROPRIATE TAX FRAMEWORK FOR BRAND ENFORCEMENT EXPENDITURES

As described earlier in this Article, litigation costs in patent and copyright infringement cases are deductible; however, attorney's fees and other litigation costs paid in connection with trademark infringement claims are generally capitalized.[316] Although it would be appealing from a tax advantage to view copyright, patent, and trademark infringement actions generically, such treatment would "ignore[ ] the actual inherent differences and purposes of the various rights and remedies involved."[317] While copyright and patent infringement claims are brought for the purpose of protecting royalties previously derived as well as those to be derived in the future, trademark infringement claims are brought for the principal purpose of removing the infringing threat to a trademark, securing the property right of the taxpayer in the trademark, eliminating future infringement, and increasing the value of the taxpayer's trademark. One court's view of trademark infringement suits was as follows:

> The purpose and effect of the [trademark litigation] expenses . . . was to increase the value of taxpayer's registered trademark and to make more secure

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[315] *See* ORG. FOR ECON. CO-OPERATION & DEV., NEW SOURCES OF GROWTH: KNOWLEDGE-BASED CAPITAL 14 (2013), http://www.oecd.org/sfi/inno/knowledge-based-capital-synthesis.pdf (noting the productive life of branding is 2.8 years). The appropriate amortization period for capitalized advertising costs is beyond the scope of this Article.

[316] *See supra* notes 195–204 and accompanying text. Tax symmetry dictates that the awards and settlements in such suits be treated differently for tax purposes. Indeed, it is generally held that awards and settlements in patent and copyright infringement suits are taxed as ordinary income. *See, e.g.*, Big Four Indus., Inc. v. Comm'r, 40 T.C. 1055, 1060 (1963) (finding that award in patent infringement litigation is taxable as ordinary income); Mathey v. Comm'r, 177 F.2d 259, 263 (1st Cir. 1949) ("[A]n award of damages is ordinarily . . . taxable to him as income in the ear received."). In contrast, awards and settlements in trademark infringement suits are received tax free if the basis of the claims lies in the trademark. *See, e.g.*, Inco Electroenergy Corp. v. Comm'r, 54 T.C.M. (CCH) 359 (1987) (finding settlement proceeds obtained in trademark litigation are taxable as capital gains).

[317] I.R.S. Field Serv. Adv. 199925012, 1999 WL 42489, at *3 (June 25, 1999).

> taxpayer's property in it by forever eliminating the possibility of having it impaired by the competitive use of this confusingly similar mark. Thus, though the complaint for infringement as originally drawn included a plea for damages, taxpayer's expenses did not finance legal activity which recovered for petitioner lost income or preserved its right to retain income earned. The financial gain which petitioner realized from these legal proceedings, through the enhancement of the value of its registered trademark, is an increment of a sort which will endure for many years to come . . . . Financing the removal of a threat to a trademark posed by an infringing mark resembles the cost of perfecting or preserving title to property, a cost well established as a capital expenditure, much more than it resembles a current business expense.[318]

Tax law generally does not place weight on the form of litigation. For example, as noted above an infringement claim for one type of intellectual property (patent or copyright) is not necessarily treated the same for tax purposes as an infringement claim for a different kind (trademark). Tax law instead relies on the substance of the litigation, and for that, the plaintiff's primary motivation in a particular claim (recover profits versus enhance value or defend property) is crucial.[319] This harkens back to the judicially-crafted "substance over form" doctrine in tax jurisprudence—the substance of a transaction will prevail over its form.[320]

There is one exception, however, in which case law has arguably elevated form over substance. In trademark litigation, the trademark owner asserts both trademark infringement and unfair competition claims. While it is generally settled that

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[318] Danskin, Inc. v. Comm'r, 331 F.2d 360, 361 (2d Cir. 1964) (citations omitted).

[319] *See supra* notes 184–85 and accompanying text (describing the "origin-of-claim" test, developed originally to determine whether costs of litigation were business-related or personal, and later adapted to determine if litigation costs are deductible).

[320] *See, e.g.*, Gregory v. Helvering, 293 U.S. 465, 469–70 (1935) (finding that a corporation created only to transfer corporate shares to the petitioner "immediately was put to death" once that purpose was realized).

litigation costs in connection with a trademark infringement claim must be capitalized, at least one case permitted current expensing of litigation costs in connection with an unfair competition claim on the basis that an unfair competition claim has its origin in recovery of profits.[321] In *Rust-Oleum Corp. v. United States*, discussed earlier, it was reasoned that the primary purpose of a trademark infringement claim is to "secure a judicial determination that the plaintiff had property rights in the mark," but the primary purpose of an unfair competition count is to "secure money damages for alleged unfair competition, passing off, etc."[322] This tax distinction is questionable.

Trademark infringement claims arise under section 32 of the Lanham Act and are available for registered trademarks.[323] Unfair competition claims arise under section 43(a) of the Lanham Act and are available to both unregistered and registered trademarks.[324] Although a plaintiff must have a federally registered mark to bring a section 32 trademark infringement claim,[325] the two claims are closely related.[326] The same standard for determining whether a trademark is valid and entitled to protection applies to both claims.[327] The same standard for establishing infringement—likelihood of consumer confusion—applies to both claims: "[I]n either a claim of trademark infringement under § 32 or a claim of unfair competition under § 43, a prima facie case is made out by showing the use of one's

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[321] Rust-Oleum Corp. v. United States, 280 F. Supp. 796 (N.D. Ill. 1967); *see also supra* notes 220–36 and accompanying text.

[322] *Rust-Oleum*, 280 F. Supp. at 801.

[323] 15 U.S.C. § 1114 (2012).

[324] *Id.* § 1125(a).

[325] *Id.* § 1114(1).

[326] Claims of trademark infringement and unfair competition "are subject to the same test." Jada Toys, Inc. v. Mattel, Inc., 518 F.3d 628, 632 (9th Cir. 2008); Century 21 Real Estate Corp. v. Sandlin, 846 F.2d 1175, 1178 (9th Cir. 1988) ("The 'ultimate' test for unfair competition is exactly the same as for trademark infringement: whether the public is likely to be deceived or confused by the similarity of the marks." (citations omitted) (internal quotation marks omitted)).

[327] *See* Two Pesos, Inc. v. Taco Cabana, Inc., 505 U.S. 763, 768 (1992) ("[I]t is common ground that § 43(a) protects qualifying unregistered trademarks and that the general principles qualifying a mark for registration under § 2 of the Lanham Act are for the most part applicable in determining whether an unregistered mark is entitled to protection under § 43(a).").

trademark by another in a way that is likely to confuse consumers as to the source of the product."[328] Most courts analyze the likelihood-of-consumer confusion test and apply the same conclusion to both claims.[329] Typically, the court extends its finding in one claim to the other claim without wasting time and judicial resources in repeating its finding. With respect to remedies, both claims offer similar relief, including injunction and damages.[330] After all, as courts have long observed, "the law of trademark infringement is but a part of the law of unfair competition, and the same test is applied in determining each claim."[331]

In light of the similarities between the two claims, litigation costs in trademark infringement suits should be treated the same—capitalized. Such approach would not elevate form over substance, but instead would recognize that the primary purpose of the trademark plaintiff is to establish the plaintiff's trademark and not to recover income, as in the case of patent and copyright infringement suits. Such approach would also avoid arbitrary apportionments of expenses between deductible and nondeductible expenditures that would be required if trademark infringement

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[328] Lois Sportswear, U.S.A., Inc. v. Levi Strauss & Co., 799 F.2d 867, 871 (2d Cir. 1986).

[329] *See* Audi AG v. D'Amato, 469 F.3d 534, 542 (6th Cir. 2006) ("Under the Lanham Act, . . . we use the same test to decide whether there has been trademark infringement, unfair competition, or false designation of origin: the likelihood of confusion between the two marks."); *see also* Fisons Horticulture, Inc. v. Vigoro Indus. Inc., 30 F.3d 466, 472–73 (3d Cir. 1994) (explaining the similar tests used to establish common law and federal trademark law and unfair competition claims.

[330] 15 U.S.C. § 1117(a) (2012) ("When a violation of any right of the registrant of a mark registered in the Patent and Trademark Office . . . shall have been established in any civil action arising under this chapter, the plaintiff shall be entitled, . . . subject to the principles of equity, to recover (1) defendant's profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action. . . . In assessing damages the court may enter judgment, according to the circumstances of the case, for any sum above the amount found as actual damages, not exceeding three times such amount. If the court shall find that the amount of the recovery based on profits is either inadequate or excessive the court may in its discretion enter judgment for such sum as the court shall find to be just, according to the circumstances of the case. Such sum in either of the above circumstances shall constitute compensation and not a penalty. The court in exceptional cases may award reasonable attorney fees to the prevailing party.").

[331] Am. Footwear Corp. v. Gen. Footwear Co., 609 F.2d 655, 664 (2d Cir. 1979) (citing Hanover Star Milling Co. v. Metcalf, 240 U.S. 403, 413 (1916)).

claims and unfair competition claims were treated differently for tax purposes.[332]

VII. CONCLUSION

Brand advertising and enforcement represent a significant investment by most firms. Yet, surprisingly, little scholarship is devoted to the ideal tax regime that should govern investments in both brand building and brand enforcement. Current tax rules governing branding evolved in the absence of an appropriate legal framework. The result is a regime with incoherent tax distinctions that lack theoretical justification, suggesting that legislative or administrative changes are warranted. This Article concludes that the current tax treatment of ordinary brand advertising (expensing) serves legitimate goals—expensing stimulates economic growth, furthers administrative efficiency, and creates an even playing field between businesses that advertise their own brands and businesses that choose instead to license from others the right to use well-known trademarks. However, current tax treatment of advertising campaigns (expensing) is fundamentally flawed: campaign expenditures, which strengthen, restore, or elevate the brand, should be analogized to costs of improvements to tangible property, which have long been considered nondeductible capital expenditures. This Article also concludes that the current tax distinction between trademark infringement claims and unfair competition claims is unjustified. If substance is to prevail in tax jurisprudence, litigation costs incurred in unfair competition claims should be capitalized to reflect that both claims are brought primarily to establish a taxpayer's trademark and not to recover income.

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[332] In *Rust-Oleum*, the court merely split the litigation costs fifty-fifty between those attributable to the trademark infringement count (not deductible) and those attributable to the unfair competition count (deductible). 280 F. Supp. 796, 801 (N.D. Ill. 1967) ("[T]he proper determination of the instant controversy is to divide the expenses . . . including those incident to the surveys, equally between those properly deductible and those not so deductible.").