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Blaneys on Business

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This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Corporate/Commercial group, Alex Mesbur at 416.593.3949 or amesbur@blaney.com.

NEW TAX RULES ON RESTRICTIVE COVENANTS – YOU WOULD BE ADVISED TO PLAY BY THEM NOW EVEN THOUGH THEY ARE NOT YET LAW

Paul L. Schnier

Changes to the *Income Tax Act* concerning taxes owed on payments made to people in lieu of them competing with, or soliciting the clients or employees of, businesses with which they were formerly associated, have been waiting in the wings for almost three years.

It is not clear when these changes will become law. What is clear, however, is that they will become law and, once that happens, they will be applied, retroactively, to the date that they were first introduced – October 7, 2003.

That means businesses would be well advised to be operating now as though the new rules were already in force.

One of the reasons that these new rules are looming – and that our tax laws generally are constantly changing – is that the *Canada Revenue Agency* (CRA) seems to be forever moving to close so-called loopholes in the *Income Tax Act*. These "loopholes" are not actually embedded in the statute. Rather, they are created by court rulings that disagree with the CRA's interpretation of the specific provisions of the Act. Whenever things do not go its way, the CRA treats us to a stream of new legislation to deal with the perceived "abuse".

One such problem is in the area of restrictive covenants, which generally encompass payments to individuals not to compete with, or not to solicit the clients or employees of, businesses with which they were formerly associated. The courts have ruled that such payments are not subject to tax. This has not corresponded with the CRA's view of the world and therefore, according to the CRA, the rules have needed to be changed.

Under proposed legislation, where an individual or a corporation receives a payment in respect of a restrictive covenant, the amount will be included in the recipient's income and, generally, the payer will be allowed to deduct it when he calculates his tax owing. There are three exceptions to this rule, all of which apply only in circumstances in which the payer and recipient are dealing at arm's length (and therefore not being seen to serve any vested interest):

1. the payment is already included in the recipient's income as salary or fees;
2. the payment relates to the sale of a business carried on by the recipient and both the payer and the recipient elect to treat the payment as additional proceeds for the sale of the goodwill of that business, or

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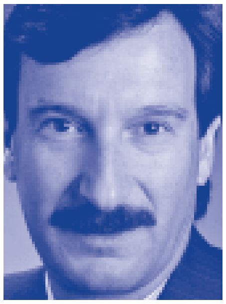

Paul L. Schnier chairs Blaney McMurtry's tax group. He restricts his practice to income tax law with emphasis on tax planning and implementation and advising as to the tax consequences of proposed transactions. He has advised a variety of public and private corporations on numerous domestic and international undertakings.

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3. the payer and recipient elect to treat the payment as additional proceeds for the disposition of shares of a corporation or an interest in a partnership that carries on the business.

Under the first exception, where the payment is already included in the recipient's income, the payment is treated fully as income and taxed at the applicable rate.

Under the second exception, where the payment is linked to the sale of goodwill, the payment is treated as business income but only one-half of it is taxable (corresponding with the rates related to goodwill).

Under the third exception, the payment is treated as a capital gain and taxed at the capital gains rate.

Under both exceptions 2 and 3, the payer and the recipient must file, as part of their tax returns, a joint election with the CRA and a copy of the restrictive covenant.

The new rules also contain a provision that allows the CRA to allocate a portion of the proceeds of a sale of shares or assets to a restrictive covenant where one has been granted as part of the transaction. However, the parties to the transaction may jointly file an election to avoid the application of this rule and therefore avoid paying full tax on that portion.

To underscore key points made at the outset, although the new rules are not yet law, when the legislation is passed it will have effect from the date that it was introduced – October 7, 2003. There is a brief transitional period for agreements that were in place as of that date but, that aside, we are operating under the system now even though the legislation has not yet been passed.

Once again, it is crucial that buyers and sellers of businesses be aware of this complex legislation before any deal is concluded. ■

LESSONS IN BRAND PROTECTION – THE SUPREME COURT OF CANADA SPEAKS ON FAMOUS TRADE-MARKS

Mala Joshi

If your business owns and regularly uses a famous registered trademark, is it absolutely protected from some other business using a similar mark?

Apparently not, according to recent Supreme Court of Canada decisions in two companion cases (*Mattel, Inc. v. 3894207 Canada Inc.,* and *Veuve Clicquot Ponsardin v. Boutiques Cliquot Ltée.,*) where the scope of protection accorded to famous marks was considered.

Mattel owns the BARBIE trade-mark for dolls and Veuve Clicquot owns the VEUVE CLICQUOT trade-mark for champagne. Mattel sued a Montreal-area restaurant named BARBIE'S and VEUVE CLICQUOT sued the owner of a small chain of mid-priced women's retail clothing stores, operating under the names CLIQUOT and LES BOUTIQUES CLIQUOT, for trade-mark infringement.

In both cases, it was argued that the famous marks were so well known that there was a likelihood that there would be confusion in the marketplace , even though there was no "connection" between the products for which the famous marks were registered and the products and services of the local businesses.

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Mala Joshi has just joined Blaneys' Corporate/Commercial and Intellectual Property Practice Groups and we are pleased to welcome her to the firm. Her practice is focused on intellectual property law including patented medicines litigation, trade-marks, access to information, product liability, internet name disputes and patent validity and infringement matters. Called to the Ontario Bar in 2004 after graduating from Dalhousie Law School and Queen's University (Life Science), Mala is a registered trade-mark agent in Canada.

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The Supreme Court held, however, that Mattel and Veuve Clicquot did not have the blanket right to prevent the use of their famous names. There had to be some connection between their marks and the nature of the goods and services being offered by the other businesses.

In *Mattel*, the Supreme Court upheld the decision of the lower courts to allow the restaurant to register the name BARBIE'S and related design in association with restaurant services, take-out services, catering and banquet services. Although it was acknowledged that BARBIE is a famous mark in relation to dolls and doll accessories, the Court held that it was not likely to be confusing to the average consumer in the circumstances.

In *Veuve Clicquot*, the Supreme Court found that there was no evidence to suggest that the famous mark would be associated by ordinary consumers with mid-priced women's clothing. According to the Supreme Court, the two businesses were "as different as chalk and cheese".

The Court said that in order to determine whether confusion is likely, regard must be had to (a) the inherent distinctiveness of the trade-marks or trade-names and the extent to which they have become known (b) length of time the trade-marks and trade-names have been in use (c) nature of the wares, services, or business (d) nature of the channels of trade (e) degree of resemblance between the trade-marks or trade-names in appearance or sound or in the ideas suggested by them and (f) other surrounding circumstances, including fame and lack of evidence of actual confusion.

The *Veuve Clicquot* decision also went on to consider the likelihood that the clothing stores' use of the name CLIQUOT would depreciate the value of goodwill in the champagne-maker's name. The Supreme Court set out four elements to be satisfied in order to prove depreciation of goodwill:

First, the registered trade-mark must be used by the defendant in connection with wares or services. Second, the registered trade-mark must be sufficiently well-known such that it has significant goodwill attached to it. Third, the mark must have been used by the defendant in a manner that was likely to have an effect upon that goodwill, and fourth, the likely effect would be to cause damage to the value of the registered trade-mark owner's goodwill. In order to establish damage to goodwill the registered owner must establish that the use complained of either (1) disparages or tarnishes the image of the registered mark, (2) "blurs" the brand image associated with the registered mark or (3) diminishes the power of the registered mark to distinguish the owner's products or services. The Supreme Court held that Veuve Clicquot failed to establish in its evidence these necessary elements.

Despite the direction of the apparently fact-specific *Mattel* and *Veuve Clicquot* decisions, owners of famous trade-marks can glean some hope from the cases, which appear at first blush to favour the adoption by smaller businesses of the registered marks for different products or services. Where there *is* a connection or association between the wares and services of two marks, having a famous mark makes it easier to establish confusion. However, where there is no such connection, exceptional circumstances would be necessary to establish confusion.

Pragmatically, owners of famous marks should show some evidence of a *likelihood* of confusion.

"If you are in the process of selecting a new trade-mark, take care to look beyond mere differences in wares and services to ensure that your proposed mark does not encroach upon any well known or famous marks."

In the *Mattel* decision, counsel sought to introduce survey evidence but the lower courts held it inadmissible because it was directed to the mere possibility, rather than a probability, of confusion.

The *Mattel* and *Veuve Clicquot* decisions, then, have left the door open for the fame of a mark to be but only one of several considerations in assessing whether trade-marks are confusing. Only in exceptional circumstances will fame extend the aura of a trade-mark as broadly as these two companies desired. It is therefore important for businesses to take both a defensive and offensive strategy when protecting their valuable trade-marks and to realize that no one strategy fits all. Given the emphasis placed by the Supreme Court on the importance of evidence in assessing confusion, trade-mark owners should consider the following:

- If you own a famous trade-mark, assess whether it would be given a broad aura of protection. Fame will provide broader protection when considering the degree of resemblance between marks for the *same* goods or services. However, without evidence of confusion, it is likely that the protection of a trade-mark will extend well beyond its related goods or services only in extreme circumstances. Accordingly you could consider strategies to extend the nature of the products and services to which your mark has some connection. You should maintain a library of all efforts regarding cross-promotions and licensing so that evidence of the connection between the registered mark with unrelated goods and services can be provided. When licensing the right to use your mark, make sure the registration is amended to encompass the licensed products or services. When considering the use of survey evidence to establish confusion, make sure the survey results address the *probability* of confusion not just the possibility.
- If you are using a trade-mark that is similar to a well known trade-mark, registration of your mark in association with your products or services may be a defence to any future action by the owner of the well known mark. If the mark is a coined word, do you have your own rationale for adopting it that is not connected to the use of the well known mark?
- If you are in the process of selecting a new trade-mark, take care to look beyond mere differences in wares and services to ensure that your proposed mark does not encroach upon any well known or famous marks.

We encourage all companies to be pro-active and review how they use and promote their brands. By assessing the potential for the brand to be adopted by others for non-competitive businesses, strategies may be developed to protect your mark and avoid the potential for the loss of the opportunity to use the brand for an expanded scope of products or services or for cross-promotions or licensing. ■

Blaneys on Business is a publication of the Business Law Department of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

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