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Responding to Tax Strategy Patents

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Responding to Tax Strategy Patents

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¶ BACKGROUND

Recently, patents for tax strategies have drawn attention from Congress, tax policymakers, the press and tax practitioners.¹ While a suit alleging infringement of a

* Associate Dean for Academic Programs, John E. Anderson Professor of Tax Law, Loyola Law School, Los Angeles. Because so much happened concerning tax strategy patents in the weeks after the 2007 Federal Tax Institute, this article includes developments through the beginning of April, 2007. Parts of the article are taken from the author's July 13, 2006 testimony before the Subcommittee on Select Revenue Measures of the House Ways and Means Committee. As a tax lawyer, I have sympathy for the point of view and concerns expressed by tax practitioners and described herein. I have also undertaken to understand and express as best I am able the point of view and concerns of many in the patent community.

¹ See, e.g., Hearing on Issues Relating to the Patenting of Tax Advice before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means, 109TH CONG. (2006), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5271>; Paul Devinsky, John Fuisz & Thomas Sykes, *Whose Tax Law Is It? Alarm Bells Should Ring Over Rising Efforts to Patent Tax Strategies*, LEGAL TIMES IP MAGAZINE, Oct. 16, 2006, at S12, available at <http://www.mwe.com/info/pubs/legaltimes101806.pdf>; ABA Section of Taxation, *ABA Task Force Will Study Patenting of Tax Advice*, 2006 TNT 194-30, Oct. 5, 2006, available on LEXIS, TNT File; Tom Herman, *Tax Report: Patents on Tax-Related Ideas Stir Worry --- Groups Fret Plans Could Be Viewed As Backed by IRS*, WALL ST. J., Mar. 14, 2007, at D3.

patent for an estate planning technique has attracted particular notice,² tax strategy patents are not limited to estate planning. Issued patents and published applications for tax strategy patents cover a number of areas of tax practice – employee benefits, charitable giving, and financial products, to name just a few.³ Although currently small in number, tax strategy patents have potentially large consequences for our tax law in the United States.

The United States Patent and Trademark Office (“PTO”) categorizes tax strategy patents as a kind of business method patent. The patent at issue in the landmark case recognizing business method patents, *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*,⁴ was motivated at least in part by tax considerations. *State Street Bank* involved a patent on a system for calculating the shares of various mutual funds in an investment pool in a way that satisfied applicable tax regulations regarding allocation of partners’ income.⁵ Following *State Street*, business method patents, often involving financial transactions and computer software, quickly became the fastest growing area of

² *Wealth Transfer Group LLC v. John W. Rowe*, Docket No. 3:06-cv-00024-AWT (D.Conn.). The patent at issue, known as the SOGRAT™ patent, used stock options to fund a grantor retained annuity trust, an estate planning technique authorized by 26 U.S.C. § 2702. See U.S. Patent No. 6,567,790 (filed Dec. 1, 1996, issued May 20, 2003). The complaint in the case was filed on January 6, 2006. The case was recently settled. The settlement states that “there are facts from which a trier of fact could conclude that the . . . patent is not invalid and is not unenforceable,” but that the “statement is not to be taken as an admission that the trier of fact would necessarily so conclude if the case were to be tried on the merits.” The parties also agree to enter “a confidential patent license and settlement agreement” that resolves their differences without the admission of liability by any part. Consent Final Judgment Regarding Settlement Agreement (on file with author).

³ See, e.g., U.S. Patent No. 6,963,852 (filed Feb. 28, 2002, issued Nov. 8, 2005) (system and method for creating a defined benefit pension plan funded with a variable life insurance policy and/or a variable annuity policy); U.S. Patent No. 6,766,303 (filed Oct. 15, 2001, issued July 20, 2004) (method for hedging one or more liabilities associated with a deferred compensation plan); U.S. Patent No. 6,292,788 (filed Dec. 3, 1998, issued Sept. 18, 2001) (methods and investment instruments for performing tax-deferred real estate exchanges).

⁴ See *State Street Bank & Trust Company v. Signature Financial Group, Inc.*, 14 Fed. 3d 1368 (Fed. Cir. 1998), cert. denied 525 U.S. 1093 (1999).

⁵ See Alan S. Lederman, *Tax-Related Patents: A Novel Incentive Or An Obvious Mistake?*, 105 J. TAX’N 325, 332-33 (2006); Joint Comm. on Taxation, *Background and Issues Relating to the Patenting of Tax Advice*, JCS-31-06 (July 12, 2006) at 18.

patents applications. Over 8,000 applications for business method patents were filed with the PTO in 2005.⁶

The PTO has also established a special subcategory in its data processing class for tax strategy patents. As of April 7, 2007, the PTO's webpage showed 53 issued patents and 84 published patent applications in its subcategory of patents on "tax strategies."⁷

The PTO has established a separate subclass for patents related to tax preparation or submission. As of April 7, this subclass had 73 issued patents and 89 published patent applications.⁸

The phenomenon of tax strategy patents presents worries many tax practitioners as a matter of both policy and practice.⁹ This article will review four categories of concerns – patent policy, the nature of our tax system, tax policy, and the impact on the tax profession. It will then consider four possible kinds of responses – prohibiting patents on tax strategies, granting immunity for infringements of tax strategy patents, reforming the patent process, and relying on changes to the tax law – such concerns suggest. Finally, it discusses the trade-off that tax practitioners will face in seeking legislative or administrative action regarding tax strategy patents. To gain any kind of special treatment for tax strategy patents under the patent system, it concludes, tax professionals

⁶ Class 705 Application Filing, *available at* <http://www.uspto.gov/web/menu/pbmethod/applicationfiling.htm>.

⁷ Search of term "ccl/705/36T" at <http://patft.uspto.gov/netahtml/PTO/search-adv.htm> and <http://appft1.uspto.gov/netahtml/PTO/search-adv.html>. This search undoubtedly understates the number of tax strategy patent applications that have been filed. Applications must be published by the PTO only if they are the subject of an international filing (which may be unlikely in this category) and then not until 18 months after submission. 35 U.S.C. § 122(b). In addition, not all tax strategy patents will be classified in subclass 36T, both because of the way the application describes the patent and because of PTO errors in classification. *See, e.g.*, U.S. Patent No. 7,096,195 (filed July 31, 2000, issued Aug. 22, 2006), which turns on the tax treatment of debt and equity, but which was not classified as a tax strategy patent by the PTO but as a part of a subclass devoted to "distribution or redemption of coupon or incentive or promotion."

⁸ Search of term "ccl/705/31" at <http://patft.uspto.gov/netahtml/PTO/search-adv.htm> and <http://appft1.uspto.gov/netahtml/PTO/search-adv.html>.

⁹ Some tax practitioners, of course, support this development and have submitted applications for and obtained patents on tax strategies. *See* Lederman, *supra* note 5.

will have to show Congress how tax practice differs from other endeavors and why special treatment would not violate obligations under our international intellectual property agreement.

¶ 101 THE CONCERNS OF TAX PRACTITONERS

¶ 101.1 Introduction

Tax practitioners' unease centers on patents involving interpretations of the tax law, not patents involving software to fill out tax forms or returns. Professional groups have labored to distinguish the two. The Texas State Bar, for example, has defined "tax planning method" to mean "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."¹⁰ The Tax Section of the New York State Bar Association suggests that tax strategy patents be understood as "interpretations of the tax law as well as applications of tax principles and laws to structuring transactions, business entities, and the ownership of property" but not as including patents "for tax preparation software and other mechanical tools for easing taxpayers' compliance with the tax laws."¹¹ For tax practitioners, tax strategy patents raise a number of concerns, from the purpose of the patent and tax laws to the effect on everyday practice.

¹⁰ *Texas State Bar Passes Resolution on Patents of Tax Planning Methods*, 2007 TNT 39-43, February 27, 2007, available on LEXIS, TNT file.

¹¹ *NYSBA Says Applying Patent Law to Tax Advice Could Cause Problems*, 2006 TNT 160-18, August 18, 2006, available on LEXIS, TNT file. As the New York State Bar formulation works to capture, tax consequences do not necessarily go to current minimization of taxes. They may involve matters of tax character, avoidance of penalties, calculation of basis, etc.

¶ 101.2 The Purpose of the Patent Laws

United States patent laws grant holders of patents a 20 year monopoly to make, sell, use or license their inventions.¹² A government-granted monopoly, like all monopolies, imposes costs. The constitutional authority for patents and the patent statutes grant patents' exclusive rights out of a conviction that the benefits of such grants outweigh the societal costs.¹³

The benefit of our patent system, most agree, is the encouragement of innovation. As one leading patent scholar has written, "Intellectual property protection in the United States has always been about generating incentives to create."¹⁴ Another leading patent scholar has recommended defining the scope of patent protection "by sticking with the question of rationales, by asking where a patent incentive is actually required to promote investment in innovation."¹⁵

Accepting this purpose, many tax practitioners suggest that no such incentive is required to encourage development of new tax strategies. Therefore, they reason, granting patents on tax strategies is not consistent with the purpose of the patent laws. Developing tax strategies, after all, does not involve the building of plants or elaborate scientific testing or other capital costs for which monopoly protection is required to prompt necessary investment. To quote my earlier testimony before Congress, "it would be hard to identify a subject less in need of further innovation than tax planning. Existing

¹² 35 U.S.C. § 154.

¹³ The requirement that an applicant must disclose an invention fully to receive a patent is part of the cost to the applicant, but is considered a public benefit that encourages further innovation. *See* 35 U.S.C. § 112.

¹⁴ Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83 TEX. L. REV. 1031, 1031 (2005).

¹⁵ Rochelle Cooper Dreyfuss, *Are Business Methods Bad for Business*, 16 SANTA CLARA COMPUTER AND HIGH TECH. L. J. 263, 278 (2000).

economic incentives already provide ample inducement for the development, promotion, and implementation of tax planning strategies.”¹⁶ Thus, tax practitioners argue, if we were to shape and interpret our patent laws according to their fundamental purpose, these laws would be structured not to permit the granting of tax strategy patents.

¶ 101.3 The Nature of Our Tax Laws

Tax practitioners further believe that, because of the nature of our tax law, tax strategy patents are likely to implicate public policy considerations in ways that patents in most other subject areas, even other areas of law, do not. Congress enacts the tax laws to fund government operations and programs. “Taxes are the life-blood of government, and their prompt and certain availability an imperious need.”¹⁷ Congress both distributes the tax burden and establishes tax incentives as it sees fit to promote the public interest.

Tax strategy patents would not exist without Congressional action, since Congress creates our tax laws. That is, Congress itself has created the universe within which tax strategies operate, and tax strategy patents have no value apart from the acts of Congress. These patents, which involve applications of the laws of Congress, are thus fundamentally different from the patents for which our patent system was designed - patents that involve applications technology and of the laws of nature.¹⁸

¹⁶ Professor Ellen P. Aprill, Testimony on Issues Relating to the Patenting of Tax Advice, *supra* note 1.

¹⁷ *Bull v. United States*, 295 U.S. 247, 259 (1935).

¹⁸ See Andrew A. Schwartz, *The Patent Office Meets the Poison Pill: Why Legal Methods Cannot Be Patented*, forthcoming 20 HARV. J. L. & TECH. (Spring 2007). State and local legislatures, of course, also enact tax laws. Tax strategy patents to date, however, have largely involved federal tax law. Moreover, tax and patent policy issues confront each other directly in the federal arena. Thus, the discussion in this article will focus on federal law and on the United States Congress, since Congress is responsible for both these sets of laws. The arguments discussed, however, applies to tax strategy patents for state and local tax laws as well.

All citizens are subject to our tax laws and to our system of voluntary self-assessment. No citizen has a choice about whether to partake of the tax system. Compliance is obligatory. Equal treatment by the government of all citizens under the tax laws is crucial to the integrity of the system. It is also important that the public perceive the system as operating fairly.

Tax practitioners view tax strategy patents as ceding authority over the tax law to private parties. While tax practitioners can and do devise tax reduction techniques for which they may charge fees, tax strategy patents differ qualitatively from these efforts because they bestow upon individuals a government-granted monopoly over particular interpretations of the tax code. Tax practitioners compete with each other to offer tax planning advice and this competition affects the prices they charge. The holder of a patent, in contrast, can charge monopoly prices. As the New York State Bar Association has observed, “The patenting of tax strategies would invariably increase the cost to taxpayers of complying with their tax obligations, a result we think is indefensible as a policy matter.”¹⁹

In the case of a tax strategy patent, the patent holder, rather than Congress, would decide eligibility for obtaining a tax advantage. The holder of a tax strategy patent has a legal right to restrict another’s access to complying with the law. Under current law, patent holders can refuse to license a tax strategy technique to anyone, including their competitors. Such private power undermines Congress’ ability both to raise revenue and to influence taxpayer behavior through the tax laws. As the American Institute of Certified Public Accountants (“AICPA”) has written, tax strategy patents “preempt Congress’s prerogative to have full legislative control over tax policy. . . . Granting patent

¹⁹ NYSBA, *supra* note 11.

protection for tax strategies ties the hands of Congress by limited its ability to develop broad public policy.”²⁰

Allowing private parties to control or to be perceived as controlling our tax system runs counter to both equal treatment and the perception of equal treatment. Even the perception of private control would undermine confidence in our tax system. Consider the possibility of a party lobbying for new tax legislation and simultaneously apply for a patent on its interpretation.²¹ Under current law, patent holders cannot be forced or required to license their patented invention, and in the worst-case scenario, the holder of the patent on a legal interpretation might be the only one able to use or comply with the law.²²

Some of these concerns would apply to the patenting of any legal strategy, of course.²³ However, because our tax system requires self-assessment by all of its citizens and because our tax system produces the revenue needed to operate all government functions, tax practitioners believe that tax strategy patents raise unique concerns.

¶ 101.4 Patent Quality and Tax Policy

Tax practitioners fear that the proliferation of tax strategy patents will undermine tax policy. Such a result could follow not only from patents for strategies that are inconsistent with the tax law, but also from patents for strategies that are consistent with

²⁰ See *AICPA Urges Congress to Legislate Against Tax Patents*, 2007 TNT 45-22, March 7, 2007, available on LEXIS, TNT file.

²¹ The authors of one commentary have compared this possibility to the common practice of granting of “essential patents” that cover technical specifications promulgated by standard setting bodies. See Charles F. Wieland & Richard S. Marshall, *Tax Strategy Patents – Policy and Practical Considerations*, 47 TAX MGT. MEMO. 499, 506 (2006).

²² See Floyd Norris, *You Can’t Use That Tax Idea. It’s Patented*, N.Y. TIMES, Oct. 20, 2006, at C1.

²³ See Schwartz, *supra* note 18.

the tax law. Indeed, patents on tax strategies consistent with the law could pose more of a threat to tax policy than patents on strategies inconsistent with the law.

The legal effect of a patent is frequently misunderstood. Patents do not give their holders the right to use their inventions; patents instead give their holders the right to exclude others from making, using, selling, offering for sale or importing the patented invention for the term of the patent. That is, patents are not a government seal of approval, although they are often seen – and may be marketed – as such.²⁴ While this misunderstanding of patents is common, its consequences for the tax system in the case of tax patents raise particular concern because of their potential impact on so key a governmental function.

Under the patent law, a patent must be useful for some valid purpose.²⁵ The required “utility” of a patent under the patent law, however, must be distinguished from the validity of the patent’s interpretation of the tax law and thus its usefulness in practice to taxpayers. Under the patent law, “[t]he threshold of utility is not high: An invention is ‘useful’ . . . if it is capable of providing some identifiable benefit.”²⁶ Although Justice Story wrote in the 19th century that inventions “injurious to the well-being, good policy, or sound morals of society” are unpatentable,²⁷ modern courts have avoided consideration of broad public policy in awarding patents and concluded that “[t]he requirement of ‘utility’ in patent law is not a directive to the Patent and Trademark Office or the courts

²⁴ See Testimony of The Honorable Mark Everson, Commissioner of the Internal Revenue Service, Issues Relating to the Patenting of Tax Advice, *supra* note 1.

²⁵ See 35 U.S.C. § 101.

²⁶ *Juicy Whip, Inc. v. Orange Bang, Inc.*, 185 F.3d 1364, 1366 (Fed. Cir. 1999).

²⁷ 185 F.3d at 1366 (*quoting* *Lowell v. Lewis*, 15 F. Case. 1018, 1019 (C.C.D. Mass. 1817)).

to serve as arbiters of deceptive trade practices.”²⁸ Such policy decisions, the courts have declared, are the duty of other agencies or for Congress itself.²⁹

The issuance of a patent, then, does not decide the correctness of its legal analysis under the tax law. The tax policy issues embedded in tax strategy patents are for the Treasury and the IRS, not the PTO, to decide. For many years, the Treasury and the IRS have been battling a constant flow of tax shelters and other questionable tax avoidance schemes. The IRS must be constantly vigilant in identifying new schemes and significant variations on old ones that require fresh IRS scrutiny to determine their validity under the tax laws. Tax patents, although they offer the IRS the advantage of public availability, are likely to make this task even more difficult. Patents carry with them the appearance of federal government approval and the legal presumption of validity. There is the risk that taxpayers and others who consider employing tax strategy patents will rely on the appearance of government approval and the presumption of validity a patent carries and, therefore, fail to evaluate carefully whether the underlying tax strategy actually works. If such is the case, there could be an impact on federal tax revenue and the need for action by the IRS and Congress to counter such strategies.

Another and perhaps more pressing set of worries concern issuance of patents that are both consistent with tax law and that represent common techniques.³⁰ Under our patent laws, patents are to be granted only for inventions that are novel and non-obvious.³¹ Obviousness is to be judged from the point of view of a “person of ordinary

²⁸ *Juicy Whip, Inc.*, 185 F.3d at 1368.

²⁹ *Id.*

³⁰ These concerns about inappropriately issued patents are in addition to and separate from the concern discussed earlier about privatizing the tax law.

³¹ *See* 35 U.S.C. §§ 102(a) and 103(a).

skill in the art.”³² A “person of ordinary skill in the art” is a fictitious person who is neither a novice nor an expert.³³

It is the duty of patent examiners in the PTO to make the determination that a patent is novel and not obvious. In order to review the validity under the patent law of applications for tax strategy patents, patent examiners need expertise not only in software and finance, but also, of course, tax. They need to understand the conceptual basis of a range of areas of tax -- financial products, estate and gift tax, pension and deferred compensation, to name a few where tax strategy patents already exist. Such expertise is difficult to obtain. Few tax practitioners have such broad knowledge in such varied aspects of the tax law. Most work very hard just to keep up in developments and changes in the law in their areas of specialization. Yet the patent examiners evaluating these tax strategy patents are trained as engineers, with few having some additional financial education, such as an MBA. They are not tax lawyers or accountants. Unless authorized by statute,³⁴ PTO examiners cannot consult others outside of the PTO, even other federal agencies, in examining particular patent applications.

For tax strategy patents, as with other patents, examiners look to information known as prior art to determine novelty and non-obviousness. Under the patent law, a person is not entitled to a patent if the invention was patented or described in a printed publication in this or a foreign country or in public use or on sale in this country, more than one year prior to the date of the application for patent in the United States.”³⁵

³² See 35 U.S.C. § 103(a).

³³ See William A. Drennan, *The Patented Loophole: How Should Congress Respond to This Judicial Invention*, 59 FLA. L. R. 229, 261-62 (2007) (describing Mr. Phosita, a person having ordinary skill in the art).

³⁴ See 35 U.S.C. § 164 (authorizing the PTO to seek the assistance of the Department of Agriculture in connection with plant patents).

³⁵ 35 U.S.C. § 102(b).

Moreover, a patent cannot be obtained if the differences between the subject matter sought to be patented is “obvious” when compared to ‘prior art.’”³⁶ The applicable regulations specify, “On taking up an application for examination or a patent in a reexamination proceeding, the examiner shall make a thorough study thereof and shall make a thorough investigation of the available prior art relating to the subject matter of the claimed invention.”³⁷ The Manual of Patent Examination Procedures defines prior art pending, published, and issued patents and printed publications.³⁸

While the applicant for a patent must include citations to prior art in the patent application, the obligation is to disclose only prior art of which the applicant is aware.³⁹ An applicant has neither the duty nor the incentive to seek out relevant prior art and patent applications have been criticized for their failure to cite prior art.⁴⁰

Third parties have the opportunity to compensate for any failings by the applicant in citing prior art only in limited circumstances and only for a limited period of time. Third parties can submit prior art only for applications that are made public. Since 2000, patent applications have generally been published within 18 months of their filing.⁴¹ However, a patent application can be kept confidential if the applicant certifies that the same idea will not be the subject of an application filed in another country requiring

³⁶ 35 U.S.C. § 103(a).

³⁷ 37 C.F.R. § 1.104(a).

³⁸ Manual of Patent Examining Procedures 901 (8th ed. 2001). The term “printed publications” includes internet sources. In practice, prior art includes any “document [that] has been disseminated or otherwise made available to the extent that persons interested and ordinarily skilled in the subject matter or art, exercising reasonable diligence, can locate it.” *I.C.E. Corp. v. Armco Steel Corp.*, 250 F. Supp. 738, 743 (S.D.N.Y. 1966).

³⁹ See 37 C.F.R. § 1.56.

⁴⁰ See Stephen M. McJohn, *Patents: Hiding from History* (March 2007) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=969447; Thomas Schneck, *The Duty to Search*, 87 J. PAT & TRADEMARK OFF. SOC’Y 869 (2005).

⁴¹ 35 U.S.C. § 122.

publication within 18 months after filing.⁴² Since inventors generally desire protection of their ideas in other countries, most patent applications are currently made public. I understand that the PTO estimates that approximately 10-15% of all patent applications and a slightly larger percentage of business method patents are kept confidential.⁴³

Protection in other countries is likely to be irrelevant for many, probably most, tax strategy patents. Thus, tax practitioners believe that a far larger percentage of tax strategy patent applications will remain confidential until issued. For those applications that are made public, patent regulations permit a member of the public to submit publications relevant to a pending published patent application, but only within two months of its publication date.⁴⁴

Patent examiners themselves have a responsibility to identify prior art during patent prosecution. For patent examiners, identifying prior art in this area is particularly difficult. This is a new arena for patent law, and the traditional source for that determination, the body of pre-existing patents, is not helpful. In the case of tax strategy patents, to decide whether the idea for which the application is made is novel and nonobvious, examiners need to know how to go about doing specialized tax research in non-patent literature and must do such research as quickly and as efficiently as possible, particularly given the severe time constraints they face.⁴⁵

⁴² 35 U.S.C. § 122(b)(2)(B).

⁴³ Applicants may wish to permit the PTO to publish business method patent applications, including tax strategy patent applications, even if they will not seek foreign patent protection, since publishing a patent application offers the advantage of triggering liability for patent infringement as of the date of such application, rather than the date the patent issues. *See* 35 U.S.C. § 154(d).

⁴⁴ *See* 37 C.F.R. § 1.99. Members of the public can also file protests based on prior art against pending applications, *see* 37 C.F.R. §1.291, and cite prior art to the PTO during any period of enforcement, *see* 37 C.F.R. § 1.502, as well as request reexamination, *see* 35 U.S.C. § 302.

⁴⁵ The American Bar Association's Section on Intellectual Property Law reports that examiners spend between 15 and 30 hours per application. *See* ABA Section of Intellectual Property Law, *A Section White Paper: Agenda for 21st Century Patent Reform*, revised February 20, 2007, at 51, available at

Constraints regarding confidentiality further complicate identification of prior art. Tax return information is confidential.⁴⁶ Communication between taxpayers and the taxpayer's advisor may be privileged.⁴⁷ Thus, material that might otherwise constitute prior art to demonstrate that a proposed tax patent is not novel or nonobvious will not be available for either patent examiners to discover or for third parties to submit to patent examiners, because of confidentiality and privilege.

As a result of the difficulties in identifying prior art, tax practitioners are concerned that many of the patents that have or will be issued for tax strategies will inevitably involve techniques that have long been accepted as routine. Many believe, for example, that the SOGRATTM patent, the patent involving the estate planning technique that was at issue in the filed infringement case, falls into this category.⁴⁸ Similar objections have been made to other tax strategy patents or patent applications, such as a current patent application designed to permit exempt organizations to invest in debt-financed entities without incurring the unrelated business income tax.⁴⁹

Patents that are issued for strategies that are both consistent with the tax laws and commonly employed raise particular concerns about the privatizing of the tax system. Once a patent has been issued on such a technique, the holder may charge high license fees. They may decline to license the technique at all or to certain competitors. Tax

<http://www.abanet.org/intelprop/home/PatentReformWP.pdf> (hereinafter "IPL White Paper"). I understand from the PTO that the average amount of time for examining a tax strategy patent is 32 hours. The Tax Section of the American Bar Association is working with the PTO to give examiners training on how to do tax research efficiently. The first session was held January 9, 2007 and the next is planned for May 2, 2007.

⁴⁶ 26 U.S.C. § 6103(a).

⁴⁷ 26 U.S.C. § 7525(a)(1).

⁴⁸ See Testimony of Dennis Belcher, *supra* note 1; Dennis I. Belcher & Dana G. Fitzsimons, *Tax Planners -- Beware of Patented Estate Planning Techniques*, PROBATE & PROPERTY, Nov./Dec. 2006, at 24.

⁴⁹ See U.S. Patent Application No. 20060026085 (filed Feb. 2, 2006).

practitioners may hesitate to recommend similar techniques to their clients out of fear of patent infringement.

Issued patents can be declared invalid in the course of a patent infringement suit, and nonobviousness is often the basis for such a determination.⁵⁰ Patent litigation, however, is enormously expensive. In 2005, the American Intellectual Property Law Association reported that the average patent infringement case as typically costing \$650,000 for each party when the amount at risk is less than \$1 million and \$2 million for each party when the amount at risk is between \$1 million and \$25 million.⁵¹

The pressure to settle patent infringement suits is therefore strong, even when the amounts at issue are large. The SOGRAT™ litigation, for example, involved stock options worth an estimated \$28.5 million.⁵² In many instances involving tax strategy patents, however, the amount at issue for any individual alleged infringer is likely to be very small. If an infringement suit is threatened, the taxpayer may be willing to pay a license fee rather than challenge the validity of the patent in court. Of course, when amounts at issue are small, the holder of the patent may be less likely to litigate as well. However, because issued patents are presumptively valid,⁵³ the very existence of the patent can be expected to have a chilling effect on tax planning and tax practitioners.

The separation of tax policy from patent policy regarding the utility and validity of tax strategy patents has two very different impacts on our tax system. On one hand, it may allow patents on techniques that constitute or approach abusive tax shelters and thus

⁵⁰ See Drennan, *supra* note 33, at 259.

⁵¹ Am. Intellectual Prop. Law Ass'n, *Report of the Economic Survey 22* (2005).

⁵² Steve Seidenberg, *Taxation Innovation: Patent Office Received Criticism for Issuing Patents on Tax Strategies*, INSIDE COUNSEL, December 2006, available at http://www.insidecounsel.com/issues/insidecounsel/15_238/ip/771-1.html.

⁵³ See 35 U.S.C. § 282.

encourage such activity. On the other, it may allow patents that constitute commonly accepted and practiced techniques and, in so doing, limit the availability of tax strategies that our tax laws permit or, in some cases, encourage. Practitioners will hesitate to use such techniques out of fear of infringing patents, however much they may believe the patent is invalid. In the case of tax strategy patents, moreover, litigation is less likely to be undertaken than with many other kinds of patents. As a result, tax practitioners will not be able to look to courts to provide their “border patrol” function - deciding uncertain cases and establishing limits. The combination of all these effects underscores the potential enormous consequences of tax strategy patents on our tax system.

¶ 101.5 Impact on the Tax Profession

Tax practitioners anticipate that tax strategy patents could change the profession in a number of ways. Potential liability for patent infringement by clients and for inducing patent infringement by tax practitioners will exert one set of pressures. At the same time, the ethical duties of tax practitioners impose another and sometimes conflicting set of pressures.

The adverse consequences for violating or inducing the violation of patents can be substantial. Patent holders generally seek injunctions against alleged infringers as well as any inducers of infringement to bar them from acting without paying damages equal to lost profits or a reasonable royalty. A taxpayer can infringe a patent without intent or actual knowledge of the patent; ignorance of an applicable patent is not a defense to an infringement action. Some patent practitioners have suggested that clients ask their tax

practitioners for indemnity agreements for any liability for patent infringement.⁵⁴

Moreover, tax practitioners can be sued for inducing patent infringement; knowingly inducing infringement could subject tax practitioners to treble damages.

These potential liabilities suggest that tax practitioners may need to begin considering whether to conduct patent searches in connection with any tax planning activity, whether to seek expert advice regarding the results of any search, and depending on the results, what course of action to pursue in response to a possible patent claim. Tax practitioners, after all, owe their clients due diligence.⁵⁵ Tax professionals may also now be under a duty to disclose to the client the existence of any relevant tax strategy patents, the possibility of licensing the patent, and the consequences of failing to do so.⁵⁶

Some have suggested that tax practitioners avoid doing patent searches to avoid liability for knowingly inducing infringement. Such a course of action, however, could increase liability for malpractice. Insurers are aware of tax strategy patents. A major insurance carrier issued an alert to its law firm insureds regarding the issue. Moreover, a strategy of conscious ignorance would seem to raise a conflict between the client's interests and the tax practitioner's personal interests.

Other ethical duties of the tax practitioner introduce further complications.⁵⁷ Tax professionals owe a duty to their clients to represent them to the full extent of the law.

⁵⁴ See Jeffrey Young, *Tax Strategists Discover US Business Patents*, available at http://www.buildingipvalue.com/07US_Can/p.88-91%20US,%20Alston.pdf, Deborah Jacobs, *Sorry, That Tax Plan Is Patented*, BUSINESSWEEK ONLINE, available at http://www.businessweek.com/innovate/content/jul2006/id20060726_214792.htm?chan=search.

⁵⁵ See, e.g., American Bar Association Model Rules of Professional Conduct, Rule 1.3: "A lawyer shall act with reasonable diligence . . . in representing a client."

⁵⁶ See, e.g., American Bar Association Model Rules of Professional Conduct, Rule 1.4(a)(2): "A lawyer shall . . . reasonable consult with the client about the means by which the client's objectives are to be accomplished."

⁵⁷ The author acknowledges her debt to material prepared by Professor Michael Lang on ethical issues posed by tax strategy patents. His thoughtful consideration includes an exploration of the issues involved when lawyers themselves are holders of tax strategy patents. Such questions are beyond the scope of this article.

Yet fear of patent infringement, a prohibitive cost for obtaining a license to use a patented technique, or the cost involved in evaluating a patented procedure might prevent a tax practitioner from giving a client the best tax advice. Tax advisors designing tax strategies for clients could face a conflict with those clients as to who has the right to patent the strategy developed.

Other issues arise in the context of defending against allegations of infringement. The patent laws include a provision, known as the “First Inventor Defense Act,”⁵⁸ that protects those accused of infringing for “a method of doing or conducting business” if they have reduced the subject matter to practice and had commercially used the subject matter at least a year before the filing date of the allegedly infringed patent, whether or not the subject matter “is accessible to or otherwise known to the public.”⁵⁹ That is, this defense is available to an individual without the need to invalidate the issued patent on the basis of prior art.

The availability of this special defense in the case of tax strategy patents is not certain. There is no case law to provide guidance. Although the United States Patent and Trademark Office classifies tax strategy patents as a form of business method patents, it is not clear that tax strategy patents, particularly those aimed at individual taxpayers in their personal capacity, constitute a method of conducting business, as the provision requires. Neither is it completely clear that the defense protects those accused of inducing infringement in addition to those accused of direct infringement.⁶⁰ Even if those

⁵⁸ 35 U.S.C. § 273.

⁵⁹ *Id.*

⁶⁰ Section 273(b)(1) refers to a “defense to an action for infringement under section 271 of this title.” It does not also specify that the provision is a defense to an action for inducing infringement.” However, section 271(b) states, “Whoever actively induces infringement of a patent shall be liable as an infringer.” Liability as an infringer may or may not be deemed to involve an action for infringement.

two hurdles are satisfied, however, the tax practitioner accused of inducing infringement may need clients to waive confidentiality in order to demonstrate the required reduction to practice and commercial use.

The proliferation of tax strategy patents would also affect professional culture. Historically, the dissemination of tax planning ideas has been open and widespread. Tax practitioners currently share information and ideas with each other freely. There is an astonishing array and number of meetings, conferences, conventions, and listservs where tax planning ideas are shared. Although the patent system is designed to encourage the dissemination and discussion of ideas and information, many tax practitioners are concerned that the spread of tax strategy patents will have the opposite effect, namely, that those with new ideas or the beginnings of ideas will hesitate to enter into discussion with others.⁶¹ If patents become an important part of the tax landscape, the atmosphere could become more secretive and less cooperative. The tax system as a whole will suffer if, in order to protect their patentable intellectual property, tax professionals are no longer willing to discuss, evaluate, and criticize each other's insights regarding how to comply with the tax system.

Tax patents could affect the very structure of the legal and accounting professions. We could well see the development of groups that spend their time working to invent additional tax strategy patents.⁶² Many such groups would not organize as lawyers or accountants. As has been seen with other kinds of patents, speculators known

⁶¹ A similar debate has surrounded enactment of the Bayh-Dole Act, 35 U.S.C. §§ 200-212, which expanded the ability of universities to obtain patents.

See Wieland & Marshall, *supra* note 21, at 601.

⁶² *See* Dan L. Burk & Brett McDonnell, *Patents, Tax Shelters, and the Firm* (Minnesota Legal Studies Research Paper No. 07-05, Feb. 5, 2007), available at <http://ssrn.com/abstract=961749>.

as patent trolls are likely to acquire tax patent portfolios to license to tax practitioners. Development of tax strategies and the power to license would reside with entrepreneurs not subject to the ethical constraints imposed upon tax lawyers and accountants.

Potential liability for patent infringement by clients and for inducing such infringement by tax practitioners will put a number of pressures on the profession. Tax strategy patents will force practitioners to operate in new ways and to reexamine their ethical duties. These patents may move tax practice even further from a professional model to a business model. Of course, whether such a move is desirable or undesirable is a matter of which individual practitioners and members of the public will disagree.

¶ 102 POSSIBLE LEGISLATIVE AND ADMINISTRATIVE RESPONSES

¶ 102.1 Introduction

Given the very different concerns that tax practitioners have regarding tax strategy patents, several different kinds of responses are possible. They involve the Judiciary Committees, the tax-writing committees, the PTO, the Department of the Treasury, and the IRS in various combinations. They range from legislative action forbidding tax strategy patents to taxpayers' disclosing on their tax returns use of tax strategy patents.

¶ 102.2 Prohibiting Patentability

Given the tax policy and tax policy concerns that tax strategy patents raise, one obvious and seemingly easy response would be for Congress to amend the law to provide that tax strategies cannot be patented. Denying patentability by legislation is not without precedent. Under Title 42 of the United States Code, the title devoted to public health and public welfare, in a provision dating back to 1946, no patent can be granted “for any invention or discovery which is useful solely in the utilization of special nuclear material or atomic energy in an atomic weapon.”⁶³

Senators Levin, Coleman and Obama have proposed an analogous prohibition for tax patents. The Stop Tax Haven Abuse Act, which was introduced on February 17, 2007, includes a provision to amend the patent law to prohibit patents for any invention “designed to minimize, avoid, defer, or otherwise affect the liability for Federal, State, local, or foreign tax.”⁶⁴

Although offered on independent policy grounds, the Levin-Coleman-Obama proposed patent prohibition is just one part of “sweeping legislation” that is “aimed at punishing the use of overseas tax havens.”⁶⁵ Other provisions in the bill include, for example, allowing U.S. governmental officials to presume that nonpublicly traded, offshore corporations are controlled by U.S. taxpayers who formed them and to treat as

⁶³ 42 U.S.C. § 2181.

⁶⁴ *S. 681 Would Restrict Tax Havens, Shelters*, 2007 TNT 35-28, Feb. 21, 2007, available on LEXIS, TNT file. The Colorado Bar Association has sent a letter to Senators Levin, Coleman, and Obama endorsing section 303. See *Colorado Bar Opposes Patenting of Tax Advice*, 2007 TNT 5-35, March 14, 2007, available on LEXIS, TNT file. The American Institute of Certified Public Accountants (“AICPA”), in its February 28 Analysis and Legislative Proposals Regarding Patents for Tax Strategies, offered as one option enactment of legislation prohibiting issuance of patents “for tax strategies based on interpretations of federal, state, or local laws.” See *AICPA Urges Congress to Legislate Against Tax Patents*, 2007 TNT 45-22, March 7, 2007, available on LEXIS, TNT file.

⁶⁵ *Levin, Coleman, Obama Introduce Measure To Curb Foreign Abuses, Stop Tax Patents*, BNA Daily Tax Report, February 21, 1006, page G-2.

trust beneficiaries those persons who actually receive offshore trust assets.⁶⁶ Levin and Coleman introduced a version of this legislation in the last Congress without effect.⁶⁷ There is little evidence to believe that the current version is more likely to achieve traction.

Even when viewed in isolation, the breadth of the proposed tax patent provision raises a number of questions. For example, nothing in the legislative language carves out protection for computer software designed for tax reporting. In his testimony before Congress, IRS Commissioner Everson took pains to emphasize that “tax administration could in fact benefit from the granting of patents to tax products that facilitate the ability of taxpayers to plan and conduct their tax affairs in compliance with the law. For example, a patent for a novel type of tax computation software that makes filing easier could benefit many taxpayers.”⁶⁸ As noted above, the PTO has established a subclass for patents related to tax preparation and submission separate from that related to tax strategies. Tax preparation software, however, does seek to minimize taxes by giving those using it all possible tax deductions, credits or other tax benefits. The legislative language in the Levin-Coleman-Obama bill would seem to prohibit these kinds of tax patents as well and would need to be amended to avoid opposition from both tax policymakers and the software industry.

An outright prohibition on patentability also raises questions regarding the United States’ obligations under the Agreement on Trade Related Aspects of Intellectual

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ See Testimony of The Honorable Mark Everson, Commissioner of the Internal Revenue Service, Issues Relating to the Patenting of Tax Advice, *supra* note 1.

Property (“TRIPs”). TRIPs provides that “patents shall be available for any inventions, whether products or processes, in all fields of technology, provided that they are new, involve an inventive step and are capable of industrial application.”⁶⁹ Analysts differ as to whether business methods must be patentable under TRIPs because they disagree as to whether business methods constitute technologies “capable of industrial applications,” as TRIPs requires.⁷⁰ If they are not, then neither would tax strategy patents, and TRIPs would not pose a problem. Perhaps, however, allowing patents for business, financial, and legal methods generally but not for tax methods would itself raise questions of discrimination under TRIPs.⁷¹ Thus, any attempt to prohibit tax patents would need to confront and resolve the TRIPs issue.⁷²

More fundamentally, such a blanket prohibition on patentability would be strongly opposed by patent practitioners and policymakers on the grounds of good patent policy. They would dispute the premise that granting patents on tax strategies is inconsistent with the fundamental purpose of the patent laws and oppose legislation prohibiting such patents. To them, a great strength of our patent system is and has always been the breadth of its application. Our Founding Fathers gave Congress a constitutional power to “promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their Respective Writings and

⁶⁹ Agreement on Trade-Related Aspects of Intellectual Property Rights art. 27, April 15, 1994, 33 I.L.M. 1197, 1208 (1994).

⁷⁰ See Drennan, *supra* note 33, at 268-71 (summarizing debate). Commentators also note that other WTO members exclude business methods from the description of patentable subject matter. See PAUL GOLDSTEIN, INTERNATIONAL INTELLECTUAL PROPERTY LAW 303, 308-309 (2001).

⁷¹ The prohibition on patents for nuclear material and atomic weapons survives TRIPs because Article 73(b) (national security exclusion).

⁷² As discussed below, the reaction to special provision for medical procedure patents underscores the importance of addressing TRIPs.

Discoveries.”⁷³ Our patent system is intended to encourage innovation in all areas of human endeavor. As the Supreme Court has explained, Congress intends for patentable subject matter to “include anything under the sun that is made by man.”⁷⁴ To limit patent protection in a particular area, they argue, is to undermine the patent system as a whole and represents a dangerous precedent that would hurt our progress as a nation. As Nicholas P. Godici, Commissioner for Patents, testified before the Senate Finance Committee in 2004:

The uniformity and flexibility of the patenting standards of novelty, non-obviousness, adequacy of disclosure, and utility -- coupled with the incentives patents provide to invent, invest in, and disclose new technology -- have allowed millions of new inventions to be developed and commercialized. This has enhanced the quality of life for all Americans and helped fuel our country's transformation from a small, struggling nation to the most powerful economy in the world. Equally as impressive, the patent system has withstood the test of time. This is powerful evidence of the system's effectiveness in simultaneously promoting the innovation and dissemination of new technologies and the creation of new industries and jobs.⁷⁵

His testimony also explained that the patent system is “technology neutral and there shall be no disparate treatment for different categories of inventions.”

In other words, the patent bar is likely to see the benefit of granting patents on financial methods as a class as outweighing the costs of granting patents on tax strategies,

⁷³ U.S. Const., Art. I, § 8, cl. i.

⁷⁴ *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980).

⁷⁵ Statement of Nicholas Godici, Commissioner for Patents, U.S. Patent and Trademark Office, before the Senate Committee on Finance Hearing on “Bridging the Tax Gap” (July 21, 2004), *available at* <http://www.ogc.doc.gov/ogc/legreg/testimon/108s/godici0721.htm>.

particularly given the difficulty of distinguishing tax patents from other financial patents. As Godici further testified, “[W]e believe that any arbitrary restriction of patentability in [financial] or other technologies would certainly have negative consequences for our country, including causing deserving innovations to go unprotected and causing deserving investment to go unrewarded.”⁷⁶

Outright prohibition of all tax patents thus faces a number of obstacles. The precedent prohibiting patents for nuclear material and atomic energy is not a close analogy. One of the stated purpose of the Atomic Energy Act, where the patent prohibition is located, is to provide:

a program for Government control of the possession, use, and production of atomic energy and special nuclear material, whether owned by the Government or others, so directed as to make the maximum contribution to the common defense and security and the national welfare, and to provide continued assurance of the Government's ability to enter into and enforce agreements with nations or groups of nations for the control of special nuclear materials and atomic weapons.⁷⁷

The patent law includes special provisions related to public security keeping secret and denying applications for patents on inventions that “would be detrimental to the national security.”⁷⁸ Tax strategy patents may be detrimental to the public fisc, but they do not

⁷⁶ *Id.* A number of responses to these arguments come to mind. Any limitation would be drawn based on important policies, not on arbitrary distinctions. International practice offers one such basis for making distinctions; many other countries do not define patentability as broadly as we do and do not, for example, patent business methods. Another is that, in practice, we do in fact have different standards of patentability for different fields. See Dreyfuss, *supra* note 15, at 268-29; John R. Thomas, *The Patenting of the Liberal Professions*, 40 B.C. L. REV. 1139, 1160 (1999).

⁷⁷ 45 U.S.C. § 2013(c).

⁷⁸ 35 U.S.C §181. This provision entered the law as part of the Invention Secrecy Act of 1951. See Robert P. Merges, *Intellectual Property in Higher Life Forms: The Patent System and Controversial Technologies*, 47 MD. L. REV. 1051, 1066–1068 (1996). As noted above, TRIPs is not a concern, because TRIPs Article 73(b) provides an exception for national security.

rise to the level of endangering national security.

In addition, as a tax policy matter, any prohibition of tax strategy patents would need to distinguish such patents from software patents for tax reporting purposes. While this particular challenge is a drafting rather than a conceptual issue, one which thoughtful tax practitioners could surely be able to solve, more serious would be the potential violation of TRIPs and our nation's own commitment to a broad and neutral patent system. Many members of the patent bar are likely to oppose strongly such an approach. Thus, while an outright prohibition undoubtedly appeals to many tax practitioners wary of the impact of tax strategy patents, the likelihood of Congress enacting such a provision does not seem great. Indeed, as discussed immediately below, an attempt in the 1990's to achieve an outright prohibition on medical procedure patents failed.

¶ 102.3 Limiting Liability

An approach short of prohibiting patents on tax strategies could limit liability for infringing or inducing infringement of such patents. A provision of current patent law, sometimes referred to as the Physicians Immunity Statute,⁷⁹ bars patent holders from obtaining damages or injunctions against medical practitioners for infringing patents on medical procedures.⁸⁰ The history of the medical procedure provision, which was enacted in 1996, has a striking number of parallels to the current controversy over tax strategy patents, and these parallels suggest consideration of a similar legislative resolution for tax strategy patents.

⁷⁹ Omnibus Consolidated Appropriations Act, 1997, Limitation On Patent Infringements Relating To A Medical Practitioner's Performance Of A Medical Activity, Pub. L. No. 104-208, 110 Stat. 3009, 616 (codified as amended at 35 U.S.C. 287(c) (2000)). See Eric Lee, *The Physician's Immunity Statute*, 79 J. PAT. & TRADEMARK OFF. SOC. 701 (1997).

⁸⁰ See 35 U.S.C. § 287(c).

As with tax strategy patents, increasing numbers of patents on medical procedures started being issued by the PTO, in this case, during the 1990's. "By 1996, it was estimated that the Patent Office had been issuing as many as 15 medical procedure patents per week."⁸¹ As with the suit regarding the SOGRAT™ patent, a landmark suit caught the attention of the professional community. In 1990, Dr. Samuel Pallin, Medical Director of an eye clinic in Arizona, sued Dr. Jack Singer, a Dartmouth College assistant professor of Opt homology and the Dartmouth-Hitchcock Clinic for infringing his patented incision for cataract surgery.⁸² Ultimately, after half a million dollars in legal fees and costs, the defendants obtained a consent order invalidating the claims at issue and preventing further enforcement of the Pallin patent.⁸³

As is currently the case for tax strategy patents, professional groups began to weigh in on the question of patents on medical procedures. The American Medical Association House of Delegates voted in 1994 to oppose patents on medical and surgical procedures as unethical, concluding that they conflict with the principles of the Hippocratic Oath, which requires physicians to share their expertise and teach each other for the benefit of their patients.⁸⁴ This opinion was based on a report from the Council on Ethical and Judicial Affairs of the American Medical Association that had concluded that "it is unethical for physicians to seek, secure, or enforce patents on medical

⁸¹ Fariba Sirjani and Dariush Keyhani, 35 *U.S.C. §287(c): Language Slightly Beyond Intent*, 3 *BUFF. INTELL. PROP. L.J.* 13, 24 (2005), *citing* Brett G. Alten, *Left to One's Devices: Congress Limits Patents on Medical Procedures*, 8 *FORDHAM INTELL. PROP. MEDIA & ENT. L. J.* 837, 838 (1998).

⁸² *See* Pallin v. Singer, 36 *U.S.P.Q.2d* (BNA) 1050 (D.Vt. 1995); Susan Leach De Blasio, *Patents on Medical Procedures and the Physician Profiteer*, FindLaw, *available at* <http://library.findlaw.com/2004/Sep/19/133572.html>.

⁸³ *President Signs Medical Patent Bill; Physicians Freed from Threat of New Medical Patent Lawsuits*, PR Newswire Association, Inc., October 1, 1996," *available on LEXIS*, News, All File.

⁸⁴ American Medical Association, Council on Ethical and Judicial Affairs, Code of Medical Ethics, Opinion E-9.095, *available at* <http://www.ama-assn.org/ama/pub/category/8542.html>.

procedures.”⁸⁵ The arguments in the report parallel closely those made by tax professionals – that the profession has long relied on the open exchange of information, that patenting of medical procedures undermines the coherence of the profession, that such patents restrict access for clients, that they interfere with client-practitioner relations and the practice of the profession, that such patents will increase the cost of serving clients, that confidentiality complicates patent enforcement, that patents are not necessary to achieve innovation, and that the traditional patent standards of novelty and non-obviousness do not function well context of professional context.⁸⁶

Understanding how such concerns produced section 287(c) is important to any consideration of a similar provision for tax strategy patents. After the filing of the *Pallin* suit, a coalition of medical professional groups began lobbying for a prohibition of medical procedure patents.⁸⁷ Legislation to that effect, entitled the “Medical Procedures Innovation and Affordability Act,” was introduced on March 3, 1995 by Representative

⁸⁵ American Medical Association, Council on Ethical and Judicial Affairs, *Ethical Issues in the Patenting of Medical Procedures*, 53 FOOD & DRUG L.J. 341, 351 (1998). Professor Thomas has made similar observation also applicable to concerns of tax practitioners: “[T]raditionally patent-free professions may resist the prospect of extensive appropriation of their techniques. Patents have the potential to constrain professionals in the exercise of autonomous responsibility in their practices. Furthermore, the ability of a profession to serve the public good may also be affected by patenting, which could alter the willingness of professionals to disseminate and put into practice new learning.” See Thomas, *supra* note 76, at 1176.

⁸⁶ Justice Breyer’s dissent from the dismissal of *certiorari* as improvidently granted in *Laboratory Corporation of America v. Metabolite Laboratories*, 126 S.Ct. 2921 (2006), echoed these concerns. He worried that upholding a particular patent claim involving detection of vitamin deficiency using a homocysteine assay could “inhibit doctors from using their best medical judgment; . . . force doctors to spend unnecessary time and energy to enter into license agreements; . . . divert resources from the medical task of healthcare to the legal task of searching patent files for similar simple correlations; and raise the cost of healthcare while inhibiting its effective delivery.” *Id.* at 2928-29.

⁸⁷ They included the American Medical Association, the American Society of Cataract and Refractive Surgery, American Academy of Dermatology, American Academy of Ophthalmology, American Academy of Orthopedic Surgeons, American Academy of Otolaryngology Head and Neck Surgery, American Association of Neurological Surgery, American College of Radiology, American College of Surgeons, American Institute of Ultrasound in Medicine, American Society of Dermatologic Surgery, American Society of Plastic and Reconstructive Surgery, American Urological Association, Association of American Medical Colleges, Society of Cardiovascular and Interventional Surgery, and the Society of Vascular Technology. See Sirjani and Keyhani, *supra* note 81, at 26.

Ganske (R-Iowa), a surgeon, on behalf of himself and Representative Ron Wyden (D-Oregon).⁸⁸

The Subcommittee on Courts and Intellectual Property of the House Judiciary Committee scheduled a hearing on the bill for October 19, 1995. The day before that hearing, Senator William Frist (R-Tennessee), also a physician, apparently responding to concerns expressed by the Biotechnology Industry Organization, introduced legislation in the Senate that, rather than prohibiting medical procedure patents, would have excluded such activities from the definition of patent infringement.⁸⁹ During the House hearing on the Medical Procedures Innovation and Affordability Act the next day, the PTO offered to hold its own hearings to try to come up with an administrative approach to the problem. The PTO held these hearings on May 2, 1995.⁹⁰

When the House of Representatives was considering funding for the PTO in July of 1996, the medical procedure issue remained unresolved, although discussion was ongoing.⁹¹ Congressman Ganske offered an amendment to the appropriations bill to prohibit the PTO from using any funds to issue medical procedure patents.⁹² The Department of Commerce, of which the PTO is a part, the Intellectual Property Law Section of the American Bar Association, the American Intellectual Property Law Association, the Biotechnology Industry Organization, and the Pharmaceutical Research

⁸⁸ H.R. 1127, 104th Cong., 1st Sess.

⁸⁹ S. 1334, 104th Cong., 1st Sess.

⁹⁰ Richard P. Burgoon, Jr., *Silk Purses, Sows Ears and Other Nuances Regarding 35 U.S.C. §287(c)*, 4 U. BALT. INTELL PROP. L.J. 69, 77-78 (1996).

⁹¹ See Gerald J. Mossinghoff, *Remedies Under Patents on Medical and Surgical Procedures*, 78 J. OF THE PAT. AND TRADEMARK. OFF. SOC'Y 789 (1996).

⁹² Sec. 616(a) of H.R. 3814, 104th Cong. (1996).

Manufacturer's Association all opposed the Ganske amendment,⁹³ although its impact was unclear.

The AMA, the Pharmaceutical Research and Manufacturers of America, and the Biotechnology Industry Organization, together with representatives of various senators, including Senator Frist, began working together to develop alternative legislation. Their efforts formed the basis for section 287(c).⁹⁴ As enacted, the legislation gives immunity to physicians, patients, licensed health care practitioners and health care entities immunity from charges of infringing or inducing infringement of medical process patents,⁹⁵ but, in order to gain the support of the pharmaceutical and biotechnology industry, it also provided exceptions from this immunity for medical procedures that include the use of devices or drugs.⁹⁶ The legislation was enacted as an alternative to the Ganske language in the Omnibus Consolidated Appropriations Act.⁹⁷

The medical procedure provision thus offers a precedent for tax practitioners with concerns about tax strategy patents so similar to the concerns of the medical community regarding medical process patents. Two professional organizations have embraced section 287(c) as a model for addressing tax strategy patents. The AICPA, for example, explains:

We believe that an immunity provision is an even more appropriate legislative solution in this context than in the case of medical procedures. In the medical context, only the professional performing medical procedures had to worry about

⁹³ *Id.*; Burgoon, Jr., *supra* note 90, at 84-85.

⁹⁴ See Mossinghoff, *supra* note 91.

⁹⁵ See Andres Rueda, *Cataract Surgery, Male Impotence, Rubber Dentures and a Murder Case – What's So Special About Medical Process Patents?* 9 U. BALT. INTELL. PROP. L.J. 109, 143 (2001).

⁹⁶ See Rueda, *supra* note 95, at 144-147, for a discussion of the influence of biotechnology and pharmaceutical industries on the legislative process leading to § 287(c).

⁹⁷ Omnibus Consolidated Appropriations Act, P.L. 104-208, Section 616, 110 Stat. 3009 (1996).

infringement liability – the patients did not have to worry that they would get sued for being treated by a doctor. But in the tax strategy patent context, tax professionals and ordinary taxpayers could be liable for infringement.⁹⁸ Similarly, the Section of Taxation of the State Bar of Texas as well as the Board of Directors of the State Bar of Texas passed a resolution supporting an amendment of section 287 modeled on section 287(c) to eliminate otherwise available legal and equitable remedies for the infringement of patents covering tax planning methods by taxpayers, tax practitioners, and their related professional organizations.⁹⁹ Taking a somewhat narrower tack, Professor William Drennan has proposed that Congress prohibit the collection of damages from patent infringement based on tax savings.¹⁰⁰

The example of the legislative immunity for infringement of medical procedure patents, however, offers some caution as well as encouragement to those concerned with tax strategy patents. The individuals and groups that opposed its enactment are likely to oppose a similar provision for tax strategy patents. Opponents of the medical procedure provision included Senators Orrin Hatch, then Chairman of the Senate Judiciary Committee, and Senator William Roth, then Chairman of the Senate Finance Committee.¹⁰¹ These senators objected both to a process that bypassed consideration by the committees of jurisdiction and to the substance as “a significant departure from principles of American patent law that have been on the books for over two hundred

⁹⁸ See AICPA, *supra* note 20.

⁹⁹ See *Texas State Bar Passes Resolution*, *supra* note 10.

¹⁰⁰ Drennan, *supra* note 33, at 330.

¹⁰¹ The Senate Finance Committee has jurisdiction not only over tax matters, but also trade issues. Thus it has jurisdiction over TRIPs. See <http://www.senate.gov/~finance/sitepages/jurisdiction.htm>.

years.”¹⁰² Although drafted as a provision limited to enforcement, Senator Hatch viewed the practical effect as denying patent protection to an important class of endeavor.

Senator Hatch and others dismayed by the medical procedure provision focused on its potential conflict with TRIPs.¹⁰³ TRIPs forbids discrimination regarding fields of technology not only as to patentability but also as to “patent rights enjoyable.”¹⁰⁴ Two exceptions in TRIPs, however, may protect the provision granting immunity for infringement of medical procedure patents. The first permits excludability from patentability for “diagnostic, therapeutic and surgical methods for the treatment of humans or animals.”¹⁰⁵ Congress, therefore, could have denied patentability to medical procedure patents. That it chose instead to grant immunity from infringement liability may nonetheless be seen as allowable on the argument that the “greater includes the lesser.”¹⁰⁶ TRIPs, however, includes no analogous provision that could be applied to tax strategy patents. One scholar has predicted, “The solution reached in § 287(c) will likely remain unique to the medical community.”¹⁰⁷

Another exception in TRIPs has also been offered as protection for the medical procedure provision. TRIPs specifies that:

Members may provide limited exceptions to the exclusive rights conferred by a patent provided that such exceptions do not unreasonably conflict with a normal exploitation of the patent and do not unreasonably prejudice the legitimate

¹⁰² Cong. Rec. S11843 (September 30, 1996).

¹⁰³ Scholarship since the provision’s enactment has also criticized § 287(c) as violating TRIPs. See Cynthia M. Ho, *Patents, Patients, and Public Policy: An Incomplete Intersection at 35 U.S.C. §287(c)*, 33 U.C. DAVIS L. REV. 601 (2000).

¹⁰⁴ TRIPs, Article 27, paragraph 1.

¹⁰⁵ TRIPs, Article 27, paragraph 3.

¹⁰⁶ Thomas, *supra* note 7685, at 1177. As discussed above, however, in the case of tax strategy patents, there is an argument that TRIPs does not apply at all because they not involve a field of technology capable of industrial application.

¹⁰⁷ *Id.*

interests of the patent owner, taking account of the legitimate interests of third parties.”¹⁰⁸

Defenders of section 287(c) maintain that, under this provision of TRIPs, the interests of patients, medical practitioners, and the general public permit the limits on liability for infringing medical process patents.¹⁰⁹ If so, a similar argument could permit immunity for infringing tax strategy patents.

Supporters of section 287(c) also make a further argument based on this same language in TRIPs - that the narrow exception providing immunity from infringement does not unreasonably conflict with the normal exploitation of patents in the medical field “because the overwhelming majority of patents in that field are owned by the biotechnology and pharmaceutical industry, and the companies in that industry do not sue medical practitioners performing medical activities.”¹¹⁰ In fact, section 287(c) defines “medical activity” to exclude procedures using pharmaceutical and biotechnical patents from the statutory immunity.¹¹¹ If such an argument is valid, then allowing tax software patents the usual recoveries for infringement would be important not only as a matter of tax policy, but also to prevent violation of TRIPs.¹¹² It would also be important for

¹⁰⁸ TRIPs, Article 30.

¹⁰⁹ See Robert M. Portman, *Legislative Restriction on Medical and Surgical Procedure Patents Removes Impediments to Medical Process*, 4 U. BALT. INTELL. PROP. L. J. 91, 119 (1996). Other scholars reject this argument, saying that the provision “cannot be reasonably interpreted to swallow entirely the substantive patent provisions of TRIPs.” Ho, *supra* note 103, at 661.

¹¹⁰ See Mossinghoff, *supra* note 91 at 800.

¹¹¹ See 35 U.S.C. § 287(c)(1)(A).

¹¹² Professor Drennan, *supra* note 33, at 271, argues that the exception for protection of “*ordre public*” (which he translates as “deep-seated public policy”) in TRIPs Article 27.2 permits special treatment of tax strategy patents. My belief is that such a reading of the exception probably proves too much. His reading would allow the exception to swallow the general rule. When the phrase is considered in context (to “protect *ordre public* or morality, including to protect human, animal or plant life or health or to avoid serious prejudice to the environment”), tax policy may not qualify as deep-seated public policy. The unique importance of tax to the very existence of government, however, may provide a basis for applying this exception.

Congress to act quickly, while the number of tax strategy patents is small and enforcement actions smaller yet.

One critic of § 287(c) has noted that TRIPs does permit compulsory licensing.¹¹³ Among other requirements, TRIPs permits such licenses only if the user has first attempted to obtain a authorization to use the patent on “reasonable commercial terms” and only if the holder is paid “adequate remuneration.”¹¹⁴ Compulsory licensing of tax strategy patents would answer some of the concerns expressed by tax practitioners regarding the privatization of the tax law, it would not answer all such concerns, Moreover, unlike other countries, the United States has resisted compulsory licensing of patents.¹¹⁵ Because of the burden and unwieldiness of mandatory licensing, such a solution to the TRIPs issue for tax strategy patents would please neither tax practitioners nor patent practitioners. Nonetheless, it is a possible compromise that both groups need to be prepared to address.

TRIPs, however, may not prove any kind of problem for tax strategy patents. If TRIPs is deemed not applicable to any kind of business method patent because of its limitation to industrial applications in fields of technology, it would not prevent limitations on liability for infringement tax strategy patents.

Even if TRIPs proves not to be a problem, the experience of the medical community in the years since enactment of section 287(c) cautions tax practitioners to

¹¹³ See Ho, *supra* note 103, at 668-70, discussing Article 31 of TRIPs.

¹¹⁴ See Ho, *supra* note 103, at 669.

¹¹⁵ Compulsory licensing has been described as “anathema” to the United States patent system, since it is based on a right to exclude. See *King Instruments Corp. v. Perego*, 65 F.3d 941, 958 (Fed. Cir. 1995). Statutory exceptions do exist. Under the Clean Air Act, the Attorney General can order a patentee to license a patent that is necessary to comply with the Act upon certification by the Attorney General to a federal District Court. 75 U.S.C. § 7608. The Department of Agriculture may grant compulsory patent licenses where necessary to insure food supply. 28 U.S.C. § 1498. See also Janice M. Mueller, *Patent Misuse Through the Capture of Industry Standards*, 17 BERKELEY TECH. L. J. 623 (2002) (discussing compulsory licensing).

exercise great care in proposing an analogous provision for tax strategy patents. The medical process provision, for example, teaches how important definitions will be. Section 287 (c) applies only to “pure” process patents. Processes involving patented drugs, devices or biotechnology products are not protected. Tax practitioners seeking to draft an analogous provision will need to consider carefully how to define tax strategy patents as distinct from tax computational patents. How to treat tax strategy patents that include computational software as one component will be a particular challenge.

Recently, two authors writing about the medical process provision have explained how the limits of the provision have become clear in the decade since its enactment.¹¹⁶ When so much medical care involves a combination of medical procedures, devices and drugs, its application only to pure process patents has severely constrained its usefulness. The writers recommend a legislative broadening of the medical protection beyond pure process patents. The legislative history of the provision, however, shows how difficult such a change would be.

These authors also note that, because the immunity applies only to “medical practitioners” who infringe in the course of a “medical activity,” nonclinicians “disseminating guidelines or educational materials that explain how physicians can perform a process” can be held liable.¹¹⁷ Any analogous provision for tax strategy patents would need to take care to protect tax practitioners even when not acting on behalf of a particular client, such as in an educational capacity. Just how far the definition of tax practitioner would extend would be an issue as well. Medical practitioners, some have pointed out, does not include veterinarians.

¹¹⁶ See Aaron S. Kesselheim & Michelle M. Mello, *Medical-Process Patents – Monopolizing the Delivery of Health Care*, 355 N.ENG. J. MED 2036, 2037 (2006).

¹¹⁷ *Id.* at 2037.

Furthermore, as a critic of the medical procedure provision has observed, determining whether the immunity of § 287(c) applies will be a question of fact and thus unlikely to be resolved on summary judgment. Thus, the provision may not protect the practitioner from litigation, and a doctor accused of patent infringement may still fact need to prepare a full defense.¹¹⁸

Thus, while section 287(c) offers an attractive model for addressing tax strategy patents, it also demonstrates the difficulties of such an approach. The Judiciary Committees of the House and Senate, the committees with jurisdiction over patent law, will need to be convinced that it is appropriate to limit patent enforcement for another field of endeavor. It will be incumbent upon tax practitioners to articulate clearly and forcefully to those who are not tax professionals why tax strategy patents are different.¹¹⁹ Many groups are likely to oppose a special provision for tax strategy patents as inconsistent with the premises of our patent law. TRIPs could prove a stumbling block. A workable distinction between tax strategy patents and tax compliance software will be crucial.¹²⁰ Achieving success in the face of so many competing concerns could produce a result with a narrower protection than tax practitioners would desire, by, for example leading to legislation limited to pure strategy patents or legislation that requires compulsory licensing.

¹¹⁸ See Ho, *supra* note 103, at 643-44.

¹¹⁹ See Anthony Figg, *Should the Patent Laws Exempt Certain Innovations for Patent Eligibility?*, 24 ABA IPL NEWSLETTER 3 (2006), at <http://www.abanet.org/intelprop/newsletter/IPL%20Winter%2006.pdf>.

¹²⁰ The legislative history of the medical procedure provision gives elaborate direction regarding mixed patents that involve composition of matter, which is a patent on the use of an unpatentable composition. For such a hybrid claim, it explains, the “claim as a whole” must be examined in two steps. “The first step in this test is to determine objective of the claimed method taking into account all of the process steps set forth in the claim. The second part of this test is to determine whether steps involving the use of one or more compositions of matter either alone or in combination contribute directly to the achievement of the objective of the claimed method.” H.R. 3610 Conf. Rprt, Appendix B to Sirjani and Keyhani, *supra* note 81.

¶ 102.4 Reforming the Patent Process

Tax practitioners could also join current efforts to improve the quality of issued patents by improving the patent process. If tax practitioners choose this route, they will be working with and welcomed by many in the patent community.

The American Bar Association's Section on Intellectual Property Law recently published a white paper, *Agenda for 21st Century Patent Reform*,¹²¹ that favors more than 20 reforms. Three of these proposals – publication of all patent applications, post-grant administrative review, and expanded pre-grant rights to submit prior art -- hold particular appeal for tax practitioners troubled by tax strategy patents.

The IPL section favors publication of all patent applications 18 months after filing.¹²² As noted above, tax practitioners believe that tax strategy patent applications are more likely than applications in other fields to qualify for the “domestic-only” exception to published applications. Thus, this proposal is of particular importance to tax practitioners. Publication of patent applications helps increase patent quality by permitting private parties to identify and submit to the PTO prior art that goes to the questions of whether the claimed invention is in fact novel and nonobvious. That is, if all tax patent applications were published, the likelihood that patents would be issued for common tax strategies would decrease. Publication of all tax strategy applications would also enable the IRS to make judgments about the validity of the legal interpretations claimed in the patent application. Following its review of a tax strategy patent application, the IRS could, if needed, issue a notice along the lines of notices now

¹²¹ IPL White Paper, *supra* note 46.

¹²² *Id.* at 25.

published in connection with potentially abusive tax shelter transactions alerting potential investors to possible liabilities if they participate in the transaction. Publishing all tax strategy patent applications would thus reduce the likelihood of widespread use of abusive tax strategy patents.

The IPL White Paper also endorses “legislation to adopt post-grant opposition procedures for challenging the validity of issued patent claims at a reasonable cost.”¹²³

Again, this proposal would be of particular use for tax strategy patents. As noted above, patent infringement litigation is enormously expensive. Since tax strategy patent infringement cases seem more likely than other kinds of patent infringement cases to involve individuals, defendants will be less likely to litigate such cases through to a decision. An administrative post-grant review proceeding, like that described by the IPL White Paper, could therefore be of particular importance for tax strategy patents.

Another suggestion frequently made in connection with post-grant review would also hold appeal for tax practitioners. Many have endorsed including as evidence in such review submission of “the common general knowledge of practitioners . . . not fully described in the published literature likely to be consulted by patent examiners.”¹²⁴

Given their concerns, tax practitioners would be enthusiastic about the ability to apply the general knowledge of practitioners in post-grant review.

¹²³ *Id.* at 26.

¹²⁴ Bronwyn H. Half and Dietmar Harhoff, *Post-Grant Reviews in the U.S. Patent System – Design Choices and Expected Impact*, 19 BERKELEY TECH. L. J. 1, 13 (2004) (quoting NAT’L ACAD. OF SCI., A PATENT SYSTEM FOR THE 21ST CENTURY (Stephen A. Merrill et al., eds, 2004) at 5. See Hearing before the Subcommittee on Courts, the Internet, and Intellectual Property of the Committee of the Judiciary, House of Representatives, on Patent Quality Improvement: Post-Grant Opposition, 108th Congress, 2nd Session, June 24, 2004, Serial No. 91.

Perhaps most importantly for tax practitioners, the IPL White Paper calls for “expanding the right of the public to submit prior art in pending patent applications.”¹²⁵ As the IPL White Paper explains so succinctly, “The single biggest means to improve patent quality is to get relevant prior art before PTO examiners and make it easy for them to appropriately apply that art.”¹²⁶ Under current law, however, third parties can submit prior art only within two months of a patent application, and “such a two-month time frame may be unreasonably short.”¹²⁷ In particular, a two-month time frame is too short for tax professional groups to organize and deploy their members’ expertise in identifying and submitting prior art. The IPL White Paper would also change current law to require an explanation of the relevance of the submission to the patent application. Current law forbids any accompanying statement. Allowing such an explanation for prior art related to tax strategy patents would enable expert tax practitioners to educate patent examiners about tax law, from general principles to subtle technicalities.

Not discussed in the PTO White Paper is another approach, peer review, which the PTO will begin as a pilot this June. Under this “Peer to Patent” project, patent applications will be posted online for review by independent evaluators.¹²⁸ The project aims at establishing an open network for community peer review of patent applications.¹²⁹ The plans include “a community rating system designed to push the most respected comments to the top of the file for serious consideration by the agency’s

¹²⁵ *Id.* at 31.

¹²⁶ *Id.*

¹²⁷ *Id.* Submission also requires a \$180.00 fee. 37 C.F.R. § 1.99, § 1.17.

¹²⁸ *Intellectual Property: Social Network for Patent Review Set To Begin*, TECHNOLOGY DAILY, March 26, 2007, available on LEXIS, News, All File.

¹²⁹ See Beth Simone Noveck, “Peer to Patent”: *Collective Intelligence, Open Review, and Patent Reform*, 20 HARV. J. LAW & TECH. 123 (2006); http://dotank.nyls.edu/communitypatent/p2p_exec_sum_feb_07.pdf.

examiners.”¹³⁰ The project, which is a collaboration of the PTO and the Institute for Information Law and Policy at New York Law School under the leadership of Professor Beth Noveck, will initially accept 250 patent applications from high-tech firms such as IBM, Intel, and Microsoft.¹³¹ Software patents were chosen for this pilot peer review project in part because it is a realm “where it is especially difficult for examiners to find related documentation.”¹³² Given similar difficulties in examiner evaluation of tax strategy patent applications, tax practitioners may well wish to urge the PTO to develop a similar pilot for tax strategy patents.

Of course, additional changes would also improve the patent examination process. Hiring more examiners, particularly examiners with tax training, and paying examiners more would undoubtedly help the quality of tax strategy patents. Thus, tax practitioners may wish to support the efforts of patent groups to ensure adequate funding for the PTO, an effort similar to one tax practitioners have long undertaken on behalf of the IRS.

Tax patent quality could also be improved if the PTO could seek the assistance of the Treasury Department and the IRS in understanding tax strategy patents. Statutory authorization would be required for the PTO to obtain such assistance. In the case of plant patents, current patent law authorizes the President by Executive order upon request of the Director of the PTO to direct the Secretary of Agriculture to furnish information, conduct research or detail employees to the PTO.¹³³ An analogous provision for tax

¹³⁰ Allan Sipress, *Open Call from the Patent Office; Agency Web Site Will Solicit Advice*, WASHINGTON POST, MARCH 5, 2007 at A1.

¹³¹ *Web Review Will Bolster Small-Business Patents, PTO Official Says*, WASHINGTON INTERNET DAILY, March 30, 2007, available on LEXIS, News, All File.

¹³² Sipress, *supra* note 130.

¹³³ 35 U.S.C. § 164 provides: “The President may by Executive order direct the Secretary of Agriculture, in accordance with the requests of the Director, for the purpose of carrying into effect the provisions of this title with respect to plants (1) to furnish available information of the Department of Agriculture, (2) to

could be considered. For example, the IRS might provide its employees to the PTO as tax professors in residence or arrange for tax professors to do so, as is currently the practice at the IRS itself, although the burden on IRS resources of any such program would need to be taken into account.

Concern about bad patents is widespread in the patent community.¹³⁴ To the extent that the concerns of tax professionals focus on patents that have been inappropriately issued, they should support the efforts of others working to improve patent quality. Such efforts, however, would not address more fundamental concerns tax strategy patents raise and could divert attention away from such concerns.

¶ 102.5 Relying on the Tax Law

Concerns about tax policy and the nature of our tax system drive tax practitioners' objections to tax strategy patents. Tax policymakers share tax practitioners' worries. The Subcommittee on Select Revenue Measures of the House Committee on Ways and Means held a hearing on the topic in July of 2006.¹³⁵ Both Eric Solomon, the Treasury Department's Assistant Secretary for Tax Policy, Michael Desmond, its Tax Legislative Counsel, have stated their belief that tax strategy patents raise major policy concerns.¹³⁶ IRS Commissioner Everson recently described himself as "uncomfortable" with the

conduct through the appropriate bureau or division of the Department research upon special problems, or (3) to detail to the Director officers and employees of the Department."

¹³⁴ See, e.g., Joseph Farrell & Robert P. Merges, *Incentives to Challenge and Defend Patents: Why Litigation Won't Reliably Fix Patent Office Errors and Why Administrative Review Might Help*, 19 Berkeley Tech. L. J. 943 (2004).

¹³⁵ See *supra* note 1.

¹³⁶ See *Patenting of Tax Strategies Raises Major Policy Concerns, Solomon Says*, BNA DAILY TAX REPORT, January 23, 2007, at G-2.

patenting of strategies designed to minimize tax liability.”¹³⁷ Thus, it may be that the issue of tax strategy patents can and should be addressed through the tax law, either in the legislative or administrative process.

Several types of legislative actions under the Internal Revenue Code could be considered. The prohibition of patents on atomic energy and nuclear weapons perhaps offers a model. As noted above, this legislation is found not in Title 35, Patent Law, but as part of Title 42, Public Health and Welfare.¹³⁸ Arguably, then, a prohibition of tax strategy patents or a limitation on liability for infringing such patents could reach Congress through the Senate Finance Committee and the House Ways and Means Committee, the tax-writing committees, rather than the House and Senate Judiciary Committees. Such a path seems an unwise course to pursue, however. The chairman of the Senate Judiciary Committee did not hesitate to express his unhappiness when the liability limitation for medical procedure patents was passed without his committee’s consideration. Congress in this day and age operates very much through committees.

Other kinds of action by the tax-writing committees to limit issuance of tax strategy patents are also possible. For example, when a new tax provision is enacted, the tax-writing committee could make an effort to include language in legislative history that anticipates possible patents. For example, if the legislative history of the gift tax provisions authorizing grantor retained annuity trusts had stated that Congress anticipates that GRATs could be funded with any appreciating asset, perhaps the SOGRAT™ patent

¹³⁷ Dustin Stamper, *Democratic Takeover Not Affecting Relationship Between Congress and IRS*, *Everson Says*, 2007 TNT 60-4, March 28, 2004, available on LEXIS, TNT file.

¹³⁸ Provisions now codified at section 2181 were first enacted as part of the Atomic Energy Act in the 1946. See DONALD S. CHISUM ET AL, *PRINCIPLES OF PATENT LAW* ¶ 1.06[4] (3d ed. 2004)

application would have been denied as obvious. How much effect such an effort would have, however, is questionable.

The tax writing committees could also consider how to give the IRS access to all tax strategy patent applications. Such access would enable the IRS not only to act more quickly against abusive tax strategy patents, but also to gauge the potential effect of tax strategy patents on our tax system. As the American Bar Association's Section of Taxation wrote in a recent submission to the Treasury Department, "the agencies responsible for tax administration and tax policy should have the maximum opportunity to ascertain and evaluate the potential impact on the tax system of the grant of the patent and to consider whether legislative or administrative responses are warranted."¹³⁹

To achieve this goal, the tax-writing committee could develop a provision in the tax code requiring disclosure to the IRS of tax patent applications upon their being filed with the PTO.¹⁴⁰ Such a tax law should enable the PTO to share all patent applications with the IRS, since patent law allows disclosure of patent applications if "necessary to carry out the provisions of an Act of Congress."¹⁴¹ The risk of such action by the tax-writing committees is that it might be seen as trespassing upon the jurisdiction of the Judiciary Committees over patents.

Disclosure of at least some tax strategy patents could also be required by administrative action. Indeed, in November, the IRS and Treasury Department requested comments as to whether it should establish a new category of reportable transactions for

¹³⁹ *ABA Members Comment on New Reportable Transaction Category for Patented Tax Strategies*, 2007 TNT 36-12, February 22, 2007, available on LEXIS, TNT file. See also Professor Ellen P. Aprill, Testimony on Issues Relating to the Patenting of Tax Advice, *supra* note 1.

¹⁴⁰ The provision applicable to atomic energy and nuclear power requires the PTO to notifying the appropriate officials in the Energy Research and Development Administration regarding any such patent application. See 42 U.S.C. § 2181(d).

¹⁴¹ 35 U.S.C. § 122(a).

patented tax strategies under section 6011,¹⁴² a provision enacted in 2004, as part of the American Jobs Creation Act, to establish a regime to discourage taxpayers from participating in abusive tax shelters. Pursuant to section 6011 and the regulations thereunder, a taxpayer that engages in any of several specified types of transaction, including transactions that has been listed as the same or substantially similar to a transaction identified as a tax avoidance transaction or transactions offered under conditions of confidentiality, and that is required to file a tax return must attach to its return a prescribed disclosure statement regarding the transaction.¹⁴³

Many, although not all, commentators have supported making reportable by a taxpayer any transaction the taxpayer undertakes under a license to use a tax strategy patent.¹⁴⁴ If adopted, such a regulation would be helpful, albeit to only a limited extent. Disclosure under this set of rules is required only when a tax return must be filed. As the ABA Tax Section points out, because “it is possible that the tax consequences of implementing a patented tax strategy may not be reportable on a tax return until long after the transaction has been entered into.”¹⁴⁵ Moreover, drafting such a regulation would be challenging. Here, as well, tax strategy patents that turn on the interpretation of the tax law would have to be distinguished from patents limited to tax compliance. The IRS and Treasury would have to determine whether they wish to impose any such requirement to all transactions involving tax strategy patents or only to potentially

¹⁴² 71 Fed. Reg. 64488, 64490 (Nov. 2, 2006).

¹⁴³ See Treas. Reg. § 1.6011-4.

¹⁴⁴ See *ABA Members*, *supra* note 139; *Texas Bar Tax Section Comments on Proposed Tax Shelter Disclosure Regs*, 2007 TNT 26-24, February 27, 2004, available on LEXIS, Tax Notes file; *cf. Making Taxpayers Report Patented Tax Advice Is Bad Idea, AICPA Rep Tells IRS*, 2007 TNT 55-33, March 21, 2007, available on LEXIS, Tax Notes file.

¹⁴⁵ See *ABA Members*, *supra* note 139. The ABA Section also notes the need to address a tax patent licensor and certain other patent advisors as “material advisors” under section 6111, another provision of the tax shelter disclosure regime. *Id.*

abusive ones. The IRS and Treasury could also consider additional requirements in any such regulations, such as requiring disclosure by advisors and promoters that the existence of a patent in no way addresses the legal validity under the tax law of the technique.¹⁴⁶

In sum, the Congressional tax-writing committees as well as the IRS and Treasury could address some issues raised by tax strategy patents. Their abilities, however, are likely to be limited to disclosure and action against abusive tax strategy patents, rather than to addressing tax strategy patents more fundamentally.

¶ 103 CONCLUSION

Tax practitioners concerned about tax strategy patents and their effect upon the tax system face a number of conceptual and practical challenges. Our patent system has always been considered a key engine of our nation's progress and its breadth of application its great strength. Any attempt to carve out special rules for one area of endeavor will face a heavy burden.

Tax practitioners could ease this burden by joining other efforts already under way. They could, for example, focus on improving the quality of tax strategy patents. If so, they could simply join efforts already under way in the patent community. Improving the quality of tax strategy patents, however, would fail to resolve tax professional worries about the impact of tax strategy patents on our tax system as a whole. Similarly, while addressing potentially abusive tax strategy patents is important and thus adding a new

¹⁴⁶ See Joint Comm. on Taxation, *supra* note 5, at 24; NYSBA, *supra* note 11.

category of reportable transaction desirable, such a development will address only a small part of the problem that tax professionals perceive.

Tax practitioners could also take an expansive approach. They could, for example, urge that the problems inherent in tax strategy patents reveal the need to revisit the whole question of interpreting our patent laws to include business method patents. Business method patents have long been controversial.¹⁴⁷ Many other countries do not recognize them.¹⁴⁸ Members of the Supreme Court seem to have their doubts as well.¹⁴⁹

Business method patents, however, are now well-established in this country. The arguments against them have not gained traction with policymakers. Arguments for legislative amendment of the standards for patentability, such as Professor John Thomas' suggestion, borrowed from the other countries, that Congress "import the requirement of industrial applicability into United States patent law,"¹⁵⁰ have not been pursued. Thus, any attempt to eliminate business method patents would be an enormous undertaking and, given the lack of response to almost a decade of criticism of business method patents, unlikely to succeed.

At a lower level of generality, tax practitioners could argue that tax strategy methods are just one example of a legal method strategy. Legal strategies patents could endanger our entire legal system and should concern all lawyers and policymakers. Congress could consider tax strategy patents as one form of legal method patents and

¹⁴⁷ See Dreyfuss, *supra* note 15.

¹⁴⁸ See European Patent Convention, Arts. 52(2)(c), (3).

¹⁴⁹ Dissenting from the decision to dismiss the grant of cert in *Laboratory Corp. of America v. Metabolite Laboratories* as improvidently granted, Justice Breyer questioned the statement in *State Street* that "a process is patentable if it produces a 'useful, concrete, and tangible result.'" He wrote that "if taken literally, the statement would cover instances when this Court has held to the contrary." 126 S.Ct. 2921, 2928 (2006). Justice Kennedy, concurring in *eBay Inc. v. MercExchange LLC*, wrote of "the potential vagueness and suspect validity" of some of "the burgeoning number of patents over business methods." 126 S.Ct. 1837, 1842 (2006).

¹⁵⁰ Thomas, *supra* note 76, at 1184.

establish special rules for all legal method patents. Congress, along with state legislatures and local governing bodies, has responsibility for laws in many areas, not just tax. Legislatures create the universe within which all legal strategy patents would operate. No legal strategy patent has utility apart from the acts of the legislature, administrative agencies, or the courts. Any legal strategy patent would be fundamentally different from the patents for which our patent system was designed -- patents that involve application of technology and the laws of nature.

While one commentator has argued our current patent law excludes legal methods,¹⁵¹ Congress could act to ensure this result. Section 101 of the Patent Act states that “inventions” are patentable. The Patent Act does not define invention. Congress could add a statutory definition based on long-standing Supreme Court cases that an invention is “the application of the law of nature to a new and useful end.”¹⁵² The legislative history of such a provision could distinguish the law of nature from the law of man.¹⁵³

Such an approach would cut more broadly than many tax practitioners feel are necessary. Tax practitioners believe that tax law raises unique issues and thus, in the patent context as in other contexts, calls for unique considerations. The public is likely to agree. Taxes are a forced extraction from private parties for public purposes. Taxes are

¹⁵¹ Schwartz, *supra* note 18.

¹⁵² Funk Bros. Seed Co. v. Kalo Inoculant Co., 333 U.S. 127, 130 (1948); Gottschalk v. Benson, 409 U.S. 63, 67 (1972); Diamond v. Diehr, 450 U.S. 175, 188 n. 111. *See generally* Schwartz, *supra* note 18.

¹⁵³ Of course, “legal method patents” would have to be defined. Of course, TRIPs would have to be considered. I believe that prohibiting patents on laws in general could be seen as consistent with TRIPs either because they are not “technology” capable of “industrial application” or under the “ordre public” exception. *See supra* note 71.

where all our citizens encounter the power of government. “The power to tax is . . . the strongest, the most pervading of all powers of government.”¹⁵⁴

If tax professionals are to succeed in persuading Congress to draft rules specifically for tax strategy patents, however, they cannot take tax’s uniqueness for granted. They will need to use all their skills to articulate simply and clearly why this area is different in a way that calls for special treatment under a set of domestic laws and international treaty obligations that are premised on nondiscrimination among fields of human endeavor.¹⁵⁵

Tax strategy patents will require both tax practitioners and patent practitioners to confront and consider anew the policies, purposes, and practical effects of both sets of laws. Fortunately, the political times are auspicious for such a review. Both Senator Patrick Leahy, Chair of the Senate Judiciary Committee and Representative Howard Berman, Chair of the House Subcommittee on Courts, the Internet, and Intellectual Property, have long advocated patent reform and intend to pursue such efforts in the 110th Congress as a high priority.¹⁵⁶ Both the tax and patent communities should take advantage of this opportunity.

¹⁵⁴ *Loan Ass’n v. Topeka*, 87 U.S. (20 Wall) 655, 663 (1874).

¹⁵⁵ For example, tax professional groups might consider identifying or even undertaking surveys regarding the public’s attitude toward the tax system and the value placed on giving all citizens equal access to tax planning.

¹⁵⁶ In December of 2006, shortly before assuming his chairmanship, Senator Leahy gave a speech at Georgetown University outlining his agenda for the next Congress in which he announced, “Reforming our patent system will also be an enormous, but critically important project in the new Congress.” Patrick Leahy, *Ensuring Liberty and Security Through Checks and Balances: A Fresh Start for the Judiciary Committee in the New 110th Congress*, available at <http://leahy.senate.gov/press/200612/121306.html>. Within weeks of becoming subcommittee chair, Representative Berman held a hearing “American Innovation at Risk: “The Case for Patent Reform on February 15, 2007. See <http://judiciary.house.gov/oversight.aspx?ID=271>.