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IRS Strikes Down Private Annuity Trusts

Paul Chmielewski, Esq., LL.M

In recent years, the private annuity trust was advertised as “the way” to sell assets that were subject to substantial capital gains tax. A typical private annuity trust transaction involves a parent selling appreciated property to an irrevocable trust created for the benefit of the parent’s children in exchange for the trust’s promise to pay the parent a stream of deferred annuity payments for life. The trust then sells the property to an unrelated third party and uses the proceeds to fund a commercial deferred annuity that can be used to pay the annuity payments owed to the parent.

Promoters claimed that the transfer of the property to the trust did not result in taxation until the commencement of annuity payments. Even then, taxes would be stretched over a period of years. Furthermore, promoters claimed that the sale of the property from the trust to the unrelated third party did not result in any tax because the sales price equaled the amount of the trust’s tax basis in the property (i.e., the amount the trust paid for the property). Finally, promoters stated that the parent could defer distributions from the trust until age 70½. Of course, the promoters also cited the fact that the property would not be included in the parent’s estate at death.

For several years, we have counseled clients that promoters of private annuity trusts were mistaken in their interpretation of the law governing private annuity trusts. As a result, we have never recommended their use. Regardless, we have heard of advisors that were generating in excess of \$50 million per year in commercial annuity sales as a result of recommending the use of private annuity trusts. It appears that the IRS finally tired of the abuses associated with private annuity trusts. The IRS recently issued proposed regulations that make it clear that the advertised tax benefits of private annuity trusts violate the tax laws. The proposed regulations became effective on October 18, 2006, for most private annuity transactions. Feel free to contact our office for guidance if you have a private annuity trust and are unsure of what you should do in light of the proposed regulations.

Intellectual Property: Patents, Trademarks, Copyrights and Trade Secrets

R. Garth Ferrell, Esq.

Some people confuse patents, copyrights, trademarks and trade secrets. Although there are similarities among these kinds of intellectual property protection, they are different and serve different purposes.

What is a Patent? A patent for an invention is the grant of the property right to the inventor, issued by the Patent and Trademark Office (“PTO”) typically for a twenty-year term from the date on which the application for the patent was filed in the United States. The U.S. patent grants are effective only within the United States, its

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territories and possessions. The patent grant gives the inventor the right to “exclude others from making, using, offering for sale, or selling” the invention in the United States, or “importing” invention into the United States.

What is a trademark or service mark? A trademark is a word, name, symbol or device which is used in commerce with goods to indicate the source of the goods and distinguish those goods from the goods of others. A service mark **TM** is the same as a trademark except that it identifies and distinguishes the source of a service, rather than a product.

Trademark rights may be used to prevent others from using a confusingly similar mark but not to prevent others from making the same goods or from selling the same goods or services under a clearly different mark. The effect of trademarks is often limited only to the specific area of commerce in which the mark is used. Trademarks are also classified for convenience into categories, such as “arbitrary and fanciful” and “suggestive.” Arbitrary and fanciful mark are marks like XEROX® which has only gained meaning through its use as a trademark. Suggestive marks include marks such as ACCU RIDE® which could mean one of many types of goods, but is a mark used in connection with furniture drawer hardware. Generic terms, such as SALT, cannot act as a trademark. Suggestive terms and surnames fit into a separate type of trademark class which at first cannot function as a registered trademark, but later, through extensive use and advertising may acquire “distinctiveness” that allows greater rights in that mark. Surnames cannot be initially registered with the PTO for example, but must be shown through use and advertising to have acquired distinctiveness in connection with the products or services.

What is a copyright? A copyright is a form of protection provided to the authors of “original works of authorship” including literary, dramatic, musical, artistic and certain other intellectual works, both published and unpublished. The 1976 Copyright Act generally gives the owner of copyright the exclusive right to reproduce the copyrighted work, to prepare derivative works, to distribute copies of a copyrighted work, to perform the copyrighted work publicly, or to display the copyrighted work publicly. The copyright laws protect the form of expression rather than the subject matter of the writing. For example, a description of a machine could be copyrighted but this would only prevent others from copying the written description; it would not prevent others from writing a description of their own or from making and using the machine. Copyrights are registered by the Copyright Office of the Library of Congress.

What is a trade secret? Trade secret law is governed by state law. In Colorado, trade secrets are governed by C.R.S. § 7-74-102, the Uniform Trade Secret Act. A trade secret, as defined by Colorado statute, is “the whole or any portion or phase of any scientific or technical information, design, process, procedure, formula, improvement, confidential business or financial information, listing of names, addresses, or telephone numbers, or other information relating to any business or profession which is secret and of value.”

The protection of trade secrets can be an important aspect of businesses both large and small. Customer lists, processes, business plans and any other matter documented or

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“What do you mean you won’t tell me, I’m a beneficiary. . .”

Robert A. McDermott, Esq., LL.M.

All too often, trustees fail to keep beneficiaries reasonably informed of what is happening in the trust. Colorado law imposes certain duties upon a trustee, and most often, trustees are simply unaware of what is required of them by Colorado law.

Once a trust cannot be revoked, the trustee must register the trust with a court and send written notice of the registration to all beneficiaries of the trust. Failure to properly register a trust subjects the trustee to statutory penalties, such as removal and denial of compensation.

“Colorado law imposes on trustees the duty to inform and account to beneficiaries.”

Colorado law imposes on trustees the duty to inform and account to beneficiaries. Beneficiaries, upon reasonable request, have the *right* to know the terms of the trust. Under most circumstances, this would mean that they have the right to a copy of the trust document. In addition, they have the right to know about the assets the trust contains, and how the trust is being administered by the trustee, such as the trustee’s compensation. Colorado law requires that beneficiaries be entitled to an annual accounting of the trust assets, as well as an accounting when the trust is terminated or when the trustee is changed.

The duties and rights listed here are not all inclusive and can become very complicated in certain circumstances. For example, problems can quickly arise when the only asset of the trust is the stock of a closely held corporation or limited liability company in which the trustee is also an officer, director, majority shareholder, manager and/or member, as well as a beneficiary under the trust document! This set of facts creates a conflict of interest that can end up with other the beneficiaries believing, rightly or wrongly, that the trustee has taken advantage of them.

Understanding and managing conflicts of interest, in addition to knowing your duties as the trustee and the rights of beneficiaries, may save you a costly lawsuit for breach of fiduciary duty as trustee of the trust. We strongly encourage you to seek legal counsel if you have been named a trustee so that you understand how to administer a trust. If you are a beneficiary of a trust, and the trustee is refusing to give you information about the trust, you also need to seek legal advice if you want to enforce your rights under Colorado law.

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undocumented which has business value, is known only to the business, and is kept secret by the business, can be a trade secret. In order to preserve a trade secret, it is imperative that the business take reasonable steps to insure its secrecy. One of the most important steps may be to have employees sign non-competition or non-disclosure agreements. These agreements, when properly drafted, can prevent certain employees from immediately working for competitors, and can forever prevent them from disclosing trade secrets. Implementing a plan to require certain employees to sign non-competition and non-disclosure agreements may require legal counsel to insure proper drafting and compliance with rules required to create a binding agreement.

Mallgren & Ferrell, P.C. has extensive experience in assisting clients with trademark and trade secret matters, and referring clients to attorneys who can handle patent and copyright matters.

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Our goal is to provide cost-effective legal assistance to help our clients achieve their personal and financial goals.

Who's Who at Mallgren & Ferrell, P.C.

R. Garth Ferrell, J.D.



Mr. Ferrell received his B.A. degree, magna cum laude, in economics from Brigham Young University in 1983 and his J.D. degree from the J. Reuben Clark Law School, Brigham Young University, in 1986. That year, he was admitted to practice in the State of Colorado and in Federal District Court. In 1993, he was admitted to practice before the Ninth Circuit Court of Appeals.

Garth began private practice at Holme, Roberts & Owen, a Denver law firm. He represented clients in a wide variety of commercial litigation matters, including creditor's rights, general contract disputes, oil and gas matters, and construction litigation. Mr. Ferrell continued his commercial litigation practice at the law firm of Parcel, Mauro, Hultin & Spaanstra, P.C., also in Denver. While at Parcel, Mauro, Garth gained significant litigation experience in matters relating to oil and gas, savings and loans, natural resources, environmental liability, employment law, complex business litigation, asbestos property litigation and personal injury defense litigation for a variety of Fortune 500 clients. He also worked to favorably resolve disputes through alternative dispute resolution, including arbitration and mediation.

Mr. Ferrell joined Mallgren & Associates, P.C. in December 1996, and in 1998 became a member of the firm. He continues his complex commercial litigation practice and has successfully resolved complex real estate, product liability, trademark, unfair competition and probate disputes.