

SECTION OF TAXATION

State Bar of Texas



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January 2, 2007

Mr. Mike Atkins
Chair, Legislative Policy Sub-Committee
State Bar of Texas Board of Directors
1414 Colorado
Austin, Texas 78711

Re: Proposed Legislation on Patented Tax Strategies
Section of Taxation of the State Bar of Texas

Dear Mr. Atkins:

On behalf of the Section of Taxation of the State Bar of Texas, I have enclosed proposed federal legislation concerning patenting of tax strategies. We are seeking permission to support the legislation in the names of both the State Bar of Texas and the Section of Taxation of the State Bar of Texas. Our package includes the following items:

1. A redline copy of our proposed revision of 35 U.S.C. 287, which adds a subsection (d) to deal with patented "tax planning methods."
2. Our bill analysis of the proposed legislation.

This will also verify that all sections and committees of the State Bar have been sent copies of this legislation for comment. To date, no comments have been received from any other section or committee. If we receive any comments, we will immediately forward them to you.

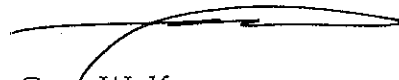
The proposed legislation has not been introduced previously in either the House or the Senate of the U.S. Congress during prior

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legislative sessions. It is helpful to note that we have elected to model our proposed legislation after existing legislation concerning the patenting of medical and surgical procedures. (*See* 35 U.S.C. 287(c)).

The Committee on Government Submissions of the Section of Taxation of the State Bar of Texas is unaware of any position taken by any other section or committee of the State Bar with regard to our proposed legislation.

Very truly yours,



Gene Wolf
Chair, Section of Taxation of the
State Bar of Texas

GW/jrc
Enclosures

cc: Mr. Kevin Thomason
Mr. Patrick O'Daniel
Ms. KaLyn Laney

35 U.S.C. 287. Limitation on damages and other remedies; marking and notice

(a) Patentees, and persons making, offering for sale, or selling within the United States any patented article for or under them, or importing any patented article into the United States, may give notice to the public that the same is patented, either by fixing thereon the word "patent" or the abbreviation "pat.", together with the number of the patent, or when, from the character of the article, this cannot be done, by fixing to it, or to the package wherein one or more of them is contained, a label containing a like notice. In the event of failure so to mark, no damages shall be recovered by the patentee in any action for infringement, except on proof that the infringer was notified of the infringement and continued to infringe thereafter, in which event damages may be recovered only for infringement occurring after such notice. Filing of an action for infringement shall constitute such notice.

(b)

(1) An infringer under **section 271(g)** shall be subject to all the provisions of this title relating to damages and injunctions except to the extent those remedies are modified by this subsection or section 9006 of the Process Patent Amendments Act of 1988. The modifications of remedies provided in this subsection shall not be available to any person who--

(A) practiced the patented process;

(B) owns or controls, or is owned or controlled by, the person who practiced the patented process; or

(C) had knowledge before the infringement that a patented process was used to make the product the importation, use, offer for sale, or sale of which constitutes the infringement.

(2) No remedies for infringement under **section 271(g)** of this title shall be available with respect to any product in the possession of, or in transit to, the person subject to liability under such section before that person had notice of infringement with respect to that product. The person subject to liability shall bear the burden of proving any such possession or transit.

(3)

(A) In making a determination with respect to the remedy in an action brought for infringement under **section 271(g)**, the court shall consider—

(i) the good faith demonstrated by the defendant with respect to a request for disclosure,

(ii) the good faith demonstrated by the plaintiff with respect to a request for disclosure, and

(iii) the need to restore the exclusive rights secured by the patent.

(B) For purposes of subparagraph (A), the following are evidence of good faith:

(i) a request for disclosure made by the defendant;

(ii) a response within a reasonable time by the person receiving the request for disclosure;
and

(iii) the submission of the response by the defendant to the manufacturer, or if the manufacturer is not known, to the supplier, of the product to be purchased by the defendant, together with a request for a written statement that the process claimed in any patent disclosed in the response is not used to produce such product. The failure to perform any acts described in the preceding sentence is evidence of absence of good faith unless there are mitigating circumstances. Mitigating circumstances include the case in which, due to the nature of the product, the number of sources for the product, or like commercial circumstances, a request for disclosure is not necessary or practicable to avoid infringement.

(4)

(A) For purposes of this subsection, a "request for disclosure" means a written request made to a person then engaged in the manufacture of a product to identify all process patents owned by or licensed to that person, as of the time of the request, that the person then reasonably believes could be asserted to be infringed under **section 271(g)** if that product were imported into, or sold, offered for sale, or used in, the United States by an unauthorized person. A request for disclosure is further limited to a request—

(i) which is made by a person regularly engaged in the United States in the sale of the same type of products as those manufactured by the person to whom the request is directed, or which includes facts showing that the person making the request plans to engage in the sale of such products in the United States;

(ii) which is made by such person before the person's first importation, use, offer for sale, or sale of units of the product produced by an infringing process and before the person had notice of infringement with respect to the product; and

(iii) which includes a representation by the person making the request that such person will promptly submit the patents identified pursuant to the request to the manufacturer, or if the manufacturer is not known, to the supplier, of the product to be purchased by the person making the request, and will request from that manufacturer or supplier a written statement that none of the processes claimed in those patents is used in the manufacture of the product.

(B) In the case of a request for disclosure received by a person to whom a patent is licensed, that person shall either identify the patent or promptly notify the licensor of the request for disclosure.

(C) A person who has marked, in the manner prescribed by subsection (a), the number of

the process patent on all products made by the patented process which have been offered for sale or sold by that person in the United States, or imported by the person into the United States, before a request for disclosure is received is not required to respond to the request for disclosure. For purposes of the preceding sentence, the term "all products" does not include products made before the effective date of the Process Patent Amendments Act of 1988.

(5)

(A) For purposes of this subsection, notice of infringement means actual knowledge, or receipt by a person of a written notification, or a combination thereof, of information sufficient to persuade a reasonable person that it is likely that a product was made by a process patented in the United States.

(B) A written notification from the patent holder charging a person with infringement shall specify the patented process alleged to have been used and the reasons for a good faith belief that such process was used. The patent holder shall include in the notification such information as is reasonably necessary to explain fairly the patent holder's belief, except that the patent holder is not required to disclose any trade secret information.

(C) A person who receives a written notification described in subparagraph (B) or a written response to a request for disclosure described in paragraph (4) shall be deemed to have notice of infringement with respect to any patent referred to in such written notification or response unless that person, absent mitigating circumstances—

(i) promptly transmits the written notification or response to the manufacturer or, if the manufacturer is not known, to the supplier, of the product purchased or to be purchased by that person; and

(ii) receives a written statement from the manufacturer or supplier which on its face sets forth a well grounded factual basis for a belief that the identified patents are not infringed.

(D) For purposes of this subsection, a person who obtains a product made by a process patented in the United States in a quantity which is abnormally large in relation to the volume of business of such person or an efficient inventory level shall be rebuttably presumed to have actual knowledge that the product was made by such patented process.

(6) A person who receives a response to a request for disclosure under this subsection shall pay to the person to whom the request was made a reasonable fee to cover actual costs incurred in complying with the request, which may not exceed the cost of a commercially available automated patent search of the matter involved, but in no case more than \$500.

(c)

(1) With respect to a medical practitioner's performance of a medical activity that constitutes

an infringement under section 271(a) or (b) of this title, the provisions of sections 281, 283, 284, and 285 of this title shall not apply against the medical practitioner or against a related health care entity with respect to such medical activity.

(2) For purposes of this subsection:

(A) the term "medical activity" means the performance of a medical or surgical procedure on a body, but shall not include (i) the use of a patented machine, manufacture, or composition of matter in violation of such patent, (ii) the practice of a patented use of a composition of matter in violation of such patent, or (iii) the practice of a process in violation of a biotechnology patent.

(B) the term "medical practitioner" means any natural person who is licensed by a State to provide the medical activity described in subsection (c)(1) or who is acting under the direction of such person in the performance of the medical activity.

(C) the term "related health care entity" shall mean an entity with which a medical practitioner has a professional affiliation under which the medical practitioner performs the medical activity, including but not limited to a nursing home, hospital, university, medical school, health maintenance organization, group medical practice, or a medical clinic.

(D) the term "professional affiliation" shall mean staff privileges, medical staff membership, employment or contractual relationship, partnership or ownership interest, academic appointment, or other affiliation under which a medical practitioner provides the medical activity on behalf of, or in association with, the health care entity.

(E) the term "body" shall mean a human body, organ or cadaver, or a nonhuman animal used in medical research or instruction directly relating to the treatment of humans.

(F) the term "patented use of a composition of matter" does not include a claim for a method of performing a medical or surgical procedure on a body that recites the use of a composition of matter where the use of that composition of matter does not directly contribute to achievement of the objective of the claimed method.

(G) the term "State" shall mean any state or territory of the United States, the District of Columbia, and the Commonwealth of Puerto Rico.

(3) This subsection does not apply to the activities of any person, or employee or agent of such person (regardless of whether such person is a tax exempt organization under section 501(c) of the Internal Revenue Code), who is engaged in the commercial development, manufacture, sale, importation, or distribution of a machine, manufacture, or composition of matter or the provision of pharmacy or clinical laboratory services (other than clinical laboratory services provided in a physician's office), where such activities are:

(A) directly related to the commercial development, manufacture, sale, importation, or distribution of a machine, manufacture, or composition of matter or the provision of pharmacy or clinical laboratory services (other than clinical laboratory services provided in a physician's office), and

(B) regulated under the Federal Food, Drug, and Cosmetic Act, the Public Health Service Act, or the Clinical Laboratories Improvement Act.

(4) This subsection shall not apply to any patent issued based on an application the earliest effective filing date of which is prior to September 30, 1996.

(d)

(1) With respect to a taxpayer's and/or tax practitioner's utilization of a tax planning method that constitutes an infringement under section 271(a) or (b) of this title, the provisions of sections 281, 283, 284, and 285 of this title shall not apply against the taxpayer, the tax practitioner, or any related professional organization with respect to such tax planning method.

(2) For the purposes of this subsection:

(A) the term "tax planning method" means a plan, strategy, technique or structure that is designed to or has, when implemented, the effect of reducing, minimizing or deferring a taxpayer's tax liability, but shall not include the use of tax preparation software or other mechanical tools used solely to perform or model mathematical calculations or prepare tax or information returns.

(B) the term "taxpayer" means an individual, entity or other person (as defined in Section 7701 of the Internal Revenue Code) that is subject to taxation directly, is required to prepare a tax return or information statement to enable one or more other persons to determine their tax liability, or is otherwise impacted by a tax law.

(C) the terms "tax," "tax laws," "tax liability," and "taxation" mean, or refer to as the context may require, any Federal, State (as defined in subsection (c)(2)(G) above), county, city, municipality or other governmental levy, assessment or imposition, whether measured by income, value or otherwise.

(D) the term "tax practitioner" means any natural person who provides advice and consultation to a taxpayer with respect to a tax planning method or who is acting under the direction of such person in connection with the development or utilization of a tax planning method.

(E) the term "related professional organization" means an entity with which a tax practitioner has a professional affiliation under which the tax practitioner may provide advice and consultation with respect to a tax planning method, including but not limited to a law firm, accounting firm, or a bank.

(F) the term "professional affiliation" shall mean an employment or contractual relationship or partnership or other ownership interest.

(3) This subsection shall not apply to any patent issued based on an application the earliest effective filing date of which is prior to _____, 2007.

Bill Analysis

Summary:

This bill amends 35 U. S. C., adding a new subsection (d) to Section 287.

Background:

Over the last few years, Federal patent law has been interpreted by the United State Patent and Trademark Office (“USPTO”) to allow the patenting of tax strategies as a subset of business method patents. The USPTO has established a special class (Class 706/36T: Tax Strategies) for such patents. To date, there are 43 patents of this class which have been granted, and there are 60 applications pending for patents in this class.

Problems:

The availability of patent protection may encourage, in a variety of ways, the development of aggressive tax shelter transactions. It could also allow tax practitioners to seek and obtain patent protection for routine tax planning, or even for certain methods of complying with the Internal Revenue Code, effectively allowing such patent holders to “capture” a property right in the Internal Revenue Code itself and extract economic rent from other tax practitioners for routine tax planning which is alleged to infringe such patents. It further may erroneously convey a governmental stamp of approval which does not exist. Also, the issuance of tax patents would impose very onerous requirements on tax practitioners, who may now have to perform an expensive patent search each and every time tax advice is delivered. Even worse, if an arguably unenforceable patent is discovered, both the practitioner and the client could face an expensive legal defense of a patent infringement suit if a suitable royalty arrangement cannot be reached with the putative holder of such patent—assuming that such putative patent holder will even deign to license the strategy. As a result, a toll charge has effectively been placed on compliance with an obligation that every taxpayer has to file an accurate tax return and on the right of every taxpayer to structure its affairs so as to pay its legally determined amount of tax—but no more than such amount. [Much of the information in this Bill Analysis is taken directly from a report on the topic prepared by the Joint Committee on Taxation of the United States Congress. See, Joint Committee on Taxation, *Background and Issues Relating to the Patenting of Tax Advice* (JCX-31-06), July 12, 2006]

Purpose:

The purpose of the proposed legislation is to eliminate the ability of a holder of a patent on a tax strategy to obtain either money damages or injunctive relief due to the infringement of such patent.

Rulemaking Authority:

This bill creates no additional rulemaking authority.

Section-By-Section:

Subsection 287(d)(1): Eliminates the ability to obtain injunctive relief or money damages with regard to a patent infringement involving a taxpayer's and/or tax practitioner's utilization of a tax planning method.

Subsection 287(d)(2): Defines various terms utilized to effectuate Section 287(d)(1).

Subsection 287(d)(3): Provides that Subsection 287(d) will not apply to any patent issued based on an applications filed prior to _____, 2007.