

WHEN WORLDS COLLIDE: TAX PLANNING METHOD PATENTS MEET TAX PRACTICE, MAKING ATTORNEYS THE LATEST PATENT INFRINGERS

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I. INTRODUCTION

Tax planning patents have produced an uproar exemplifying the unexpected conflict that can result “when worlds collide.”¹ Tax planning patents apply to methods of income and asset management that produce desirable tax results.² These patents exist at the intersection of two specialized and previously separated legal worlds. The patent world is governed by intellectual property rules and the bedrock principle that certain types of non-obvious innovations are best encouraged by giving their originators broad controls over the innovations for limited periods.³ The tax world is governed by a complex set of tax law standards against which the affairs of clients must be evaluated and shaped to aid the clients in lawfully reducing their tax

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1. The original “When Worlds Collide” was a 1932 science fiction novel co-written by Philip Gordon Wylie and Edwin Balmer, both of whom also authored the sequel *After Worlds Collide*. See PHILIP WYLIE & EDWIN BALMER, *AFTER WORLDS COLLIDE* (1982); PHILIP WYLIE & EDWIN BALMER, *WHEN WORLDS COLLIDE* (1999). Perhaps more familiar to most readers is the 1951 film that won the 1951 Academy Award for Best Effects, Special Effects. *When Worlds Collide* (1951), Awards, <http://www.imdb.com/title/tt0044207/awards> (last visited May 13, 2008).

2. For purposes of this article, “methods of income and asset management” include any manipulated sequence of events that alters the character or timing of income or an asset in order to achieve a legitimately available tax advantage. A second type of patent covers administrative practices used by tax specialists and other parties to carry out activities related to providing advice to clients about tax matters or carrying out client wishes regarding such matters. Such administrative practices are typically aimed at implementing an older tax planning strategy through new, more effective or efficient administrative means. In contrast, the tax strategy patents that are the primary focus of this article are aimed at directly reducing tax liabilities by qualifying a tax payer to pay a lower tax amount than would be the case if the taxpayer did not follow the new, patented method. Administrative patents affecting the implementation of tax planning strategies, while subject to many of the same considerations as the tax strategy patents evaluated here and of considerable importance in their own right as potential limitations on the professional activities of tax specialists, are not considered in depth in this article.

3. JOINT COMM. ON TAXATION, *BACKGROUND AND ISSUES RELATING TO THE PATENTING OF TAX ADVICE 2* (2006), available at <http://www.house.gov/jct/x-31-06.pdf>.

liabilities.⁴ These worlds have collided—with surprising consequences for both patent and tax specialists within the legal community—through the issuance and enforcement of patents purporting to create proprietary interests in certain tax planning techniques and thereby limiting the use of these techniques by tax planning lawyers and their clients.⁵

Practitioners from the patent and tax fields have very different opinions of tax planning patents, with each relating these patents to fundamentally different analytic frameworks that have shaped their respective world views to this point. From the perspective of patent specialists, tax planning patents are new but not surprising, evolutionary rather than revolutionary.⁶ These patents are simply logical successors to both business-method and information-processing patents, having features of both these prior types of patents.⁷ Tax planning patents typically protect computer-based means to manage income and assets in ways that produced advantageous financial results for taxpayers through tax savings.⁸ In these respects, tax planning patents are close cousins to financial method patents that have been sought and enforced for some years to protect methods of managing and monitoring financial processes.⁹

However, from the perspective of tax specialists, patents that purport to limit parties' choices about how to structure the sequence and timing of investments and income in ways that produce desirable tax consequences represent unexpected restrictions on client affairs and improperly restrict the ability of tax practitioners to provide valuable tax planning services to clients.¹⁰ When confronted with these sorts of patents, many of which were

4. David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 864 (1999).

5. For a summary of many of the concerns raised by tax planning patents, see JOINT COMM. ON TAXATION, *supra* note 3, at 22-25.

6. See Paul Schaafsma, "Tax Shelter" Patent May Be Test Case for Financial Patents, FIN. ENGINEER NEWS, Nov./Dec. 2006, 5, 20-21, <http://www.fenews-digital.com/fenews/20061112/?pg=21> (discussing prior patents relating to tax matters).

7. See, e.g., Dan L. Burk & Brett H. McDonald, *Patents, Tax Shelters and the Firm 1* (Minn. Legal Studies, Research Paper no. 07-05, 2007), available at http://papers.ssm.com/sol3/papers.cfm?abstract_id=961749 ("[F]rom the standpoint of patent law, [none of the recent recognition of tax planning patents] is particularly startling . . .").

8. See U.S. Patent No. 6,154,732 (filed July 25, 1997) (disclosing a system providing investment advice and management of pension assets).

9. Indeed, tax planning patents are arguably just a subset of financial planning patents, with the particular mechanism of achieving financial advantages associated with the former dependant on tax laws and tax savings rather than on more traditional means of producing increased business profits or other income. See *Bridging the Tax Gap: Hearing Before the S. Comm. on Fin.*, 108th Cong. 37-39 (2004) (statement of Nicholas P. Godici, Comm'r of Patents), available at <http://finance.senate.gov/hearings/95484.pdf> [hereinafter Godici Statement] (describing tax planning innovations as patentable subject matter on the ground that such methods comprise a subcategory of business methods, which have generally been found by federal courts to be patentable subject matter).

10. E.g., AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, ANALYSIS AND LEGISLATIVE PROPOSALS REGARDING PATENTS FOR TAX STRATEGIES 9 (2007), http://tax.aicpa.org/NR/rdonlyres/809114A5-558D-4A29-9E11-10C4E4254B1E/0/022807_AICPA_tax_strategy_patent_paperletterhead.DOC [hereinafter AICPA ANALYSIS]; William A. Drennan, *The Patented Loophole: How Should Congress Respond to the Judicial Invention?*, 59 FLA. L. REV. 229, 322 (2007); Matthew A. Melone, *The Patenting of Tax Strategies: A Patently Unnecessary Development*, 5 DEPAUL BUS. & COM. L.J. 437, 457-61 (2007); Dennis I. Belcher & Dana G. Fitzsimons Jr., *Tax Planners—Beware of Patented Estate Planning Techniques!*, PROBATE & PROP., Nov.-Dec. 2006, at 24, 25.

issued from the United States Patent and Trademark Office (“USPTO”) as far back as 2003, tax practitioners often respond in disbelief with comments like “surely you can’t patent that. . .” or “are you serious?”¹¹ This sense of disbelief is striking to patent practitioners only because it follows the same sense of disbelief experienced by software programmers, financial service providers, and Internet business persons as their respective fields became targets of increased levels of patent applications and litigation.

Tax specialists also express strong concerns about the impact of tax planning patents on the tax system and the equity of tax liabilities faced by taxpayers. These include concerns that: (1) tax planning patents may encourage undesirable types of innovations in tax reduction strategies, (2) the USPTO may be unable to adequately review tax planning patent applications and consequently fail to limit the restrictive impacts of patents to innovative tax planning methods, (3) the issuance of tax planning patents may incorrectly suggest to taxpayers that patented methods have special merit or legitimacy, (4) the enforcement of tax planning patents may improperly allow patent holders to gain from taxpayers’ efforts to comply with the law, and (5) the enforcement of these patents may improperly impair the equal access of taxpayers to means for complying with tax laws.¹²

This Article analyzes the growing controversies over tax method patents, focusing on tax method patents as the latest example of patent restrictions on intangible information processing innovations and related beneficial services to innovation users. The analysis presented in this Article also serves as a case study of the potential consequences and unexpected impacts of extending patent enforcement into a professional field such as legal practice by tax specialist, illuminating the potential negative interplay between patent enforcement and compliance with the law.

The discussions here do not attempt to address all of the legal issues that may stem from the issuance and enforcement of tax planning patents. Instead, I focus on five principle topics. First, I describe the steady expansion of patent-law standards concerning intangible inventions, leading to present patentable subject matter standards under which tax planning patents seem evolutionary, not revolutionary. Second, I assess whether tax planning methods are fundamentally different from prior sorts of useful advances that have been treated as patentable subject matter such that these methods should be excluded from the incentives and enforcement impacts of the patent system. Third, in order to identify some of the future consequences of patent enforcement regarding tax planning patents, I describe an existing tax planning patent and the manner in which it may be enforced against taxpayers, attorneys, accountants, and financial institutions. Fourth, I assess the ways that patents may influence the development of tax planning methods, using lessons

11. *E.g.*, Gary C. Bubb, *Commentary: Patented Tax Strategies—Are You Serious?*, 35 MASS. LAW. WKLY. 2663, 2663 (2007).

12. These types of arguments against tax planning patents based on the possible impacts of such patents on the tax system are examined in detail at a later point in this article. *See infra* Part IV.

gained from recent experience with patents on financial methods and other “intangible inventions” that, like tax planning methods, entail the management of information and other intangible items for user gains. Fifth, I evaluate recent federal legislation purporting to “solve” the problem of tax planning patents and argue that the solution may raise its own unanticipated problems.

Although the focus here is on tax planning patents, such patents (and the enforcement controversies that surround them) are but examples of a broader range of information processing and business-management patents that are likely to emerge and intersect with lawyers’ activities and law compliance in the future.¹³ In a time when almost every field is dominated by computer-based practices and devices, and when patents covering advances in these sorts of practices and devices are fundamentally important features of numerous business fields, many significant future developments in patent law may entail dealing with innovative “intangible inventions” like tax planning methods.

II. BACKGROUND

A number of United States patents now apply to steps for managing assets and income in ways that achieve advantageous tax results.¹⁴ The developers of these methods have claimed that their tax planning steps are significantly new and useful methods for achieving practical results and have obtained patents covering the methods. If valid, these patents will preclude other parties from using the patented methods without the patent holders’ permission.¹⁵

For intellectual property specialists, tax planning patents are simply the latest business-method patents, reflecting the systemization of tax reduction methods and services and the ability of computer-enhanced financial management strategies to achieve highly valuable tax results under certain circumstances. For tax practitioners, tax method patents strike at the heart of their professional services, raising the potential that they will be impeded in aiding clients to pursue lawful strategies for tax minimization because the best course for a given client is patented and cannot be used without the permission of the patent holder. In short, tax method patents promise to reward and expand efforts to strengthen tax reduction innovations by large-scale service

13. Some commentators have already expressed concern about the possibility that diverse types of legal techniques—not limited to the tax field—may be the targets of future patents. *E.g.*, Andrew A. Schwartz, *The Patent Office Meets the Poison Pill: Why Legal Methods Cannot Be Patented*, 20 HARV. J.L. & TECH. 333, 346-50 (2007).

14. *See Issues Relating to the Patenting of Tax Advice: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways & Means*, 109th Cong. (2006) (testimony of James A. Toupin, General Counsel, USPTO), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5103> [hereinafter Toupin Statement] (identifying 41 issued patents and 61 published by as yet unexamined patent applications concerning tax planning methods as of July 13, 2006).

15. A valid patent does not guarantee the patent holder the right to use the patented invention (the invention may contain features that are patented and controlled by other parties) but does allow the patent holder to prevent others from making, using, selling, or importing the patented invention without the patent holder’s permission. *See* 35 U.S.C. § 271(a) (2000) (“[W]hoever without authority makes, uses, offers to sell, or sells any patented invention . . . infringes the patent.”).

providers while impeding the client-specific, individualized service activities of traditional tax practitioners.

When tax planning practitioners are told that the tax planning methods they implement for clients may be covered by restrictive patents, they typically respond with great surprise because the patent system has, up to this point, not even been on the horizon of concern to most tax specialists.¹⁶ When told further that the attorneys themselves may be liable for patent infringement—as inducers of the infringement undertaken by clients—the level of disbelief only rises at the seemingly bizarre notion that these attorneys need to keep track of patents not only to protect their clients but to protect themselves.

Yet, these threats of patent-infringement liability are not hypothetical projections of future possibilities. The USPTO has issued a number of patents on tax planning methods¹⁷ and has even created a subclassification¹⁸ in its subject-matter records in anticipation of the large volume of such patents to come.¹⁹ At least one such patent has been the subject of litigation against a

16. See, Bubb, *supra* note 11 (commenting how most lawyers are not aware that tax strategies are patentable).

17. *E.g.*, U.S. Patent No. 6,567,790 (filed Dec. 1, 1999).

18. In 2006, the USPTO added subclass 36T to Class 705 in its patent classification system to cover innovations involving tax strategies. Full Title for Class 705 Subclass 36T, http://uspto.gov/go/classification/shadowFiles/defs705sf.htm?705_36T&S&W&1U&1V&1W#1W (last visited Apr. 2, 2008). Class 705 covers a broad range of inventions that include apparatus and corresponding methods for performing data processing operations related to the administration or management of a business or the processing of financial data. *Id.* As of July 13, 2006, there were 41 issued patents related to tax strategies classified in subclass 36T of Class 705. Toupin Statement, *supra* note 14. Further, as of that date, 61 published applications, not yet examined, related to tax strategies and were classified in this subcategory. *Id.* However, these numbers of patents and published applications may understate the actual counts. A quick review of patents purporting to implement tax shelters or otherwise achieve favorable tax results revealed a number of patents that were not included in subclass 705/36T in addition to those included in the above count. *See, e.g.*, U.S. Patent No. 5,966,693 (filed May 7, 1994) (disclosing procedure to reduce tax liabilities which is not classified in subclass 36T of Class 705). These additional patents not yet classified in the relatively new subclass devoted to tax strategies may simply reflect the USPTO's ongoing efforts to reclassify patents into this new subcategory, efforts which have not yet reached and reclassified all of the relevant patents.

19. Interestingly, by treating the new classification for tax strategy patents as a subclass of Class 705, the USPTO recognized both the important role of computer processing in many of the methods covered by these patents and the close familial relationship between tax strategy patents and other business and financial methods patents. The USPTO's patent classification definitions describe Class 705 as follows:

DATA PROCESSING: FINANCIAL, BUSINESS PRACTICE, MANAGEMENT, OR COST/PRICE DETERMINATION

This is the generic class for apparatus and corresponding methods for performing data processing operations, in which there is a significant change in the data or for performing calculation operations wherein the apparatus or method is uniquely designed for or utilized in the practice, administration, or management of an enterprise, or in the processing of financial data.

This class also provides for apparatus and corresponding methods for performing data processing or calculating operations in which a charge for goods or services is determined.

SCOPE OF THE CLASS

1. The arrangements in this class are generally used for problems relating to administration of an organization, commodities or financial transactions.

2. Mere designation of an arrangement as a "business machine" or a document as a "business form" or "business chart" without any particular business function will not cause classification in this class or its subclasses.

3. For classification herein, there must be significant claim recitation of the data processing system or calculating computer and only nominal claim recitation of any external art environment. Significantly claimed apparatus external to this class, claimed in combination with apparatus

taxpayer who assuredly implemented a patented tax planning method without a license.²⁰ Another patent has been the subject of further enforcement threats

under the class definition, which perform data processing or calculation operations are classified in the class appropriate to the external device unless specifically excluded therefrom.

4. Nominally claimed apparatus external to this class in combination with apparatus under the class definition is classified in this class unless provided for in the appropriate external class.

5. In view of the nature of the subject matter included herein, consideration of the classification schedule for the diverse art or environment is necessary for proper search.

Class 705, Data Processing: Financial, Business Practice, Management, or Cost/Price Determination, <http://www.uspto.gov/web/offices/ac/ido/oeip/taf/def/705.htm> (last visited on Apr. 2, 2008).

The new subclass 36T related to tax strategies encompass a specialized subset of the inventions included in subclass 36. *Id.* Subclass 36 is defined as including inventions that meet all of the definitions of subclasses 1, 35, and 36 (that is, subclass 36 is a subset of larger subclasses 1 and 35 of Class 705). *Id.* Thus, to fall with subclass 36, an invention must have all of the following characteristics specified in the USPTO's patent classification standards:

Subclass 1

AUTOMATED ELECTRICAL FINANCIAL OR BUSINESS PRACTICE OR MANAGEMENT ARRANGEMENT:

This subclass is indented under the class definition. Subject matter wherein an electrical apparatus and its corresponding methods perform the data processing operations, in which there is a significant change in the data or for performing calculation operations wherein the apparatus or method is uniquely designed for or utilized in the practice, administration, or management of an enterprise, or in the processing of financial data.

(1) Note. The term "arrangement" as used in this and its indented subclasses refers to either a device or to a method of use of a device for performing the indicated process. Further, a device may be an assemblage of components at a single location or may have its several components at graphically distinct locations, i.e., a network.

(2) Note. The term "enterprise" as used in this and its indented subclasses is intended to include governmental and nonprofit organizations, as well as conventional business organizations.

(3) Note. The arrangements in this and its indented subclasses are generally used for problems relating to administration of an organization, commodities, financial transactions, or recreation.

(4) Note. Mere designation of an arrangement as a "business machine" or a document as a "business form" or "business chart" without any particular business function will not cause classification in this or its indented subclasses.

...

Subclass: 35

Finance (e.g., banking, investment or credit):

This subclass is indented under subclass 1. Subject matter drawn to a computerized arrangement for planning the disposition or use of funds or securities, or extension of credit.

...

Subclass: 36

Portfolio selection, planning or analysis:

This subclass is indented under subclass 35. Subject matter drawn to a computerized arrangement for planning the selection or evaluation of securities or other investments for a single entity.

(1) Note. The term "entity" refers to an individual or other legally recognized body.

Id.

20. *Wealth Transfer Group v. Rowe*, No. 06CV00024 (D. Conn. settled Mar. 9, 2007). This litigation has gained considerable attention from tax practitioners. One tax specialist described this case as follows:

On January 6, 2006, the SOGRAT patent holder filed suit in the Connecticut United States Federal District Court for infringement of the SOGRAT patent [U.S. Patent No. 6,567,790]. The defendant in the lawsuit is Dr. John W. Rowe, the Executive Chairman of Aetna, Inc. The lawsuit is in the discovery stage and is anticipated to go to trial in 2007. Because I understand that the lawsuit is being prosecuted vigorously, the lawsuit cannot be considered a nuisance lawsuit. When this lawsuit was discussed at ACTEC's Estate and Gift Tax Committee on July 8, 2006, the vast majority of lawyers present (more than 100 experienced estate planning lawyers) indicated that they would not recommend to any client the use of a GRAT funded with nonqualified stock options without disclosing the existence of the SOGRAT patent and the pending lawsuit. In addition, these lawyers indicated that they would be reluctant to allow a client to use this technique without the permission of the patent holder.

against attorneys who, according to the patent holder, have offered or were about to offer to aid clients in using the patented method without appropriate licenses.²¹

Patents regarding tax planning techniques are emerging as significant concerns within the tax planning community.²² Tax attorneys and other tax planning specialists have raised objections that patents will limit their ability to provide valuable services to their clients and produce unexpected patent-infringement liability for themselves and their clients.²³ At the same time, parties seeking and obtaining these patents assert that they have developed advances in tax planning methods that are significant departures from earlier methods and are deserving of the sorts of patent protections and rewards that have traditionally applied to useful advances.²⁴

According to Dennis I. Belcher, an experienced tax counsel writing on behalf of the American College of Trust and Estate Counsel, tax planning patents are problematic for three reasons:

1. Patents on tax planning methods are against public policy because such patents prevent taxpayers from exercising their rights to minimize their taxes within the limits of the law, and avoiding the activity in question—the payment of taxes—is not an option;²⁵

2. “Patenting [tax] planning techniques unfairly increases a taxpayer’s costs or . . . the taxes payable by [a] taxpayer if patented techniques are not used;”²⁶ and

Issues Relating to the Patenting of Tax Advice: Hearing Before the H. Comm. on Ways & Means, 109th Cong. (2006) (statement of Dennis I. Belcher, Partner, McGuireWoods LLP), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5107> [hereinafter Belcher Statement]. This suit was settled in March of 2007 on terms that seemed to support the validity of the patent involved. This settlement and its implications for tax practitioners was described by one commentator as follows:

Unfortunately, the case settled in March on terms that are not satisfactory to practitioners. In a consent final judgment based on stipulations of the parties, the court declared that the SOGRAT patent was valid and enforceable, and that the parties had entered into a confidential patent license agreement. As a result, the SOGRAT case has done nothing to allay the concerns of tax practitioners about a growing area of malpractice and patent infringement liability exposure.

Bubb, *supra* note 11.

21. This enforcement technique was described by one observer as follows:

One prominent practitioner recently told me that a holder of a tax strategy patent obtained the list of all the attendees at a meeting held to consider the area of tax law involved in the patent. The patent holder sent all of the attendees a letter saying that their business activities might be infringing his patent. Some of those who received the letter in fact paid royalties, as the least costly course of action; others went through the burden and expense of asking their lawyers to review the patent to ensure that they were not guilty of any infringement.

Issues Relating to the Patenting of Tax Advice: Hearing Before the H. Comm. on Ways & Means, 109th Cong. (2006) (statement of Ellen P. Aprill, Assoc. Dean, Loyola Law School, Los Angeles, Cal.), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5106> [hereinafter Aprill Statement].

22. AICPA ANALYSIS, *supra* note 10, at 5 (stating the AICPA’s position that tax strategy patents are contrary to sound public policy).

23. *Id.* at 2.

24. See Wendy Davis, *Patenting Tax Strategies*, TR. & EST., Mar. 2004, at 42, 44 (discussing benefits of tax strategy patents); Deborah L. Jacobs, *Patent Pending*, BLOOMBERG WEALTH MANAGER, May 2005, at 40, 42 (citing the novelty requirement as evidence of useful advances).

25. Belcher Statement, *supra* note 20.

26. *Id.*

3. “Because a patent on a tax planning technique can add credibility to the technique, patents on objectionable or aggressive tax planning techniques can hurt compliance with the federal tax laws.”²⁷

For its part, the USPTO has evidenced its agreement that advances in this field can qualify for patents by issuing a number of patents in this domain.²⁸ Responding to concerns that patented tax planning methods might implement abusive tax shelters or other misleading tax planning methods that are illegal or promote illegal underreporting of tax liabilities, the USPTO has noted that the mere possibility that a patented method might be used illegally or might be against public policy is not, by itself, a basis for the USPTO to reject a patent on a particular tax planning method.²⁹ Rather, according to the USPTO, the responsibility to police the use of tax planning methods lies with the Internal Revenue Service, the Office of Tax Policy in the Treasury Department, and Congress. The USPTO appears to feel that it has neither the statutory charter nor the expertise to preclude patents for potentially abusive tax planning methods.³⁰

Records of published patent applications regarding tax planning methods indicate that the volume of patent applications in this field is growing, meaning that the numbers of issued patents and enforcement disputes concerning tax planning patents are likely to increase in the future.³¹ Recently proposed federal legislation may halt this trend, but at the cost of creating other problems as is discussed in Part VI of this Article. These new problems relate to the difficulty of surgically excluding certain types of advances from the patent laws through vague statutory language that is likely to lead to new types of enforcement controversies about the boundaries of patenting opportunities and to potentially over-broad exclusion of advances from the patent system.

27. *Id.*

28. *See* Toupin Statement, *supra* note 14 (noting that the criteria for deciding whether to issue patent protection is “new and useful”).

29. *See id.* (citing the Federal Circuit’s decision in *Juicy Whip, Inc. v. Orange Bang, Inc.* as support for the view that potential illegal use or public policy concerns regarding an innovation are not reasons to reject a patent on the innovation, even if these concerns may justify regulation or barring of the making or use of the innovation). *Juicy Whip* involved a patent on a drink dispenser design that may have misled customers in restaurants about the source of drinks that they purchased. *Juicy Whip, Inc. v. Orange Bang, Inc.* 185 F.3d 1364, 1365 (Fed. Cir. 1999). The defendant in this case argued that the design served a misleading purpose and should not have been capable of being patented on public policy grounds. *Id.* at 1366. The Federal Circuit court rejected this view, concluding that:

Congress is free to declare particular types of inventions unpatentable for a variety of reasons, including deceptiveness. . . . Until such time as Congress does so, however, we find no basis in [the provision of federal law defining patentable subject matter] to hold that inventions can be ruled unpatentable for lack of utility simply because they have the capacity to fool some members of the public.

Id. at 1368.

30. Toupin Statement, *supra* note 14.

31. *See id.* (stating that as a result of the increasing volume of patent applications, the examination process of tax strategy patents is a growing field).

III. APPLYING PATENTS TO INTANGIBLE INNOVATIONS SUCH AS TAX PLANNING METHODS

A. *Open-Ended Extension of Patents to New Technologies and Useful Innovations*

The proper scope of patentable subject matter—and, as a consequence, the range of innovations potentially influenced by the patent system—has been one of the fundamentally important issues in patent law over the past several decades.³² Some parties have argued that historical notions of engineering and patentable subject matter should govern the outer boundaries of the patent system.³³ Up until a few decades ago, patents were applied almost exclusively to promote the development of physical technologies, including physical devices, materials, and processes.³⁴ A continuing emphasis on this history would support a view of the patent system that was limited to the types of advances emerging from useful trades or industrial activities in the past.

However, courts have thus far seen the patent system as far more dynamic than this. They have interpreted Congress's will in enacting patent laws to be that incentives should exist under those laws to expand the boundaries of what we consider to be technology and useful inventions.³⁵ Evolving patterns of innovation and product and service development have produced many major new advances that turn primarily on changes in intangible information processing.³⁶ Persons need reach no further than their purses or pockets for their cell phones to locate a primary example of this new trend in innovation. Cell phone advances have turned largely on information processing breakthroughs and the associated abilities of companies around the world to implement and manage highly complex communication systems to support cell phone calls.³⁷ Many of the key technology breakthroughs in this field were patented under the expanded notions of information-processing patents and technologies applied in recent years.³⁸

32. See generally Richard S. Gruner, *In Search of the Undiscovered Country: The Challenge of Describing Patentable Subject Matter*, 23 SANTA CLARA COMPUTER & HIGH TECH. L.J. 395, 398 (2007) (noting that federal courts have tried to define the "boundaries of patentable subject matter without knowing what sorts of advances may fall within those boundaries").

33. E.g., John R. Thomas, *The Post Industrial Patent System*, 10 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 3, 34-35 (1999).

34. See Richard S. Gruner, *Better Living Through Software: Promoting Information Processing Advances Through Patent Incentives*, 74 ST. JOHN'S L. REV. 977, 980 (2000) [hereinafter Gruner, *Better Living*] (describing the transition of patent protections from primarily physical device, materials and processes to include further types of information processing and software advances in recent years).

35. See, e.g., *Diamond v. Chakrabarty*, 447 U.S. 303, 308-09 (1980) (noting Congressional intent that patent laws be interpreted to apply to diverse types of new inventions).

36. Gruner, *Better Living*, *supra* note 34, at 990 n.31.

37. Examples of information processing methods patented in the communications field include methods for managing a communications data line, U.S. Patent No. 6,813,256 (filed Nov. 2, 2004), methods for message conversion between formats, U.S. Patent No. 7,072,359 (filed Jul. 4, 2006), and communication load monitoring and management methods, U.S. Patent No. 5,859,838 (filed Jun. 12, 1999).

38. Even relatively mundane areas of communications services, such as recording and processing of long distance service usage information, have been the targets of patent protections. See, e.g., *AT&T Corp. v.*

In general, courts have adopted a highly inclusive view of what is a new and useful advance that is potentially patentable.³⁹ By viewing the patent system as a forward-looking institution with the aim of encouraging useful designs well beyond our present knowledge, courts have rejected a view of patentable subject matters that would look to the past and limit patents to historically important lines of innovation.⁴⁰ Rather, courts have disengaged definitions of patentable subject matter from old notions of technologies or industrial practices.⁴¹ Indeed, a failure to take this sort of encompassing view of the potential range of patentable inventions would risk rendering the patent system irrelevant to many modern modes of technological advance. Actual patterns of technological advance—whether physical or intangible-based (that is, information processing)—will dictate the directions of valuable additions to consumer products. If it is to have a continuing influence in encouraging the development of many of our most socially important and commercially valuable innovations, the patent system must keep up with actual patterns of practical innovation by extending patents to the full range of innovations, tangible and intangible, that are broadly replicable, distributable, and, therefore, of widespread public importance.

B. The Central Role of Patents on New Information-Processing Technologies

One result of this open-ended view of patentable subject matter has been a trend towards the patenting of advances that emphasize information-processing methods and devices incorporating such methods.⁴² Examples of fields in which information-processing advances have been highly important—as vehicles for both commercially significant products and highly valuable patents—include:

Biotechnology—Use of genetic information for diagnostic procedures and biological product designs;⁴³

Computer Controls—Use of advanced information-processing technologies to control older devices and processes;⁴⁴

Communications—Use of new information-processing methods to

Excel Commc'ns, Inc., 172 F.3d 1352, 1353-54 (Fed. Cir. 1999) (reviewing a patented design for a recordkeeping format and method used in billing for long distance communications services).

39. See Gruner, *Better Living*, *supra* note 34, at 398-427 (summarizing trends in the development of patentable subject matter standards and the increasing inclusiveness of such standards).

40. See, e.g., *Chakrabarty*, 447 U.S. at 318 (holding that advanced biotechnology is covered by existing patent law).

41. See, e.g., *id.* at 308 (discussing the expansive language used by Congress to define the limits of patentability).

42. E.g., *Diamond v. Diehr*, 450 U.S. 175, 187 (1981) (“[A] claim drawn to subject matter otherwise statutory does not become non-statutory simply because it uses a mathematical formula, computer program, or digital computer.”).

43. See, e.g., *Chakrabarty*, 447 U.S. at 305-18 (discussing the patentability of genetically modified bacteria).

44. See, e.g., *Diehr*, 450 U.S. at 181 n.5 (dealing with the addition of computer analysis to an existing rubber molding process to better assess the molding process).

increase the volume and quality of communications systems;⁴⁵

Interpretive Systems—Use of information-processing advances aimed at squeezing analytic insights out of existent information (e.g., heart monitor data processing systems or seismic data analysis systems)⁴⁶

C. *The Judicial March Towards Inclusive Patentability Standards Regarding Intangible Innovations*

Although there are many other examples of this trend in the case law of federal courts, the following sections illustrate the broadly inclusive views that federal courts have taken of patentable subject matter. These cases define a path that leads to patent coverage for numerous information-processing advances, financial-management methods, and, by little or no extension, tax planning processes.

1. *Biotechnology*

In *Diamond v. Chakrabarty*, Chief Justice Berger, writing for the Supreme Court, articulated a broadly inclusive view of United States patent laws that continues to influence our analyses of applications of patent laws to new technologies.⁴⁷ In this case, the Court held that patent law covers advances in biotechnology, including a newly bioengineered type of bacteria that was useful in helping to break down oil products and clean up oil slicks.⁴⁸ The Court observed that the patent system authorized by Congress is not limited to older notions of what constitutes technology or engineering.⁴⁹ Rather, the Court felt that Congress intended patentable subject matter to include “anything under the sun that is made by man.”⁵⁰ Although this case dealt with a tangible innovation—a new type of bacteria—its inclusive approach to patentable subject matter signaled the potential coverage of patents for artificially created information-processing methods with practical value as examples of useful advances “made by man.”⁵¹

2. *Computer Systems for Information Processing*

In re Alappat involved a computer system for controlling visual outputs on a video screen.⁵² The computer system carefully evaluated electronic

45. For example, Qualcomm, Inc. has obtained several patents on information management technology for cell phones. See generally Simon Romero, *Qualcomm's Shrinking Act Could Pay Off Big: Company Prospers by Shedding Divisions and Focusing Fiercely on Patents*, N.Y. TIMES, Oct. 23, 2000, at C1.

46. See e.g., *Diehr*, 450 U.S. at 188-89 (discussing the interpretive function of the information processing system at issue).

47. 447 U.S. at 308-10.

48. *Id.* at 305, 318 (“A live, human-made micro-organism is patentable subject matter”).

49. *Id.* at 308 (discussing Congressional language).

50. *Id.* at 309.

51. *Id.*

52. *In re Alappat*, 33 F.3d 1526, 1537 (Fed. Cir. 1994) (en banc).

signals and determined how to best display the signals on a video screen.⁵³ The only new components in the computer system were the information processing sequences defined by the applicable computer program.⁵⁴ The Court of Appeals for the Federal Circuit found this invention to entail patentable subject matter because the system was “a specific machine that produces a useful, concrete, and tangible result.”⁵⁵

3. *Financial-Information-Processing Method*

State Street Bank & Trust Co. v. Signature Financial Group, Inc. considered a patent on a business method calling for central investment of funds from multiple financial institutions, with frequent investment status reports made to the contributing institutions (a so called “hub and spoke” system of investment and reporting).⁵⁶ This method was found to be a patentable process because the information handling involved had practical consequences in managing funds.⁵⁷ The Federal Circuit court specifically noted that, given their practical consequences, business methods should be treated no differently than other practical advances and that innovative business methods should qualify as patentable subject matters like other useful advances.⁵⁸

4. *Business-Record-Keeping Method*

The Federal Circuit court reaffirmed its support for business method patents in *AT&T Corp. v. Excel Communications, Inc.*⁵⁹ That case involved a new electronic record-keeping method for handling information on long-distance calls,⁶⁰ which was found to be patentable subject matter because of its practical usefulness in phone usage, record-keeping, and associated billing systems.⁶¹

5. *Medical-Information-Processing Method*

In *Arrhythmia Research Technology, Inc. v. Corazonix Corp.*,⁶² the Federal Circuit court considered the patentability of a computer-implemented method for interpreting heartbeat monitor data to detect possible heart problems. This system was patentable because the results it produced were not

53. *Id.*

54. *Id.* at 1561.

55. *Id.* at 1544.

56. *State Street Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1370 (Fed.Cir. 1998).

57. *Id.* at 1377.

58. *Id.* at 1375-76.

59. 172 F.3d 1352, 1356 (Fed.Cir. 1999) (reiterating that “any step-by-step process” such as this is patentable subject matter).

60. *Id.* at 1358.

61. *Id.* at 1361.

62. 958 F.2d 1053, 1054-55 (Fed. Cir. 1992).

abstract data but rather information “related to the patient’s heart activity.”⁶³ Patentable subject matter was present here because heartbeat monitor signals were “transformed” to produce a practically useful result in identifying heart abnormalities.⁶⁴

D. General Standard for Patentable Subject Matter in Intangible Innovations

The Court of Appeals for the Federal Circuit has held that patentable subject matter is present in a new composition, device, or process if one of these types of innovations is a specific advance that can be employed to produce “a useful, concrete, and tangible result.”⁶⁵ This standard is aimed at distinguishing inventions involving patentable subject matter from disembodied concepts incorporating unpatentable “abstract ideas.”⁶⁶

The key to identifying patentable subject matter—in intangible advances as well as tangible ones—is to identify features that distinguish a patentable invention from a mere abstract idea. To date, inventions involving innovations in intangible information processing have produced sufficiently practical real world effects distinguishable from unpatentable abstract ideas if the inventions have either of two types of physical impacts.⁶⁷

First, new types of information processing sometimes produce useful results by controlling the operation of a physical device or process that is separate from the computer running the software.⁶⁸ This type of invention is present where a computer-implemented information processing sequence is used to control a further device.⁶⁹ Such an invention is simply a computer-controlled machine or process, having many of the same characteristics as an equivalent process or machine that is operated through human manipulation or some other purely mechanical control mechanism.⁷⁰

Second, new types of information processing sometimes produce practical impacts by interpreting real world conditions or processes to produce additional useful information about the conditions or processes. For example, a computer-based invention can produce useful results by processing data or

63. *Id.* at 1059.

64. *Id.* at 1059.

65. *AT&T Corp.*, 172 F.3d at 1357 (Fed. Cir. 1999); *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1373 (Fed. Cir. 1998); *In re Alappat*, 33 F.3d 1526, 1544 (Fed. Cir. 1994) (en banc). *But see* *Lab. Corp. of Am. Holdings v. Metabolite Labs., Inc.*, 548 U.S. 124, 136-37 (2006) (Breyer, J., dissenting) (questioning whether standard for patentable subject matter applied by the Federal Circuit in *State Street* is consistent with Supreme Court precedent regarding such subject matter).

66. *See AT&T Corp.*, 172 F.3d at 1357 (discussing infringement action brought by holder of patent to method of indicating telephone call information against a competitor); *In re Alappat*, 33 F.3d at 1544 (distinguishing claims that are mere “abstract idea[s]” from those that “produce a useful, concrete, and tangible result”).

67. *See* Richard S. Gruner, *Intangible Inventions: Patentable Subject Matter for an Information Age*, 35 *LOY. L.A. L. REV.* 355, 457 (2002) [hereinafter Gruner, *Intangible Inventions*] (stating the “ways that software-based inventions can produce sufficient practical utility for patenting”).

68. *See, e.g., Diamond v. Diehr*, 450 U.S. 175, 187 (1981) (holding that use of a mathematical formula in an industrial process does not render it unpatentable).

69. *Id.* at 180.

70. *Id.* at 187.

signals to measure or interpret external physical surroundings. This type of invention is present where a computer controls a measurement or analysis system for gathering or analyzing data corresponding to physical characteristics, such as a system for analyzing or organizing heart beat monitor data⁷¹ or financial accounting data.⁷²

Tax planning methods can fall within either of these categories of information processing advances having practical implications. Some tax planning methods involve investment or asset management strategies that are aimed at achieving reductions in tax payments.⁷³ These sorts of methods involve practical, physical consequences in both the alterations in tax payments they produce and in the altered patterns of investment and asset management that follow as the strategies are carried out.⁷⁴ Other tax planning methods focus on better measurement and reporting of income, loss, or asset features of taxpayers' affairs.⁷⁵ These methods achieve practical utility through better measurement and interpretation of physical conditions in the form of the income, loss, or asset features monitored.⁷⁶

Given that the patent system is aimed at encouraging the development and propagation of new innovations that are useful to substantial segments of the population, the proper scope of patent protections for new types of innovations such as new tax planning methods should be interpreted in light of these goals.⁷⁷ The cases to date—particularly the rulings of the Court of Appeals for the Federal Circuit—indicate that a new method of undertaking a useful procedure will have a sufficiently practical impact to be a potentially patentable innovation if the method:

1. Fills a user need with identifiable value;
2. Addresses a need shared by multiple parties;
3. Operates in a regular manner producing consistent results; and
4. Is capable of being described clearly so as to permit effective evaluation of the innovation and its results by potential users.⁷⁸

An innovative tax planning method, capable of use by a broad set of taxpayers and producing favorable, valuable tax results would appear to meet this standard for patentable subject matter.⁷⁹

71. *Arrhythmia Research Tech., Inc. v. Corazonix Corp.*, 958 F.2d 1053, 1058-60 (Fed. Cir. 1992).

72. *See State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1370-75 (discussing suit brought by bank against assignee for electronic accounting system).

73. *See, e.g.*, U.S. Patent No. 6,567,790, at [57] (filed Dec. 1, 1999) (patenting a strategy for minimization of taxes on stock options).

74. *Id.* at col.1 1.50.

75. *See, e.g.*, U.S. Patent No. 6,292,788, at [57] (filed Sep. 18, 2001) (patenting a tax method for the management of real estate assets).

76. *Id.* at col.1 1.54

77. *See Gruner, Intangible Inventions, supra* note 67, at 423-51 (noting that the patent system's innovations should be developed in ways which are helpful to the general population).

78. *Id.* at 451-52.

79. *See Godici Statement, supra* note 9 (describing tax planning innovations as patentable subject matter).

IV. ARE TAX PLANNING PATENTS A SPECIAL CASE? DISTINCTIVE POLICY ARGUMENTS FOR EXCLUDING TAX PLANNING METHODS FROM THE PATENT SYSTEM

A number of commentators—most of them tax specialists concerned about the intrusion of patent rights into their field as a new source of restrictions on services to clients—have argued that, whatever the merits of patents generally as valuable incentives for the development and dissemination of innovations, patent interests and incentives concerning tax planning methods are undesirable due to special considerations peculiar to the tax field.⁸⁰ The arguments against tax planning patents have generally revolved around five themes: (1) tax planning patents may encourage undesirable types of innovations in tax reduction strategies (2) the USPTO may be unable to adequately review tax planning patent applications and to limit the resulting patents to properly patentable innovations, (3) the issuance of tax planning patents may improperly suggest to taxpayers that patented methods have special merit or legitimacy, (4) the enforcement of tax planning patents may improperly allow patent holders to gain from taxpayers' efforts to comply with the law, and (5) the enforcement of these patents may improperly limit the means that taxpayers have available to comply with tax laws.⁸¹ These types of domain-specific arguments against tax planning patents are examined in this section.

A. *Tax Planning Patents May Be Undesirable Because They Promote Unwanted Tax Planning Innovations*

Tax planning patents may be undesirable because the types of tax planning innovations they promote are themselves illegal or, at least, not socially beneficial. Several different versions of this argument have been put forth, each focusing on a different type of undesirable tax planning consequence or other harmful end result that tax planning patents are asserted to promote. The different variants of this argument are explored in individual subsections below.

1. *Tax Planning Patents May Encourage the Development of Abusive Tax Shelters and Planning Methods*

One concern about tax planning patents that is peculiar to the tax planning field is that the incentives or impacts of tax planning patents may encourage parties to develop or market more improper tax planning strategies than would

80. *E.g.*, Belcher & Fitzsimons Jr., *supra* note 10, at 24; Drennan, *supra* note 10, at 229; Melone, *supra* note 10, at 437 (explaining that patent interests involving tax planning methods are inapplicable to the field of tax).

81. *See* Belcher & Fitzsimons, *supra* note 10, at 26 (detailing undesirable innovations, institutional limitations of the USPTO and IRS, legitimacy issues with patented methods, and possible private ownership implications).

be the case in the absence of these patents.⁸² Abusive tax strategies may be encouraged by tax planning patents for at least two different reasons: first, the patenting of tax planning methods may aid tax shelter developers in avoiding reporting requirements designed by the IRS to curb the use of abusive tax shelters and, second, the promise of patent rewards may cause innovators to develop more abusive tax reduction strategies than would be the case without tax planning patents. For reasons described in this subsection, neither of these may be a substantial concern.

a. Circumventing Reportable Transaction Regulations

One objection to patents for tax planning methods is that tax shelter promoters might use these patents to circumvent certain reporting requirements administered by the Internal Revenue Service (“IRS”) as means for curbing abusive tax shelters.⁸³ Under present tax regulations, certain types of tax shelter arrangements must be described to the IRS in conjunction with the filing of a tax return.⁸⁴ A person (including an individual, trust, estate, partnership, association, company, or corporation) who is required to file a tax return and who participates in a “reportable transaction” is required to file a special disclosure statement in conjunction with that party’s tax return.⁸⁵ A “reportable transaction” is one of two types of tax avoidance arrangements:⁸⁶ (1) a transaction that is the same as, or substantially similar to, a “listed transaction” specifically identified by the IRS as a tax avoidance transaction and identified as a “listed transaction” by an IRS notice, regulation, or other form of published guidance;⁸⁷ or (2) one of five specific categories of transactions, including “confidential transactions” offered to a taxpayer under conditions of confidentiality⁸⁸ and for which the taxpayer has paid an advisor a minimum fee.⁸⁹

An innovative tax reduction method offered by an innovator to taxpayers under confidentiality restrictions (probably as part of trade secret licenses) obligating the taxpayers using the method not to disclose it publicly would appear to be “confidential transaction” triggering the IRS’s special reporting requirements.⁹⁰ Thus, in the absence of patent protection for a tax strategy, the

82. *Id.*

83. JOINT COMM. ON TAXATION, *supra* note 3, at 25.

84. *See* Treas. Reg. § 1.6011-4(a) (2007) (describing required statement of disclosure).

85. *Id.*

86. *Id.* § 1.6011-4(b)(1).

87. *Id.* § 1.6011-4(b)(2).

88. *Id.* § 1.6011-4(b)(3)(i). “A transaction is . . . offered . . . under conditions of confidentiality if the advisor . . . places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor’s tax strategies.” *Id.* § 1.6011-4(b)(3)(ii). This type of confidentiality arrangement would appear to protect the tax strategy involved as a trade secret of the tax advisor. Interestingly, confidentiality demanded by a taxpayer, or imposed on an advisor who is an attorney or accountant under professional responsibility rules, would not seem to establish a confidential transaction under these standards in the absence of further obligations of confidentiality imposed by the advisor.

89. *Id.* § 1.6011-4(b)(3)(i).

90. *See* JOINT COMM. ON TAXATION, *supra* note 3, at 23 (describing reportable and confidential

developer of an innovative tax strategy is faced with a difficult choice:

A tax advisor who wishes to protect a ‘proprietary’ tax structure from duplication by other competing tax advisors must, under present law and absent the availability of patent protection, weigh the cost of public disclosure (if the advisor does not insist on confidentiality) against the cost of having the transaction characterized as a reportable transaction and thus subject to heightened scrutiny (if the advisor insists on confidentiality rendering the transaction a confidential transaction [that is reportable to the IRS]).⁹¹

Patent protection for a particular tax shelter strategy may offer a third option.⁹² A tax advisor can obtain a tax planning patent on a particular strategy, thereby making it public and non-confidential.⁹³ Once implemented for particular clients (as licensees of the relevant patent holder), the strategy would arguably not constitute a confidential transaction of the sort required to be specially flagged to the IRS in tax returns because the advisor offering the strategy is not binding taxpayers to confidentiality regarding the strategy.⁹⁴ At the same time, the developer of the tax strategy would retain control over the use of it by others through the enforcement of patent rights concerning the strategy.⁹⁵

This interpretation assumes that the patented strategy is not itself a “listed transaction” or the equivalent and reportable on that ground. Furthermore, this anticipated impact of tax planning patents ignores the possibility that a particular tax advisor will add certain non-patented enhancements to a patented method and seek to keep the enhanced version confidential, thereby making the enhanced method a confidential, reportable transaction.

However, assuming that confidentiality imposed by a tax advisor (rather than a client taxpayer) must be present before a transaction is required to be reported and that only the patented and therefore public features of a patented tax planning method are implemented on behalf of a particular client, this would appear to place the taxpayer’s use of the strategy outside the IRS’s present reporting requirements.

This result may not undercut the IRS’s efforts to curb abusive tax shelters for several reasons. First, the tendency of increased patenting to bring the features of new tax shelter arrangements to public light through published patent applications and patents will increase the IRS’s opportunities to scrutinize and comment on these shelters relative to a system involving the use of similar shelters under the cloak of confidentiality agreements.⁹⁶ Second, to

transactions).

91. *Id.*

92. *Id.*

93. *Id.*

94. *See id.* (examining the new approach offered by patent protection).

95. *See id.* (noting that a patent on the structure provides protection against duplication).

96. *See id.* at 23-24 (“[E]ven some who are concerned about patents on aggressive tax avoidance strategies nevertheless suggest that the information flow from the patenting of tax strategies may allow the Congress and the IRS to more quickly identify and address any abusive tax strategies, thus curtailing the availability of such strategies. According to this argument, patents for aggressive tax structures provide a

the extent that the IRS wishes to continue monitoring taxpayers' use of tax shelters, it can simply alter its regulations to require taxpayers to disclose the use of both confidential and publicly disclosed (including patented) types of shelters. Indeed, this might be a useful way to determine the relative prevalence of different types of tax shelter methodologies and, accordingly, the degree to which the IRS may wish to devote scrutiny and evaluations to any particular type of tax shelter.

Other parties have recognized that changes in tax regulations or patent laws might be sufficient to continue to provide the IRS with information on tax shelter practices and other tax planning methods covered by patents.⁹⁷ Some of these further changes were summarized by the staff of the Congressional Joint Committee on Taxation as follows:

[T]he IRS and Treasury could amend the reportable transaction regulations to include the application, grant, or use of a tax strategy patent (either of one's own patented strategy, or pursuant to a license from the patent-holder) as a reportable transaction, or could issue administrative guidance treating certain of these actions as listed transactions. Likewise, patent-holders might be required to provide the IRS with lists of those to whom the patented tax structure has been marketed. Further, to the extent the IRS concludes (on a case-by-case basis) that a particular patented tax strategy constitutes an abusive tax avoidance transaction, the IRS can issue guidance identifying it as a listed transaction.⁹⁸

Given these options for changes in IRS reporting requirements and enforcement practices that seem able to maintain or even increase present efforts to reveal and curb abusive tax shelters, it seems unnecessary to specially restrict the incentives provided by tax planning patents to achieve enforcement benefits concerning the relatively few patented methods that will entail abusive tax reduction strategies. In short, the exclusion of all tax reduction strategies from patenting does not seem necessary to curb the few (if any) patented strategies that are abusive.

b. Producing More Abusive Strategies

Rewards associated with tax method patents may also be undesirable because they simply encourage tax method innovators to produce more abusive tax reduction strategies that are illegal and are the targets of IRS enforcement efforts.⁹⁹ Assuming that the USPTO does not detect the purely illegal

useful window into the current 'state-of-the-art' in tax shelter creation and promotion, and allow the IRS to focus its limited enforcement resources accordingly.'').

97. *Id.* at 23.

98. *Id.*

99. *Issues Relating to the Patenting of Tax Advice: Hearing before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways & Means*, 109th Cong. (2006) (statement of Hon. Mark Everson, Commissioner, Internal Revenue Service), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5104> [hereinafter Everson Statement] ("[T]axpayers may attempt to patent abusive tax schemes.").

character of a given strategy and bar a patent for the strategy based on its lack of utility, it is conceivable that the lure of an apparent patent reward might cause a tax innovator to file for and obtain a patent on an abusive method. However, this type of patent application is unlikely to be pursued as this would simply bring the abusive technique to public light and the attention of the IRS. It could easily be analyzed and publicly characterized as abusive. Furthermore, any licensing of the illegal method by the patent holder could lead the IRS directly to all those taxpayers that used the abusive method. Based on these undesirable features of patent disclosures—and the low likelihood that taxpayers would pay royalties for and adopt a patented method labeled by the IRS as abusive—the positive impact of patent incentives on the encouragement and expansion of abusive tax methods seems illusory.

Thus far, tax method innovators do not seem to view patent applications as an attractive means to protect and gain rewards for potentially abusive tax planning methods.¹⁰⁰ A review by the IRS of tax method patents and published patent applications as of July, 2006, found no abusive methods in the innovations covered by these patents and patent applications.¹⁰¹

2. Tax Planning Patents May Be Undesirable Because Patent Protection is not Needed to Encourage Tax Innovation

Tax method patents are also targets of complaints that these patents are not needed to promote innovation in the tax field as there are other incentives encouraging innovation.¹⁰² Some degree of innovation in tax reduction methods will follow from the economic interests of all taxpayers in reducing their own taxes.¹⁰³ Because they are each subject to these personal incentives to develop new tax reduction methods, taxpayers will be constantly encouraged to produce new methods.¹⁰⁴ Given the large number of taxpayers with such incentives, personal incentives may drive the creation of sufficiently numerous new ways to reduce tax payments, making the incentives created by tax planning patents superfluous.

Although personal economic incentives related to the advantages of reducing one's own taxes will doubtless encourage some innovation in taxpayers' affairs, there are two reasons to question whether these sorts of personal benefits from innovations in tax reduction methods will advance the field of tax methods to the full extent possible. First, the incentives presented to individual taxpayers may only produce relatively small, incremental advances in tax methods rather than the sort of significant, non-obvious advances over prior methods that are the objectives of patent incentives.

100. *Id.* (“[W]e thus far have not seen the use of patents in developing or marketing aggressive or abusive tax strategies.”).

101. *Id.*

102. *E.g.*, AICPA ANALYSIS, *supra* note 10, at 1-2, 8-9 (criticizing tax method patents).

103. *See* Aprilil Statement, *supra* note 21 (“Existing economic incentives already provide ample inducement for the development, promotion, and implementation of tax planning strategies.”).

104. *Id.* (discussing existing tax reduction incentives).

Second, even if a taxpayer (or an attorney working on behalf of the taxpayer) develops a non-obvious tax reduction method, that taxpayer may have little or no incentive to disclose the new method to the public, meaning that it will not enhance the overall improvement of methods in this area.

Assuming that advances in tax reduction methods are a publicly desirable goal, a system of patent rewards may add an increment of special incentives for non-obvious innovations above and beyond the personal incentives presented to taxpayers to do better in their own tax payments. Furthermore, the public disclosures achieved by patents will ensure that new methods are brought to public attention in a way that may not occur if taxpayers only have incentives to use new methods in their own non-public tax returns. In short, the type of advances promoted by the patent system are not the same as the small scale, incremental advances encouraged by personal economic interests and the scope of new method dissemination resulting from advances used by taxpayers in personal returns is likely to be far less extensive and beneficial to the tax field than the disclosures achieved through patents.

3. Tax Planning Patents May Be Undesirable Because They Encourage Actions—Lesser Payment of Taxes—That Are Not in the Public Interest

The fundamental—and most serious—objection to tax planning patents may be that we simply do not want more strategies for tax payment reductions. That is, unlike the types of benefits achieved by most patented inventions, tax planning advances do not achieve net increases in societal benefits.¹⁰⁵ Rather, tax reductions merely deprive the government—and hence, to some extent, all of us as potential beneficiaries of government action—of payments that, dollar for dollar, are kept by the taxpayer who has saved taxes. In short, there is no new efficiency or gain achieved by tax planning methods; rather, there is simply retention of money by taxpayers rather than transferring the money to the government through tax payments.

This means that improvements in tax planning methods achieve ends that are arguably undesirable in two respects: first, the “benefits” achieved are no more than dollar-for-dollar shifts of control over funds from the government to taxpayers and involve no net gains in total societal well-being; and second, the loser in this wealth transfer is the government and, by extension, the often needy societal members who would otherwise benefit from governmental expenditures of greater tax revenues.

This argument turns on drawing a distinction between social-utility-enhancing innovations and innovations achieving mere equivalents of economic transfers from one party to another. In the context of tax planning methods, the distinction between forms of utility normally promoted by patented innovations and those benefits realized through patented tax planning methods was described by one commentator as follows:

105. Drennan, *supra* note 10, at 235-36 (discussing the fact that tax strategy patents will not improve Americans' quality of life, promote economic growth, or strengthen the U.S. economy).

[T]he traditional utilitarian rationales for issuing patents [are] that new inventions improve the quality of life for all Americans, stimulate economic growth, and make the U.S. economy stronger. While those utilitarian rationales may apply in almost all other industries, they fail to support tax-strategy [sic] patents because more tax loopholes will not enhance the quality of life for all Americans, stimulate economic growth, or make the U.S. economy stronger.¹⁰⁶

There are at least three responses as to why this sort of objection to the patenting of tax method patents is misguided. These responses relate to whether tax reduction strategies should be discouraged, whether the assistance of tax reduction strategies by experts should be discouraged, and whether the dollar benefits achieved from tax avoidance are any different than the wealth transfer benefits achieved by a number of other types of patentable inventions.¹⁰⁷

a. The Merit of Tax Reduction

One type of objection to the “benefits” achieved by patented tax planning methods is that the government—and those of us who might benefit from enhanced governmental action—are harmed by tax payment reductions and such reductions should be discouraged.¹⁰⁸ However, if the tax reduction results achieved by tax method patents are illegitimate (or at least undesirable as a matter of public policy), then not only should governments discourage the development of new tax reduction strategies, but they should also discourage the use of tax reduction methods generally.

This argument disfavoring tax reductions runs afoul of the long-standing view that taxpayers’ efforts to reduce their taxes while acting within the bounds of the law are legitimate activities that should be encouraged by expert assistance.¹⁰⁹ No lesser legal figure than Learned Hand has weighed in on this point, describing the legitimacy of tax reduction activities in the following glowing terms: “Over and over again courts have said that there is nothing sinister in so arranging one’s affairs as to keep taxes as low as possible . . . nobody owes any public duty to pay more than the law demands, taxes are enforced extractions, not voluntary contributions.”¹¹⁰

In short, the law protects the legitimacy of taxpayer control over and furtherance of tax payment reductions for many of the same reasons that the law protects individuals’ control over personal financial affairs generally. That

106. *Id.*

107. See discussion *infra* Part IV.A.3.a-c.

108. Brant J. Hellwig, *Questioning the Wisdom of Patent Protection for Tax Planning*, 26 VA. TAX REV. 1005, 1006-07 (2007) (discussing the social desirability of tax planning patents).

109. *Id.* at 12.

110. *Comm’r v. Newman*, 159 F.2d 848, 850-51 (2d Cir. 1947) (Hand, J., dissenting); see also *Rothschild v. United States*, 407 F.2d 404, 413 (Ct. Cl. 1969); *Turner Constr. Co. v. United States*, 270 F. Supp. 918, 927 (S.D.N.Y. 1964); *Gregory v. Helvering*, 293 U.S. 465, 469 (1935); *Vinson & Elkins v. Comm’r*, 99 T.C. 9, 57 (1992) (standing for the concept that there is “nothing sinister” about arranging affairs to keep taxes low).

is, such control both encourages personal responsibility for their financial affairs and promotes the various other personal activities that individuals can pursue with the support of financial resources not otherwise spent on payments to the government and others.

A somewhat different argument might be raised in favor of tax payment reductions on governmental size grounds. If, as opponents of “big government” have argued for some years, governmental entities are relatively inefficient in undertaking many social tasks,¹¹¹ it may be desirable to adopt governmental policies assessing low taxes, leaving the funds in private hands that would otherwise be paid as taxes, and relying on the private individuals retaining the funds to apply the funds to desirable social purposes. If this sort of argument justifies imposing low tax levels, it would seem to also support the maximization of tax reductions—and maximization of personally retained revenues—within the bounds allowed by current tax laws. Hence, tax reduction within legal limits may be a means to promote smaller government and enhanced personal choices regarding allocations of funds, providing a somewhat different ground for the legitimacy of patented tax planning methods that aid taxpayers in tax payment reductions.

Given the general legitimacy of wealth-maximizing activities of individuals and the view expressed by Hand and others that tax reductions within the bounds allowed by law are simply instances of legitimate private wealth maximizing conduct, it is hard to argue that actions taken in the pursuit of lawful reductions in tax payments—or, to put it in positive terms, the avoidance of payment of unnecessary taxes not required by law—are illegitimate activities. Rather, they are activities aimed at minimizing the disruption and curtailment that tax payments realize in other private conduct that relies on economic resources. As such, these activities support the many valuable other things that individuals are able to do with the tax revenues that they do not pay to the government through tax reduction methods.

b. The Merit of Assistance to Taxpayers in Tax Avoidance

If the legitimacy of tax reductions generally is granted, one might still argue that, although tax reductions are allowed, they should not be encouraged. As a corollary to this point, perhaps governments should leave taxpayers to their own devices and understanding of the tax laws and let them only achieve the tax savings that they can accomplish through personal (and often unsophisticated) efforts. The difficulty with this view is that it demonizes all those who would assist taxpayers in reducing taxes. There is an entire industry of such parties—we call them “tax attorneys” and consider that they ply an honorable trade. It is difficult to separate on moral or public-policy grounds the tax attorney who aids a few clients in lawfully avoiding some measure of

111. I express no view here as to the merit of this argument (about which I have doubts, particularly in connection with governmental execution of certain social assistance programs). I only note the prevalence of support for a small government model in some quarters and the implicit legitimacy of tax reduction strategies if the desirability of smaller government is assumed.

taxes from the tax method developer who aids perhaps more parties in avoiding taxes. Both serve a similarly valuable role and, to this point, society and lawmakers have treated the tax attorneys as providing services with a net positive value.¹¹² The same should probably be said for the developers of advanced tax reduction strategies.

William A. Drennan has attempted to distinguish between tax specialists who aid taxpayers in implementing tax reduction strategies and developers of new and potentially patentable means of tax reduction, pejoratively labeling the latter a form of “mad scientist.”¹¹³ This type of innovator in tax reduction strategies should be discouraged, according to Drennan, because their innovative efforts will tend to promote unequal treatment of similarly situated taxpayers.¹¹⁴ He asserts that:

[T]he availability of tax-strategy [sic] patents will encourage a new breed of “mad-scientist” tax planners, who will pour over every new tax statute, case, or ruling in search of a nascent loophole. Taxpayers, or their advisors, who independently determine that taking certain steps will reduce their taxes may find that they must either pay license fees or face a possible infringement lawsuit. . . . Other inequities will arise, for example, between taxpayers who pay license fees to the inventor and use the loophole, and taxpayers who decide not to use the loophole because of the license fees. When similarly situated taxpayers are not treated in a similar manner, respect for the tax system erodes, triggering lower levels of voluntary tax compliance.¹¹⁵

Although the differences cited by Drennan in tax payments by licensed users of patented methods and non-licensees will doubtless be real, it is unclear why these differences are any more objectionable than those that result between taxpayers who pay sophisticated tax counsel for legal advice and reduce their tax payments accordingly and other similarly situated taxpayers who do not obtain this advice and pay more taxes. In both cases, so long as the opportunity to gain access to tax advice or tax planning methods is available to all similarly situated taxpayers, they all have the same opportunity to respond to their tax payment obligations in a similar manner. Although the desirability of similar opportunities may suggest a need for tax planning patents to be available to all taxpayers for licensing on equal terms—that is, provide an argument for forced licensing if a patent holder does not offer up licenses on equal terms—it does not make a case for rejecting tax planning patents entirely.

112. See, e.g., Free File, <http://www.irs.gov/app/freeFile/jsp/index.jsp> (last visited Apr. 2, 2008) (listing tax filing services associated with a public-private partnership to provide tax preparation help to the public).

113. Drennan, *supra* note 10, at 236; see also *SKK, Inc. v. Cambridge Sys. Group, Inc.*, 723 F.2d 553, 560 (7th Cir. 1983) (rejecting the suggestion that a software developer’s principles were “mad scientists to be locked in a corner of the castle while they tinker with new inventions”).

114. Drennan, *supra* note 10, at 236.

115. *Id.*

c. The Merit of Patent Rewards for Economic Transfers Without Increased Social Utility

Because there are arguably no net increased societal benefits from innovative tax planning methods because the resulting gains to taxpayers in tax reductions have dollar-for-dollar counterparts in reductions of governmental resources, the benefits resulting from the methods might be seen as lacking the sort of utility needed to qualify the innovations for patenting and patent rewards. However, these sorts of direct transfer benefits to users—that is, gains involving no net increase in the overall benefit shared by society, only a transfer of wealth from the government to individual taxpayers—seem similar to other types of transfer benefits that arise in a wide variety of business settings and that have been sufficient to support a wide range of business-method patents.¹¹⁶

To date, courts have not drawn a line between innovations capable of producing net increases in societal benefits and innovations just capable of transferring benefits from one party to another.¹¹⁷ The presence of utility needed for patenting is typically measured from the standpoint of the innovation user and whether that user benefited. The related question of whether another party was hurt or received some detriment from the use of the innovation is not factored into the utility discussion,¹¹⁸ meaning that the question of whether the use of the innovation creates a net gain in social benefits (taking into account all its positive and negative consequences) is never confronted. In part, this unwillingness of courts to demand a net “total” utility increase before allowing the patenting of an invention no doubt stems from judicial doubts that the full net utility produced by an innovation can be measured and summed. Utility assessments as part of patent-law analyses have been much more modest, requiring only that a modicum of positive utility or social benefit be shown in connection with an innovation for the innovation to meet the utility requirements of patent law.¹¹⁹

116. Compare *supra* Parts IV.A.3.a-b (discussing the merits of patenting tax methods), with U.S. PATENT & TRADEMARK OFFICE, AUTOMATED FINANCIAL OR MANAGEMENT DATA PROCESSING METHODS (BUSINESS METHODS) 1-6, <http://www.uspto.gov/web/menu/busmethp/whitepaper.pdf> (last visited May 14, 2008) (outlining the history of financial business method patents).

117. See, e.g., *AT&T Corp. v. Excel Commc'ns, Inc.*, 172 F.3d 1352, 1353-54 (Fed.Cir. 1999) (confirming invention constituted patentable subject matter where benefits achieved involved improved service billing records and more effective realization of one-to-one transfer payments from service users to service provider, but not considering whether invention involved any net societal gains).

118. See *Juicy Whip v. Orange Bang*, 185 F.3d 1364, 1368 (Fed. Cir. 1999) (“[E]ven if the use of a reservoir containing fluid that is not dispensed is considered deceptive, that is not by itself sufficient to render the invention unpatentable. The requirement of ‘utility’ in patent law is not a directive to the Patent and Trademark Office or the courts to serve as arbiters of deceptive trade practices.”).

119. Compare *Lowell v. Lewis*, 15 F. Cas. 1018, 1019 (C.C.D. Mass. 1817) (Story, Circuit Justice) (“All that the law requires is, that the invention should not be frivolous or injurious to the well-being, good policy, or sound morals of society. The word ‘useful,’ therefore, is incorporated into the act in contradistinction to mischievous or immoral. For instance, a new invention to poison people, or to promote debauchery, or to facilitate private assassination, is not a patentable invention. But if the invention steers wide of these objections, whether it be more or less useful is a circumstance very material to the interests of the patentee, but of no importance to the public. If it be not extensively useful, it will silently sink into contempt and disregard.”); with *Brenner v. Manson*, 383 U.S. 519, 535-36 (1966) (doing away with the morality criteria and

Once this sort of modicum of positive benefit is shown, as measured from the perspective of invention users, an invention can be covered by a patent upon the satisfaction of other patent law requirements.¹²⁰ Whether the overall benefits achieved by the invention—to users or society in general—suggest that the innovation should be adopted is left to market and regulatory processes that will subsequently govern the pricing and use of the patented invention.¹²¹ Market pricing will affect subsequent patterns of use of the patented invention because users will not be willing to pay more for access to the invention than their gains in increased utility from using the patented invention over their benefits from unpatented substitutes.¹²² Regulatory standards, including, in extreme cases, total bans on the use of the patented invention if it is found by a government authority to be generally harmful, will constrain the circumstances and practices for use of the patented invention.¹²³ The issuance of a patent merely indicates that, if the patented invention is perceived as having a net value, the patent holder will control use of the invention for the life of his or her patent and will be in a position to force the user of the invention to share some of the benefits of use of the innovation with the patent holder.¹²⁴

4. Tax Planning Patents May Produce Net Societal Losses by Impairing the IRS's Efforts to Collect Taxes

Tax planning methods may be undesirable because, by granting such patents, the USPTO frustrates the efforts of the IRS to collect taxes.¹²⁵ The losses entailed may be two-fold. If there are more tax avoidance strategies encouraged by taxpayers and needing review by the IRS, the efforts and resources needed by the IRS to keep up with the latest strategies may be greater than would be the case without tax method patents. In addition, the IRS may simply do a poorer job in collecting taxes, resulting in a reduction in tax revenues and reduced governmental resources.

This type of objection to tax method patents is an administrative counterpart to the view that tax method patents are bad because the ends that

stating that “[t]he basic quid pro quo contemplated by the Constitution and the Congress for granting a patent monopoly is the benefit derived by the public from an invention with substantial utility. Unless and until a process is refined and developed to this point—where specific benefit exists in currently available form—there is insufficient justification for permitting an applicant to engross what may prove to be a broad field.”)

120. See 35 U.S.C. §§ 101-03 (2000) (laying out the conditions for patentability, including novelty, non-obviousness, and the non-existence of specified conditions that bar patentability).

121. R. CARL MOY, 2 MOY'S WALKER ON PATENTS § 6:4 (4th ed. 2003).

122. See generally, e.g., HAROLD WINTER, TRADE-OFFS (2005) (stating that rational actors make decisions that accrue a net personal gain).

123. See Toupin Statement, *supra* note 14 (noting that the primary responsibility for regulating abusive tax planning methods—including those methods for which patents are granted—lies with the IRS and Congress).

124. See Alex Chartove, *Seller Beware! Your Own Business Methods May Make You a Target for Patent Litigation*, E-COMMERCE UPDATE, Feb. 2000, at 3, available at <http://www.akingump.com/docs/publication/184.pdf> (“Patents are extremely effective economic weapons that can be used to prevent competitors from making, using, or selling specific products or services.”).

125. See Drennan, *supra* note 10, at 236 (noting that by granting tax patents, the PTO is “frustrating the efforts . . . to reduce the economic rewards for inventing tax loopholes.”).

they promote—reductions in tax payments—are bad. Even if we (grudgingly) accept that the tax savings achieved by lawful tax reduction methods are legitimate, we need not encourage more of these reductions when we are devoting significant administrative resources in opposite directions through the efforts of the IRS to collect more taxes. The essence of this argument is that the USPTO should not undercut what the IRS is undertaking much to achieve.

This argument somewhat mischaracterizes what it is that the IRS is authorized to pursue. The activities of the IRS are aimed at ensuring that taxpayers comply with federal tax laws, which means that taxpayers should achieve no greater tax savings than the law allows. However, this does not mean that the IRS is authorized to discourage persons from realizing the benefits of lawful tax reduction methods. Hence, as tax method patents produce more and more tax reduction strategies and persons move their affairs into these methods, the individuals pursuing the new strategies will not be undertaking the sorts of abusive, illegal activities that the IRS is authorized to combat. If anything, the use of patented tax reduction strategies may make the job of the IRS easier by ensuring that the details of the various strategies involved are publicly disclosed and subjected to criticism by IRS experts and other commentators. This level of critique—as opposed to the secrecy that might otherwise cloak tax method advances and implementation—will help to ensure that abusive methods are caught and prohibited earlier and that the lines for taxpayers between legitimate and illegitimate tax reduction methods are clearer.

5. Tax Planning Patents May Produce a Net Reduction in Innovation Due to Their Stifling Effect on Tax Planning and Curtailment of Analysis and Debate

During the period of enforcement of a particular patent covering a tax planning method, it is likely that the need to obtain a license for the method and the cost of using that method under a license will reduce the frequency of its use relative to the levels of use that would prevail if the method were freely available and no patent applied.¹²⁶ This is a consequence of simple economics. Once a patent allows the patent holder to control the use of an invention and to set the price for its use, supracompetitive prices result. This elevated price will in turn lessen demand relative to levels found under active competition. The result is a curtailed use of the patented invention, either because the patent holder refuses to license it to some parties or because the patent holder charges a substantial licensing fee to license it.

Although this scenario is doubtless correct, it is the same consequence that always follows from patent enforcement during the temporary period of the life of a patent. During this period, patent holders are authorized to demand supra-competitive profits (and curtail free use of the patented

126. See Belcher Statement, *supra* note 20 (“If the taxpayer refuses to pay tribute . . . the taxpayer will be forced to forgo the use of an estate planning technique authorized by law.”); Drennan, *supra*, note 10 (noting the disadvantage to people who do not use a tax loophole because they do not pay for a license).

innovation) in order to provide them with a reward for producing the patented invention. This payment scheme is viewed as a fair means to restrict the patented innovation because the parties who use the patented invention during the period of licensing in effect “pay back” the innovator for producing his or her advance.

A key point in this analysis is that patent enforcement does not take away any of the techniques of tax reduction that existed prior to the development of the patented method. Thus, those who do not obtain a license to use the new method are no worse off than if the patented innovation had not been developed and the relevant patent had not issued. These taxpayers can still use the then existing non-patented substitutes for the patented method. These substitute methods will be available both as means for taxpayers to realize tax payment reductions and as starting points for the development of additional innovations in tax reduction methods. Because all of these substitutes for the patented method remain available, the issuance of a patent should not restrict the patterns of tax planning method use and innovation prevailing when the patented method was produced.

In addition, even at the elevated licensing prices dictated by patent enforcement, there will probably still be substantial patterns of use of the patented innovation because the patent holder will have economic incentives to price the relevant licensing royalties at levels that will ensure that taxpayers achieve net gains from the use of the patented method even after paying the necessary licensing fees. No party will pay a licensing fee that the party expects will cause her to lose money relative to the tax levels that she would achieve through non-patented methods. Hence, individuals’ projected tax savings from using a patented tax planning method will establish a practical ceiling on the royalties that parties will pay and a patent holder will be strongly encouraged to license a patented method at royalty levels that still achieve a net tax savings for the taxpayers who pay the relevant licensing fees. Hence, royalty arrangements will tend to evolve to levels that are attractive to at least a substantial number of taxpayers, who will use the method and have an opportunity to develop further tax reduction methods that incorporate the method.

The parties who will be incrementally limited in the use of patented tax planning innovations by patent enforcement are parties who would have had access to patented methods absent the issuance of tax planning patents, but who are precluded from such access by patent enforcement. If patents are generally limited to non-obvious innovations that would have been unlikely to have been developed and publicly disclosed absent the heightened motivations provided by patent incentives, then tax reduction methods that are restricted by tax planning patents will mostly be ones that would not be available to taxpayers absent such patents. For the most part, the methods that users will be “deprived” of by the enforcement of tax method patents are methods that would not have existed (or at least would not have been publicly disclosed) without the promise of patent rewards. Thus, assuming that patents encourage an increment of new methods that would not otherwise exist and it is only this

increment that is limited by subsequent patent enforcement, taxpayers are not deprived of many (if any) tax reduction methods that they would otherwise have. Likewise, subsequent development of further tax methods derived from the patented methods is not incrementally limited because the patented methods would not exist as a base for further development absent the patents.

Indeed, under this view, the existence of patents on tax planning methods and the incremental set of methods these patents will tend to produce should enhance, rather than reduce, the availability and development of new tax methods. Tax planning patents will encourage the development of new and more diverse types of tax reduction methods that are extreme “outliers” in the tax planning field because working with fundamentally new tax planning techniques or technologies will heighten the likelihood that the resulting method will be seen as non-obvious and potentially patentable. Tax planning patents will also encourage greater public disclosure of previously non-obvious methods, leading to greater dissemination and use of these significantly different techniques. Access to the broader range of tax planning methods encouraged by these patents will be partially restricted during the period of patent enforcement—that is, available only under licensing constraints—and then unrestricted once the relevant patents have expired. However, in both periods, the range of tax planning methods available to the public will be greater than would be the case without tax planning patents, provided that such patents are generally granted for types of tax planning innovations that would not have been developed through normal day-to-day efforts of average tax planning experts.

Thus, if the problem of proper tailoring of the scope of tax planning method patents can be solved—that is, if such patents can be limited primarily to advances that are non-obvious and unlikely to have been produced by the normal day-to-day evolution of tax planning methods by average tax planning experts—then the net negative impacts of tax method patents on the public’s access to desirable tax planning strategies may be small. Indeed, the incentives created by these patents should increase the range of available tax planning methods over time.

B. Tax Planning Patents May Be Undesirable Because the USPTO Cannot Properly Review and Limit Such Patents

1. Special Challenges in Determining the Validity of Tax Planning Patents

Tax planning patents may be properly excluded from the patent system if there are reasons to believe that the USPTO will be unable to adequately review applications for tax planning innovations and that the USPTO’s errors will so frequent and continuing that this type of innovation should be precluded from patenting categorically to prevent these sorts of errors. Two types of problems may be especially difficult as the USPTO seeks to limit the issuance of tax planning patents to advances that are non-obvious extensions of the prior knowledge or “prior art” in this field.

First, because they are often incorporated in the private tax planning practices of individual clients and their disclosure is constrained by confidentiality agreements or professional obligations, the advances in this field may be poorly reflected in the public records used to determine the state of knowledge in the tax planning field as of the time a new innovation is asserted to have been made. An innovation that is, in fact, not new—or, alternatively, that is a mere obvious variation from prior methods—may appear to be a significant, patentable leap forward when compared to an incomplete record of prior advances. To draw an analogy to accumulated knowledge as reflected in a library, a great deal of knowledge would appear to be new and non-obvious if one only had a fraction of the library's books to look to as a point of reference in measuring prior knowledge.

Second, because the methods for extending prior knowledge in this field are either not well understood because they are undertaken behind closed doors in confidential relationships between attorneys and clients or because many of the current means for extending prior techniques involve computerized methods for augmenting earlier tax planning methods in ways that are new to the tax planning field, evaluations of what is a non-obvious advance over prior tax planning knowledge may be particularly difficult. In this respect, tax planning method patents may suffer from the sorts of problems that are plaguing many fields as computer-enhanced versions of older devices and methods are submitted for patenting and non-obviousness evaluations turn on whether the functionality achieved by bringing computers and related capabilities into already well defined analyses and processes add non-obvious components to the earlier designs in the affected fields.¹²⁷

2. Potential Steps to Limit the Issuance and Enforcement of Improper Tax Planning Patents

Though the problems just described will be real, they may just be transitional as tax method advances are brought within the patent system and prior art records and necessary examiner skills for proper application reviews are identified and expanded. A number of steps may be useful in ensuring that tax method patents are limited to innovative tax planning methods that are significant, non-obvious departures from prior methods in this field. The following subsections summarize these possible strategies for future action.

a. Identify Field-Specific Prior Art Sources for Use in Patent Examination Processes and Enforcement Disputes

Tax specialists might profitably work with the USPTO to identify publicly accessible sources of information about past tax planning strategies so that these known strategies can be taken into account in the processing of

127. See generally Richard Gruner, *Everything Old Is New Again: Obviousness Limitations on Patenting Computer Updates of Old Designs*, 9 B.U. J. SCI & TECH. L. 209 (2003) (discussing difficulties involved with the emergence of computer updates to earlier inventions) [hereinafter Gruner, *Everything Old*].

applications for patents on tax planning methods. Prior art sources in the tax field are different in both location and content from many other types of information commonly considered by patent examiners. A complete picture of the prior art against which tax method patent applications should be measured may require personnel in the patent office to gain new information on the sources and meaning of publicly available descriptions of “state-of-the-art” tax planning methods. This same information on sources and implications of prior art, if made available to the public, would assist defendants in patent cases to challenge the validity of improvidently issued patents on tax planning methods.

b. Develop Means to Expand the Knowledge of Patent Examiners
Regarding Tax Planning Methods and Improvement Patterns

To the extent that methods of tax planning and techniques for extending prior tax planning methods to produce new methods are unfamiliar to patent examiners, presentations by tax practitioners to USPTO personnel on current tax planning techniques may be highly valuable. These sorts of presentations might be modeled on similar information sessions that the USPTO conducted to learn more about computer software programming methods and advances in the period when software patents and their examination were growing concerns for the USPTO.

c. Encourage the Submission of Prior Art References to Support the
Examination or Reexamination of Tax Planning Patents

USPTO procedures allow members of the public to submit to the agency prior art references related to published patent applications.¹²⁸ These submissions are intended for use by examiners in the subsequent review of the published applications.¹²⁹ The USPTO also has the ability to reexamine and invalidate issued patents in light of prior art that was not originally considered in the initial examination of the patents.¹³⁰ Given the uncertain state of prior art in the field of tax planning patents, a policy adopted by the Patent Office that encourages the submission of prior art in this field to enhance examination reviews and to trigger reexamination proceedings might be valuable means to ensure that unwarranted patents do not reach the stage of active enforcement.

*C. Tax Planning Patents May Be Undesirable Because They Mislead the
Public into Thinking that Patented Tax Reduction Methods are Effective or
Approved by the Government*

The issuance of a tax planning patent may be taken by taxpayers as a sign of approval by the government of a patented tax planning method or at least a

128. 37 C.F.R. § 1.99 (2007).

129. *Id.*

130. See 35 U.S.C. § 311 (2000) (“Any third-party requester at any time may file a request for inter partes reexamination by the Office of a patent on the basis of any prior art cited . . .”).

sign that the patent method is particularly effective.¹³¹ According to this view:

Patents are granted by the federal government, posing a significant risk in the case of tax strategy patents. Taxpayers may be misled into believing that a patented tax strategy bears the approval of other government agencies, such as the IRS, and therefore is a valid and viable technique under tax law.¹³²

Indeed, marketing efforts of some tax planning advisors have emphasized their capability to provide a patented method without specifying in detail how the patented method will actually benefit particular taxpayers.¹³³ This type of emphasis suggests that the parties marketing the methods hope that taxpayers will automatically believe that patented methods are proper and superior to alternatives.

Unfortunately, neither may be the case. A patented tax planning method might still be illegal because it violates statutory or regulatory standards. As noted by the staff of the Congressional Joint Committee on Taxation:

The grant of a patent in no way constitutes government (i.e., IRS) approval of the purported tax treatment asserted by the patent-holder; indeed, the IRS is often unaware of an application for a tax strategy patent until after the patent is granted. While this fact is likely to be readily understood by large and sophisticated corporate taxpayers (many of whom employ a number of in-house and outside legal advisors well-versed in both intellectual property law and tax law), this critical point may not be appreciated by an individual without formal legal training and with limited direct interaction with the Federal government. It is argued that unscrupulous tax shelter promoters could prey on such unfamiliarity by falsely holding out a patent as evidence that an aggressive tax structure has been reviewed and approved by the government and that it thus ‘works’ as advertised.¹³⁴

The type of confusion involved in the argument that a patent reflects a government endorsement of a patented method stems not from the features of tax method patents, but rather from a misconception of the scope and goals of patent laws. These laws are aimed at promoting new means of accomplishing useful tasks. The issuance of a patent does not give the patent holder an affirmative right to undertake a patented process or indicate governmental approval of the patented process. Rather, the issuance of a patent merely achieves a negative result—that is, it gives the patent holder the right to

131. AICPA ANALYSIS, *supra* note, at 10.

132. *Id.*

133. One example of the marketing uses of tax planning patents is reflected in the Web site of the Wealth Transfer Group, LLC. The first line of the Web site for these tax planners reads: “If you own non-qualified stock options, we have a patented technique to help you increase the value your family will receive.” Wealth Transfer Group, Home Page, <http://www.wealth-transfer.com/index.html> (last visited Mar. 5, 2008). The patented status of the technique in question is emphasized in this portion of the site to tweak taxpayers’ interest. Only when a site user clicks on a hyperlink are the features of the patented method and some of its possible benefits for taxpayers explained. *See id.*

134. JOINT COMM. ON TAXATION, *supra* note 3, at 24.

prevent others from using the patented process without gaining the patent holder's permission and paying an associated licensing fee. If a patented method is (or becomes) illegal, no one can use the method.

The fact that use of a patented device or method may be illegal is not peculiar to the tax field. Similar issues have arisen in many fields where certain uses or applications of patented devices and methods are banned by legal standards outside the patent laws.¹³⁵ Just a few examples include a patented method of producing alcoholic liquids, which could have been used illegally during Prohibition,¹³⁶ a patented radar detector, which could be used to facilitate illegal speeding and is illegal to use in some jurisdictions,¹³⁷ a patented device for use in cock fights despite the fact that such fights are illegal in most jurisdictions,¹³⁸ and a patented gambling device, the use of which would be illegal in most jurisdictions.¹³⁹ In granting these and other like patents, the USPTO has applied patent law standards without purporting to apply other bodies of criminal or regulatory law.¹⁴⁰ This approach carries out the USPTO's limited mission as defined by the Patent Act and avoids involving that agency in law enforcement and moral analyses which the agency is poorly equipped to undertake.¹⁴¹

Whether the devices or activities governed by a patent should be regulated or even banned due to their negative social impacts is a separate matter, which can be addressed by additional legislation if Congress or a state government so wishes. Prohibitions in a number of areas prevent persons—even those with a patent license or ownership of a patented product acquired from a legitimate source—from using a patented invention. For example, in states that have prohibited the use of radar detectors, persons possessing radar detectors with patented designs are precluded from using the devices. The existence of a patent covering features of the radar detectors carries no weight in legitimizing the devices or in providing patent holders or their licensees with a basis or authorization to use the devices. The same will be true for tax method patents. The issuance of a patent will say nothing about the legal legitimacy of the method covered by the patent.

In addition to being potentially illegal, the use of patented tax planning

135. See *Toupin Statement*, *supra* note 14 (stating that the USPTO has issued patents that may be illegal in some jurisdictions).

136. U.S. Patent No. 1,785,447 (filed June, 1926).

137. U.S. Patent No. 7,023,374 (filed Oct. 6, 2002).

138. U.S. Patent No. 6,928,960 (filed Sept. 6, 2001).

139. U.S. Patent No. 6,540,609 (filed April 1, 2003).

140. In this regard, the USPTO is following the lead of the Court of Appeals for the Federal Circuit in *Juicy Whip, Inc. v. Orange Bang, Inc.*, 185 F.3d 1364 (Fed. Cir. 1999). This case involved an assertion that the inventor of an allegedly misleading design for a drink dispenser was improperly granted a patent. *Id.* at 1366. In rejecting the view that its potentially misleading use should have precluded a patent for the device, the Federal Circuit court noted:

The requirement of "utility" in patent law is not a directive to the Patent and Trademark Office or the courts to serve as arbiters of deceptive trade practices. Other agencies, such as the Federal Trade Commission and the Food and Drug Administration, are assigned the task of protecting consumers from fraud and deception in the sale of food products.

Id. at 1366.

141. *Toupin Statement*, *supra* note 14.

methods may just be ineffective—that is, little or no better in tax reduction than unpatented alternatives.¹⁴² Taxpayers may interpret the issuance of a patent as an indication that the patented tax planning method is “better” than its predecessors rather than reaching the correct conclusion that a patent just provides some evidence that the patented method is different than its predecessors or at least was perceived as such by USPTO examiners.

These sorts of potentially harmful effects on taxpayers stem at bottom from misimpressions of the practical meaning of the issuance of a patent for a tax planning method. Rather than banning or limiting such patents entirely, these sorts of informational problems are probably best solved by increasing countervailing information available to taxpayers about the potential illegality or at least limited utility of specific tax planning methods covered by patents. With this additional information, taxpayers—or, more realistically, their tax advisors—can make intelligent and accurate decisions about whether the adoption of a patented tax planning method (and the payment of an associated royalty to the patent holder) will be in the best interests of the taxpayers.

As a practical matter, concerns over the patenting of abusive tax reduction strategies and the consequent public confusion about the legitimacy of such strategies may be overstated because few, if any, abusive strategies are being patented. A review by the IRS in mid-2006 found that none of the tax reduction strategy patents issued to that point appeared to cover an abusive tax reduction method.¹⁴³

D. Tax Planning Patents May Be Undesirable Because They Allow Private Parties to “Capture” or Control Law Compliance Methods

1. Tax Planning Methods May Improperly “Capture” Certain Law Compliance Methods Under the Temporary Monopoly Control of Patent Holders

A somewhat different problem raised by tax planning patents is that a given patent may allow a patent holder to control or “capture” means of compliance with particular tax law requirements. These concerns potentially apply to non-aggressive, clearly lawful tax planning methods that are restricted by patents. The concern here is that: “patent-holders could effectively claim ownership of certain routine planning tools, or even of a method which constitutes the most efficient (or, in the extreme, the only) manner of complying with the requirements of the Internal Revenue Code and administrative guidance thereunder.”¹⁴⁴

This concern seems misplaced because, in almost all cases, a patent holder will only control one means of law compliance, not all means of law compliance. In many settings, a patented tax planning method will be only one

142. See JOINT COMM. ON TAXATION, *supra* note 3, at 24-25.

143. Everson Statement, *supra* note 99.

144. JOINT COMM. ON TAXATION, *supra* note 3, at 25.

of many means of structuring a taxpayer's affairs in a lawful manner that complies with applicable tax liability and reporting standards. Where there are numerous, unrestricted alternatives to the patented method, the mere fact that the patented version is particularly attractive should not provide special grounds for precluding patenting of the method to ensure that it is available to all parties who desire it. Patented devices or methods in various fields—for example, patented devices that are useful for complying with environmental pollution standards—are frequently more attractive than unpatented devices or methods, but this does not provide a valid argument for free use of the patented devices or methods without paying associated royalties.

Another possible objection to the “capturing” of a mode of tax law compliance through a patent is that, because all persons must obey the tax laws, the frequency with which persons could make beneficial use of innovative tax planning methods is particularly great and the costs of withholding those methods through patent rights are more significant than in other fields. However, if tax planning methods are frequently valuable to numerous parties, these would seem to be methods that we should most want the patent system to cover, thereby ensuring that patent incentives and rewards promote attention to the creation of these sorts of new methods of widespread value. This is a central principle of patent law generally: the most widely useful inventions are the ones that deserve the strongest patent protections to encourage the most vigorous development efforts, thereby matching the incentives and rewards of the system to the scope of societal benefit an inventor has pursued and achieved.

It is important to remember in thinking about the consequences of limiting access to patented tax planning methods under patent rights that a patent holder cannot force a taxpayer to adopt a patented method and that rational taxpayers will only pay an amount in royalties for use of a patented method that still achieves a net benefit for the taxpayer. At any higher rate, the taxpayer would simply forego use of the patented method and rely on non-patented substitutes. Because, under this logic, access to patented tax planning methods will tend to be available to taxpayers on terms that produce net gains to the taxpayers, the development and increased public availability of patented tax planning methods through patent-influenced processes should only expand the range of techniques available to the public and achieve net benefits to taxpayers even after the payment of associated royalties.

A related argument against patented tax planning patents is that, at least if patented tax planning methods include methods used by relatively unsophisticated taxpayers, such taxpayers may inadvertently adopt a patented method without awareness of the patent covering the method and open themselves up to patent infringement liability and disruption of their future tax planning. The short term answer to this objection is that most if not all of the sorts of tax planning methods that have qualified for patents as yet cover methods that are only helpful to and capable of use by highly affluent individual taxpayers or corporations, all of which are likely to be represented by sophisticated tax advisors. These tax advisors—probably in conjunction

with patent attorneys engaged by the advisors as patents become more important in the tax field—will be able to monitor and properly respond to patented methods as they appear. To the extent that tax planning patents may extend to techniques used by less sophisticated taxpayers in the future, the USPTO, IRS, or some other governmental agency may wish to initiate special informational practices (such as the operation of a special Web site or newsletter service) identifying and describing newly patented tax planning techniques of substantial potential importance to large numbers of relatively unsophisticated taxpayers. Of course, the patent holders themselves will have substantial motivations to publicize the emergence of these same patents.

If a patented method is the only means to comply with a particular legal requirement—or if the other alternatives are so inferior as to make their adoption economically unreasonable—there is a stronger case for restricting absolute control by the patentee over the patented method. However, this concern is similar to those in areas other than tax law compliance where rights arising under patent laws intersect with requirements of some regulatory regime.¹⁴⁵ For example, imagine a governmental health and safety standard that can only be met by using a patented product or method. To reconcile patent and regulatory considerations in these circumstances, Professor Janice M. Mueller has suggested that “[w]hen government mandates a technology standard . . . any entity holding patent rights in the subject matter of the standard should be required to license all users at reasonable commercial terms,” and failing that, “the government should consider the exercise of eminent domain over the patent.”¹⁴⁶

Though potential concerns over patent holder control of law compliance practices may be particularly strong in an area like tax planning where the very focus of innovations is on improvements in law compliance methods and associated financial results, these concerns seem no more intractable in connection with tax planning patents than they have been in other legal settings. As a basic matter, it seems unlikely that a patented tax planning method will be the only way of complying with some tax law requirement. When the requirement was imposed, Congress or the IRS presumably had at least one mode of compliance in mind and probably described it publicly. Unless that mode was one that already infringed a patent, this initially contemplated, unpatented method of compliance will continue to be available to taxpayers regardless of what later improvements or alternative methods of compliance are developed and patented. Hence, it seems highly unlikely that patenting of the sole means of compliance with a tax law requirement will ever occur.

In the extreme case where taxpayers have little practical choice but to adopt a patented tax planning method in order to comply with some statutory standard or IRS regulation, the types of legal responses advocated by Professor

145. *Id.*

146. Janice M. Mueller, *Patent Misuse Through the Capture of Industry Standards*, 17 BERKELEY TECH. L.J. 623, 684 (2002).

Mueller seem to provide adequate solutions so long as governmental actions are taken in accordance with Professor Mueller's guidance. Patent holders in these situations should be given an opportunity to adopt a reasonable royalty structure available to all taxpayers who might benefit from patented tax planning methods. If they do not adopt such a generally open approach to licensing an essential or highly valuable tax planning method, then the government should consider either alterations in the tax laws to open up further alternatives for taxpayer compliance and reduce the advantage of the patented method or the government should consider an eminent domain proceeding to compensate the patent holder for making the patented method freely available thereafter.

2. Tax Planning Patents May Improperly Transfer Some of the Benefits of Tax Reduction Strategies to Patent Holders

According to an analysis performed by the American Institute of Certified Public Accountants ("AICPA"), tax method patents are improper in part because of the surcharges such patents place on certain methods of law compliance.¹⁴⁷ In the AICPA's estimation:

The Tax Code, like other laws enacted by Congress (and state legislatures), is intended to protect the public's collective interest. In a world of tax strategy patents, whenever Congress wants to pass a tax provision to accomplish a public policy goal, it will increasingly find that the provision serves the private interest of a patent holder instead of being equally available to all. Allowing private monopolies in the form of patent protection undercuts that legislative intent. Such patents permit one person to either: (a) exclude others from the advantages of particular laws; or (b) impose a surcharge on those who want to comply with particular laws.¹⁴⁸

It is certainly true that a patented tax method and the licensing arrangement that allows a particular taxpayer to use the patented method will tend to cause the taxpayer and the patent licensor to split the economic benefit that the patented method achieves. However, even after the payment of a royalty for use of a patented method, the taxpayer must feel that he or she is achieving a net gain from the use of the patented method over the taxpayer's situation without the method. Otherwise, the taxpayer would stick with unpatented compliance techniques. Hence, even taking royalty payments into account, taxpayers will generally gain from the use of patented tax planning methods.

An example will make this economic principle clear. Suppose a patented tax method is capable of saving a taxpayer \$1000 per year in income taxes. The taxpayer would be willing to pay up to \$1000 to use this method, but not more. If the taxpayer agreed to pay \$900 for use of the method, the taxpayer

147. AICPA ANALYSIS, *supra* note 10, at 5.

148. *Id.*

would still gain \$100 a year from use of the method. If the patent holder demands \$1100 for use of the method, the taxpayer will forego the use of the method and stick with the tax results that would prevail without the method. Under these conditions, patent holders will tend to set their licensing charges to levels that are low enough to ensure that users of the patented methods retain a net advantage from the use of the methods. Absent this pricing level, the patented methods will simply not be used during the life of the patent and potential users will rely on non-patented alternatives.

Hence, although the enforcement of tax method patents will divert some of the benefit of new tax reduction methods to patent holders, the use of the patented methods, under the licensing terms that are likely to prevail due to market forces affecting the pricing of licenses in the manner just described, will still tend to achieve net benefits for taxpayers. The portion of the tax savings diverted to patent holders is simply a way to pay innovators for the development of the enhanced tax reduction strategies that allow taxpayers to produce greater tax savings than were available under prior methods. Provided that patent rewards encourage the development of more new tax reduction strategies than would be the case without such strategies, the diversion of some of the economic benefit of patented methods to the patent holders still leaves taxpayers in a better position than would prevail in the absence of tax method patents and the incremental number of tax reduction strategies these patents produce.

E. Tax Planning Patents May Be Undesirable Because the Enforcement of Such Patents May Improperly Limit the Use of Law Compliance Methods by Taxpayers

1. Tax Strategy Patents May Undermine Congressional Authority and Intent Regarding Tax Law

Tax method patents may be improper because they undercut Congressional control over tax policy and the availability of tax reduction strategies written into the tax laws. According to this view,

Congress enacts tax law provisions applicable to various taxpayers and intends that taxpayers will be able to use them. Tax strategy patents thwart this Congressional intent by giving tax strategy patent holders the power to decide how select tax law provisions can be used and who can use them. If Congress wanted to restrict the use of a particular provision in this manner, that restriction would be written into the tax law. A patent holder should not be able to unilaterally restrict the use of a particular tax provision.¹⁴⁹

This objection would be a serious problem if it were consistent with the results that would actually be obtained under patent laws. However, this argument incorrectly presumes that enforceable patents will issue for the very techniques that Congress has addressed in passing various tax laws. By

149. AICPA ANALYSIS, *supra* note 10, at 5.

definition, once Congress has specified a technique in a bill, or even in pending legislation that is published or publicly discussed, the techniques specified by Congress become “old” techniques within the field of tax reduction strategies and are not, of themselves, thereafter capable of the new creation or “invention” required for a patent.¹⁵⁰ Furthermore, all the tax reduction techniques and associated implementation details that are obvious from the way that Congress laid out a tax law provision would also be unpatentable as mere obvious variations of what Congress disclosed in the provision.¹⁵¹ What would be patentable following a new enactment would be non-obvious means of implementing the enactment or of using the tax advantages made available by the enactment as part of some non-obvious broader arrangement. Hence, in this way, patent incentives may cause innovators to extend or go beyond a Congressional enactment and define and disclose non-obvious ways of working with that enactment. However, the techniques specified by Congress could not be locked up through an enforceable patent under present provisions of the patent laws.

A related argument to the objection that patents will allow particular parties to lock up and restrict tax reduction techniques that Congress has authorized is the concern expressed by some commentators that tax strategists may seek to patent tax reduction techniques in anticipation of future Congressional enactments that would make the strategies valuable as tax reduction methods.¹⁵² Again, this argument proceeds from a mistaken view of the patent laws. As Congress considers possible tax legislation, the matters that it is considering (or that are likely to be considered in light of prior enactments) are typically going to be matters of public record, having either been discussed publicly by Congresspersons or described in publications seeking to project future Congressional actions. All the tax reduction measures that are disclosed in this way, plus the further techniques that are obvious from the disclosed techniques, could not be the subject of a valid patent if the measures were developed by the patent applicant after the point of public revelation of Congress’ actions.

Prior to the point where some party has publicly revealed a Congressional action suggesting the effectiveness of a new tax reduction method, it is unlikely the same method will have any demonstrable likelihood of reducing taxes. Absent at least some projected reduction of taxes (or at least a meaningful chance of achieving such a reduction) a method of managing investments or assets would not appear to have any tax-related utility and would fail to qualify for a patent for lack of any utility unless another type of utility were shown.

150. 35 U.S.C. § 102(a) (2000) (stating that there is no entitlement to a patent if invention is known or used by others).

151. *Id.* § 103 (stating that patents are not allowed for obvious subject matter).

152. AICPA ANALYSIS, *supra* note 10, at 5.

2. Tax Strategy Patents May Create Improper Inequalities Between Taxpayers

According to the American Institute of Certified Public Accountants (“AICPA”), tax strategy patents threaten to “undermine the integrity of our nation’s voluntary tax system” by unfairly limiting the ability of similarly situated taxpayers to make equal use of various tax reduction strategies.¹⁵³ The claim here is that all taxpayers should be able to gain the benefit of a tax reduction opportunity created by Congress without paying any special royalty charge for use of a patented method and capitalizing on the opportunity.

This argument does not specify why the features or social impacts of innovative tax reduction methods justify free public access to the methods. Patents normally produce differential access to patented innovations because only some users are licensed to use the patented methods and persons without licenses are prevented from making use of the methods. This sort of differential access is maintained under patent laws for all types of inventions — including highly important inventions such as life-saving drugs — in order to support the rewards and incentives of the patent system. Perhaps there are special reasons to protect equal access to tax reduction methods and not to accept the normal operation of patents in this area, but this distinctive treatment for tax reduction methods must be specially justified as an exception to normal patent policy and not premised on the mere fact that tax method patents will limit general access to tax reduction methods. Patents always have this differential access impact.

Furthermore, it is not clear that excluding tax reduction methods from patenting will ensure equal taxpayer access to all such methods. In the absence of such patents and the public disclosures of tax reduction methods they produce, innovators in tax reduction methods will be entitled to keep their methods secret and rely on trade secret protections to ensure a lack of general public knowledge of the methods.¹⁵⁴ They will be able to gain a commercial return by selectively licensing persons to use the new methods. Persons who can pay the license fee to gain access to the new method will be able to use it; persons who do not pay will not be able to use it. This type of differential access to new tax reduction methods was precisely the pattern that prevailed among some tax strategy innovators before innovators started seeking tax method patents.¹⁵⁵ Hence, the absence of tax method patents will not

153. *Id.*

154. A trade secret is a design, practice, device, or compilation of information that is used in one’s business and gives the trade secret holder an advantage over competitors who do not know or use the trade secret. 18 U.S.C. § 1839(3) (2000); *see also* RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39 (1995) (defining trade secret); UNIFORM TRADE SECRETS ACT § 1(4) (1985) (defining trade secret).

155. Tax planning methods have a substantial history of protection as trade secrets. While some innovative tax planning methods have been discussed widely among tax specialists soon after the methods were developed (at events such as continuing legal education conferences for tax specialists), a substantial number of tax specialists working on innovative tax planning methods have not disclosed their new methods, but have rather attempted to realize value from those methods by constraining access to them. *See* Burk & McDonald, *supra* note 7 (noting that until they began obtaining patents regarding those strategies, “innovators in tax planning had to either rely on trade secrecy or else let others use their innovations without compensation”); Davis, *supra* note 24 (discussing the advantages of patents over trade secrets); Jacobs, *supra*

necessarily lead to a system of generally available tax reduction methods, but may instead just produce a greater emphasis on trade secret protections.¹⁵⁶

3. *Because Tax Planning Patents Involve Compliance with the Law, Taxpayers Might Not Be Able to Avoid Infringing Such Patents*

Some commentators have asserted that tax planning patents are improper because taxpayers might not be able to comply with tax laws without also infringing certain patents and being forced to pay the patent holders to comply with the law.¹⁵⁷ Though it is true that the benefits achieved by carrying out patented tax planning methods are in part dictated by tax laws, it is doubtful that those laws will cover exactly the method that is patented. As has been previously discussed, if tax laws require a particular set of steps, it is doubtful that this set of steps has sufficient utility prior to the enactment or novelty after the enactment of the laws to qualify for a patent. Hence, the scenario in which a particular set of steps is legally required, but is also governed by patent rights such that a party would need to pay a patent owner to comply with the law, is highly unlikely.

What is likely is that the law will require a particular practice or payment of a certain level of taxes under certain circumstances and that a patented method will help an individual to undertake the required steps or to avoid the circumstances leading to the specified tax liability.¹⁵⁸ In these circumstances, the patented method will be one of many means of implementing the required procedure or of dealing with the circumstances leading to the tax liability. Hence, the question for patent law is whether it is appropriate for patent incentives to encourage parties to develop better alternatives for law compliance, not whether those laws will “lock up” or create charges for the only methods of law compliance.

Framed this way, it is hard to distinguish better means of law compliance and the utility they achieve from other patentable practices benefiting persons through economic gains. In many instances, better means of law compliance

note 22 (describing the use of trade secrets to protect innovative tax planning strategies and the reasons why innovators came to prefer patent protections).

156. See Godici Statement, *supra* note 9, at 202 (explaining that legislation excluding tax planning innovations from the patent system might increase the use of trade secret protections as an alternative, with a resulting reduction in public disclosures of innovative methods).

157. AICPA ANALYSIS, *supra* note 10, at 6-7; see also DOUGLAS L. YOUMANS, THE STATE BAR OF CAL., TAX PATENTS (2007), <http://www.pgdc.com/usa/item/?itemID=419800> (arguing that, if a tax method patent were enforced, “the patent holder could refuse to license the tax strategy, blocking the taxpayer’s ability to comply with the law”).

158. Douglas L. Youmans, a member of the Corporate and Business Entities Committee of the Taxation Section of the State Bar of California has argued that tax method patents generally concern implementation details regarding law compliance, not the sole means of law compliance, when, in comments on tax method patents, when he complained that “[t]ax patents thwart Congressional intent by giving patent holders the power to decide how tax law can be used and who can use it.” YOUMANS, *supra* note 157. While it is not clear that it will “thwart Congressional intent” to give patent holders incentives to develop better means for parties to comply with laws, it is true that the resulting patents will limit how the patented strategies can be used and, therefore, with respect to that method only, limit how the related tax laws can be used and by whom they can be used.

produce lower costs for carrying out required conduct or other economic benefits for the parties using these means. This suggests that such law compliance improvements achieve benefits to users that are equivalent to the economic benefits achieved by a wide variety of patented methods in other fields. In the past, an identifiable economic benefit from a patented method has uniformly been seen as sufficient benefit to meet the utility requirements of the patent laws without question.¹⁵⁹

It is unclear why economic benefit resulting from improved law compliance or an improved legal position before the government (such as a tax savings) should have a lesser status under patent laws than that other types of economic gains or why improvements in law compliance methods are any less important than other types of personal and business practices such that we should leave tax reduction methods outside of the generally desirable incentive system for innovation created by the patent laws. Absent a clear case as to why tax savings and the associated economic benefits to taxpayers are not sufficient to meet the utility requirements for a patent, patents for tax planning methods should probably be seen as valid means to increase the economic resources held and controlled by taxpayers and the many desirable taxpayer activities those resources may support.

4. Tax Reduction Method Patents May Limit Access to Tax Reduction Methods by Impairing the Simplicity and Administration of Tax Law

Tax method patents have been criticized as potentially producing new transactional barriers to the implementation of tax reduction strategies. These barriers are expected to develop because of the steps that tax professionals and taxpayers may adopt to ensure that they take the impact of tax method patents into account before selecting tax reduction strategies. As noted by the AICPA:

Tax strategy patents greatly complicate tax advice provided by tax professionals and compliance by taxpayers, both of whom need to understand the impact of such patents on their ability to comply with the tax law. Tax law is already quite complex. The addition of rapidly proliferating patents on tax planning techniques and concepts will render tax compliance much more difficult.¹⁶⁰

It is true that tax law requirements and responses to those requirements by taxpayers may be quite complex and the need to keep track of patent restrictions on new tax reduction methods may add a further complexity to an already complex field, it is unclear why this is any different than the impact of patents in highly complex and technical engineering domains. In highly

159. See, e.g., *AT&T Corp. v. Excel Comm'ns, Inc.*, 172 F.3d 1352, 1358 (Fed. Cir. 1999) (describing and enforcing patent with commercial benefit as the primary source of utility); *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1377 (Fed. Cir. 1998) (indicating a useful result in terms of "price, profit, percentage, cost, or loss" renders the invention proper subject matter).

160. Cover Letter from AICPA to Tax-Writing Comm. 1 (Feb. 28, 2007) [hereinafter Cover Letter from AICPA], available at http://tax.aicpa.org/NR/rdonlyres/75CE5A8A-3A5A-454A-81B7-8E9731DE0505/0/022807_AICPA_tax_strategy_patent_cover_letterletterhead1.doc.

complex areas like communications, engineering, or biotechnology, the administrative impacts of patents are accommodated and accepted as a necessary offshoot of the rewards and innovation incentives that patents add to these fields. The same acceptance of patent administration costs as necessary means to achieve patent rewards may be appropriate for tax planning patents.

The number and subject matter of patents for tax reduction methods should be narrowly maintained to ensure that only a few highly innovative methods are affected by patents and that the broad range of frequently used tax reduction methods can be used without considering the potential impact of patents. However, a complete exclusion of tax planning methods from patenting to avoid the costs of administering responses to patents on these methods is an extreme solution that should only be imposed where the evidence of exceptionally high administrative costs for responses to tax planning patents is clear.

5. Tax Planning Patents May Cause Tax Specialists to Give Less Effective Legal Advice and Thereby Reduce the Tax Planning Alternatives Available to Taxpayers

Threats of patent infringement liability for attorneys may bias the attorneys towards favoring non-patented strategies and adversely affect the quality of their legal advice. These threats of liability may also increase the cost of legal advice provided by tax specialists as these specialists try to recover liability payments or pay for liability insurance.¹⁶¹ Threats that attorneys and other tax specialists may face certain types of patent infringement liability for aiding clients in implementing patented but unlicensed tax reduction strategies may have several impacts on how such attorneys and specialists render advice to clients. Some of these threats to taxpayers and their attorneys are discussed in Part IV of this Article. The discussion here will focus on tax attorneys, although similar considerations will affect accountants and other specialists who materially aid clients in implementing patented tax strategies that the clients do not have licenses to use.

Biasing of legal advice due to threats of infringement liability under tax planning patents may adversely affect the legal advice given taxpayers in at least two respects. First, tax attorneys may be hesitant to provide advice on tax planning methods for which they do not possess a license to provide material aid and be hesitant to refer a client to law firms that do have licenses to aid clients in using the patented methods. Second, tax attorneys may be deterred from conducting the full range of studies of prior patents in their field due to concerns that such studies will put them on notice of relevant patents, thereby increasing the attorneys' risk that they will face punitive damage liability for willful patent infringement liability if they aid clients in implementing methods the attorneys know to be patented.

161. AICPA ANALYSIS, *supra* note 10, at 13.

Even though these sorts of consequences may follow from the issuance of tax planning patents, they are no different than the implications of patents in any field where highly specialized advisors give guidance regarding how to implement practices or devices and components of those practices or devices may be patented. For example, an engineer or architect aiding in the design of a device or building for another party would encounter parallel concerns to those of a tax attorney seeking to aid a client in constructing a new tax reduction strategy.¹⁶² Costs of monitoring patent constraints and of modifying behavior—costs faced by both potential direct infringers such as taxpayers and persons such as tax attorneys who would aid the taxpayers and give materially important advice shaping the conduct of the direct infringers—are necessary features of a system providing patent monopolies and rewards for innovative advances. Unless it is clear that these costs of increased monitoring and modified behavior are greater than the net benefits of patent rewards, the incidental costs associated with carrying out the patent system in this setting should not be grounds for avoiding patent protections altogether.

6. Tax Planning Patents May Be Undesirable Because They Hinder the Exchange of Information Between Tax Specialists and Thereby Diminish the Quality of Legal Advice Supplied to Taxpayers

The threat of enforcement of tax reduction method patents against tax professionals or their clients may reduce discussions of innovative methods among tax professionals. The result may be a restriction in “the broad, free and open public discussion that has long been a hallmark of our nation’s tax system.”¹⁶³ The AICPA has summarized this point as follows:

Tax strategy patents also inhibit the flow of information between [sic] tax professionals. For example, practitioners seeking patent protection may decide not to publish or discuss their ideas until a patent is issued. The existence of tax strategy patents could also discourage tax practitioners from freely discussing tax issues with other professionals out of fear that they will be exposed to infringement liability.¹⁶⁴

It is unclear that the flow of information about many new tax reduction methods is as free as these comments suggest. A number of innovators in tax reduction methods have made these methods available to clients only under trade secret restrictions that have limited public dissemination and discussion of these methods.¹⁶⁵ Clearly, a shift towards patents for these methods would increase, not decrease, public dissemination and discussion of the methods.

If enforceable patents cover particular tax reduction methods, the

162. See, e.g., *Baut v. Pethick Constr. Co.*, 262 F. Supp. 350, 366 (M.D. Pa. 1966) (holding an architect liable for inducement of patent infringement where the architect aided in the design of a building component knowing that the component was covered by a patent).

163. AICPA ANALYSIS, *supra* note 10, at 8-9.

164. *Id.* at 8.

165. E.g., *Burk & McDonald*, *supra* note 7, at 5.

discussion of those methods will not, per se, constitute infringement. Discussion of matters related to the methods may be affected, however. For example, discussions of a patented method that include additional implementation details that materially facilitate the use of the method may constitute inducement of infringement and be discouraged because of the threat of liability for such inducement. Though these sorts of impacts may result from tax planning patents, it is unclear that these types of infringement-enhancing discussions have public benefits such that patent enforcement should be withheld to protect the discussions.

V. SCOPE AND ENFORCEMENT TARGETS OF TAX PLANNING PATENTS

A variety of existing patents address methods of either directly reducing tax-related expenses by decreasing tax liabilities or lowering transaction costs of monitoring and reporting taxable events.¹⁶⁶ This section examines three topics related to the practical impacts of tax planning patent enforcement. The first subsection provides an overview of several tax planning patents to give a sense of the broad range of techniques already covered by patents in this field. The second subsection describes a particular tax planning patent in greater detail and examines how it might be enforced against several types of infringers. The third subsection focuses on tax attorneys and other professional specialists as potential targets of tax planning patent enforcement, discussing the circumstances in which these professionals may be held liable for aiding or “inducing” their clients’ patent infringement.

A. *Examples of Tax Planning Patents*

This subsection profiles a few tax planning patents to give a rough idea of the breadth of methods already covered by patents in this field. In each summary below, the description of the patented method is drawn directly from the patent itself. More detailed information about the particular features of the methods covered by these patents can be gained by inspecting the claims portions of the patents.

The presentation of brief descriptions of several patents below is not intended to suggest that the methods or practices covered by these patents are necessarily new or that these patents are valid and enforceable. Rather, this group of patents is summarized to illustrate the many types of tax planning strategies and related practices of tax specialists that are already covered by patent enforcement threats related to issued patents and to indicate the many portions of the tax field that are likely to be influenced by patents in the future.

166. In 2006, the USPTO added subclass 36T to Class 705 in its patent classification system to cover innovations involving tax strategies. Toupin Statement, *supra* note 14. As of July 13, 2006, there were 41 issued patents related to tax strategies classified in subcategory 36T of Class 705. *Id.* Further, as of that date, 61 published applications, not yet examined, related to tax strategies and were classified in this subcategory. *Id.*

1. Patented Methods for Lowering Tax Liabilities

a. Income Taxes

*Method and Apparatus for Tax Efficient Investment Management:*¹⁶⁷ A method and apparatus for automatically managing investment portfolios is disclosed, which substantially tracks a selected index and automatically harvests tax losses. The system includes an accounting system for maintaining tax lot information for individual accounts, an optimization system for rebalancing each account to substantially model the index and for harvesting tax losses, and a trading system for executing trades. Each investor owns the securities in his/her account, and therefore, harvested losses can be used to offset capital gains. Securities sold to harvest tax losses are repurchased at a later time selected to avoid application of the Internal Revenue Service wash sale rules, with exchange traded funds (ETF's) [sic] from the same technological sector as the securities being sold to harvest tax losses being used as temporary replacement securities for the portfolios.¹⁶⁸

*Method and Apparatus for Tax-Efficient Investment Using Both Long and Short Positions:*¹⁶⁹ Methods and apparatuses are provided for investment. These methods and apparatuses utilize knowledge that predicts financial instruments that are expected to outperform or underperform their markets. By using this information, as well as risk information, a portfolio is assembled that contains both long and short holdings. The portfolio also uses leverage. The portfolio is managed so that loss positions are aggressively harvested while still short term and gains are held for the long term.¹⁷⁰

b. Estate and Transfer Taxes

*Method and Apparatus for Modeling and Executing Deferred Award Instrument Plan:*¹⁷¹ The present invention is directed to the administration of various deferred compensation programs that can effectively reduce an individual's income or estate tax by assisting a company in the identification of appropriate employees, and through the use of a novel modeling method and apparatus to implement a deferred compensation program through a novel Rabbi Trust maintenance plan that permits the employees to benefit from their deferred compensation (such as stock options or life insurance benefits), while having a minimal financial impact on the company.¹⁷²

167. U.S. Patent No. 7,031,937 (filed Jan. 18, 2002).

168. *Id.* at [57].

169. U.S. Patent No. 6,832,209 (filed Oct. 6, 1999).

170. *Id.* at [57].

171. U.S. Patent No. 6,609,111 (filed Oct. 18, 2000).

172. *Id.* at [57].

c. Use Taxes

*Use Tax Optimization Process and System:*¹⁷³ A computer system and method for a lessor to determine correct use tax on moveable equipment, which may be subject to tax by more than one tax authority comprising inventory records for each individual item of equipment comprising an equipment identifier, equipment category, acquisition cost, depreciation, net book value, and branch; updating the inventory records to reflect each modification, improvement, disposition, and change in equipment category, and use tax paid; activity records comprising each lease event pertaining to each item of equipment; and a set of tax rules, which are periodically updated, for each taxing authority where any of the items of equipment may be leased or used, comprising sets of formulas reflecting relationships between tax due and acquisition of equipment, first leasing of equipment, subsequent leasing of equipment, length of lease term, age of equipment, and/or equipment categories. Upon selection of a tax authority and a date range, the amount of tax that is due to the selected tax authority for each item of equipment is automatically determined and, upon verification that tax will be paid, the inventory records are updated to reflect tax paid. Upon querying the system to determine availability of equipment of a selected class, delivery branch, and date range, the system preferably ranks available equipment according to the amount of use tax that will be due upon leasing.¹⁷⁴

2. *Patented Methods for Reducing Administrative Burdens of Tax Law Compliance*

*Method and Apparatus for Automatic Tax Verification:*¹⁷⁵ A method for tracking tax payment information includes fixing a unique machine readable identifier to each of a number of taxable items, storing each of the unique machine readable identifiers in a computer readable memory, and storing tax payment information in the computer readable memory for each of the items. The unique machine readable identifier may take the form of a machine readable symbol such as a barcode symbol or as a wireless memory device such as a radio frequency identification (“RFID”) tag. The tax information may include data such as the tax payment status, tax payment authority, a tax payment sum, a tax payment date, identify of a manufacturer, identify of a product or product type, and the identify of a product origin. Tax payment information may include tax payment information from multiple taxing authorities. The method may further include reading the unique machine readable identifier and retrieving the tax payment information based on the identifier to verify that the appropriate taxes have been paid. The computer readable memory may be a centralized database, may be located in a reading device being used to verify compliance, or be located in the RFID tag secured

173. U.S. Patent No. 6,298,333 (filed Feb. 8, 2000).

174. *Id.* at [57].

175. U.S. Patent No. 6,360,208 (filed Feb. 4, 1999).

to the taxed good.¹⁷⁶

*System for Performing Tax Computations:*¹⁷⁷ A computer implemented application architecture and software component for providing tax computations for the administration of insurance and annuity products in a reusable software component. A Tax Server is implemented using object-oriented programming techniques and is controlled by a computer processor. The Tax Server has tax regulation classes and product classes that are inter-coupled according to design models so as to model the tax interpretation for various insurance and annuity products.¹⁷⁸

B. Anatomy of a Tax Planning Patent and Its Potential Enforcement

In order to appreciate the scope of potential infringement liability resulting from patents on tax planning methods, it is useful to consider the legal protections sought under one of these patents and the ways in which this patent might be enforced. This section briefly describes a patent issued in 2003 covering a method for achieving an advantageous tax result by establishing and managing a trust funded by a particular type of stock options in a specified fashion. It also considers the ways this patent might be enforced against taxpayers, financial institutions, and tax attorneys.

1. The SOGRAT Patent

United States patent number 6,567,790 purports to protect:

An estate planning method for minimizing transfer tax liability with respect to the transfer of the value of stock options from a holder of stock options to a family member of the holder. The method comprises establishing a Grantor Retained Annuity Trust [(“GRAT”)] funded with nonqualified stock options. The method maximizes the transfer of wealth from the grantor of the GRAT to a family member by minimizing the amount of estate and gift taxes paid. By placing the options outside the grantor’s estate, the method takes advantage of the appreciation of the options in said GRAT.¹⁷⁹

A “nonqualified stock option” for tax law purposes is any stock option that does not qualify as an incentive stock option (“ISO”) and does not receive the favorable tax treatment accorded to ISOs.¹⁸⁰ Generally, a nonqualified stock option is not taxed at the date it is granted, but is instead taxed upon the exercise of the option. The amount subject to tax is the difference between the fair market value of the stock on the date of the exercise of the option and the exercise price paid for the stock.¹⁸¹ After the exercise of an option, the

176. *Id.* at [57].

177. U.S. Patent No. 6,064,983 (filed Mar. 21, 1997).

178. *Id.* at [57].

179. U.S. Patent No. 6,567,790, at [57] (filed Dec. 1, 1999).

180. I.R.C. § 421 (2000); Kevin Wiggins, *Capital Gain v. Ordinary Income and the FICA Tax Treatment of Employee Stock Purchase Plans*, 53 TAX LAW. 703, 704 (2000).

181. Wiggins, *supra* note 180, at 703.

taxpayer holds the corresponding stock as a capital asset and is subject to normal capital gains rules on the disposition of the stock.¹⁸²

Because the GRAT used in this method involves stock options, the patent applicant describes this method as involving a “Stock Option Grantor Retained Annuity Trust” or “SOGRAT.”¹⁸³ As a further measure of intellectual property protection, the patent applicant claims trademark protection for the use of the term “SOGRAT” (this claim is noted in the patent covering the method).¹⁸⁴ In the remainder of this Article, the above patent is referred to as the “SOGRAT patent.” For purposes of discussion here, this patent is presumed to be valid.¹⁸⁵

2. *Scope of Protection*

The scope of protection granted by the SOGRAT patent can only be gauged from the claims stated in the patent. These claims, located at the end of the patent document, describe the “metes and bounds” of the legal rights conferred by the issuance of the patent.¹⁸⁶ The patent holder will be able to prevent others from using a tax planning method only if the method of the other party is within the description of the protected process provided by the claims.¹⁸⁷ In patent law terms, a tax planning method of a party other than the patent holder will be infringing if the claims describe or “read on” the method of that other party.¹⁸⁸

The SOGRAT patent has a number of claims describing different versions of the claimed method. The first claim is the broadest and reads as follows:

What is claimed is:

1. A method for minimizing transfer tax liability of a grantor for the transfer of the value of nonqualified stock options to a family member grantee, the stock options having a stated exercise price and a stated

182. *Id.* at 706.

183. Patent ‘790, at col.2 l.36-37.

184. *Id.* at col.2 l.36 n.1.

185. Some commentators have expressed doubts about the validity of the SOGRAT patent and the quality of the USPTO’s review in granting this patent. *See, e.g.,* Bubb, *supra* note 11, at 2663 (noting that “[t]he SOGRAT patent is evidence that the PTO presently lacks the expertise to determine that a tax strategy is novel and nonobvious”). Discussions of the possible invalidity of the SOGRAT patent for lack of novelty or obviousness of the patented invention are beyond the scope of this article.

186. As summarized by one leading commentator:

Patent claims serve two functions. First, they define the invention for the purpose of applying the conditions of patentability (eligible subject matter, originality, novelty, utility, and non-obviousness), the statutory bars, and the disclosure requirements. Second, they define the invention for the purpose of determining infringement, that is, what constitutes the “patented invention” that persons cannot make, use or sell without the authority of the patent owner.

3 DONALD S. CHISUM, CHISUM ON PATENTS § 8.01 (2007) (citations omitted).

187. An assertedly infringing device or process is deemed to fall within the claims of a patent and be subject to the patent holder’s control if the claims literally describe the device or process (literal infringement) or the device or process is equivalent to the invention described in the claims (infringement under the doctrine of equivalents). *Id.* § 16.02[1][a][ii] (2005).

188. A claim “reads on” or covers products or processes that contain all of the elements and limitations of the claim. *Id.* at G 1-3 (2008).

period of exercise, the method performed at least in part within a signal processing device and comprising: establishing a [GRAT]; funding said GRAT with assets comprising stock options, the stock options having a determined value at the time the transfer is made; setting a term for said GRAT and a schedule and amount of annuity payments to be made from said GRAT; and performing a valuation of the stock options as each annuity payment is made and determining the number of stock options to include in the annuity payment.¹⁸⁹

The portions of this claim language separated by semicolons identify the steps or elements that a tax planning process will need to have to fall within this claim and to be infringing. These elements provide a checklist for analyzing the activities of taxpayers for the purpose of determining if they are infringing this patent. Using this approach, a party would appear to infringe this patent (assuming that the patent is valid and enforceable) if the party (using, at least in part, a “signal processing device” such as a computer) completed the following steps:

- 1) establishing a GRAT;
- 2) funding said GRAT with assets comprising stock options, the stock options having a determined value at the time the transfer is made;
- 3) setting a term for said GRAT and a schedule and amount of annuity payments to be made from said GRAT; [and]
- 4) performing a valuation of the stock options as each annuity payment is made and determining the number of stock options to include in the annuity payment.¹⁹⁰

Assuming that a tax planning method has these features, its implementation by a taxpayer would infringe the SOGRAT patent, even if the method had other details or characteristics. If a taxpayer’s tax reduction method does not include exact counterparts to every one of the steps recited in the SOGRAT patent, its use by the taxpayer would still be infringing so long as the taxpayer’s method included either the same action or an equivalent action for each of the steps in the SOGRAT patent.¹⁹¹ A step will generally be seen as an equivalent of a claimed step if the alternative step involves a similar means of operation, function, and result to the counterpart step in the patent claims.¹⁹²

189. ‘790 Patent, at col.7 l.60 - col.8 l.1-9.

190. *Id.* at col.10 l.9-14, 24-53.

191. Infringement liability is imposed under these circumstances because the method involved, though not literally identical to the patented invention, is seen as an equivalent of the patented invention. *See, e.g., Warner-Jenkinson Co., Inc. v. Hilton Davis Chem. Co.*, 520 U.S. 17, 24-35 (1997) (describing standards for evaluating infringement liability under the “doctrine of equivalents”).

192. *See id.* at 39-40 (discussing how a focus on individual elements is an important inquiry); *Graver Tank & Mfg. Co. v. Linde Air Prods. Co.*, 339 U.S. 605, 609-12 (1950) (explaining that equivalency is determined by a patent’s context, prior art, and circumstances of the case).

3. *Potential Infringers*

a. Clients

Clients for whom tax planning methods are implemented and who benefit from the resulting taxation outcomes would be the primary or “direct” infringers of a patented method like that described above if they use the patented method without a license.¹⁹³ A party seeking to implement the SOGRAT strategy without the patent holder’s permission could be enjoined from doing so. A party who implemented the patented method (even without being aware of the patent involved) would be liable for patent infringement damages equal to a reasonable royalty payment for use of the patented method.¹⁹⁴ If the party was aware of the patent and aware that the course of conduct he or she contemplated was apparently covered by the patent, but went ahead anyway with the infringing conduct having no good faith reason to believe that it was non-infringing or that the patent was invalid, the party could be held liable for punitive damages of up to three times the patent holder’s compensatory damages.¹⁹⁵

b. Attorneys/Accountants

The federal Patent Act specifies that persons who induce others to engage in patent infringement are equally as liable as the parties who actually undertake the infringement.¹⁹⁶ The notion here is that an inducer is essentially an aider and abetter of the patent infringer and should thus be equally responsible for patent damages.¹⁹⁷ Numerous cases hold that persons who instruct others how to infringe a patent or who help in a material way to design implementations of an infringing design are deemed to be inducers of the resulting infringement and liable under the Patent Act.¹⁹⁸ Tax attorneys and accountants who specialize in tax matters will commonly provide advice, instruction, and relevant document creation services aiding clients in setting up tax planning strategies. If these professionals are aware that the tax planning

193. See 35 U.S.C. § 271 (2000) (stating that a license in this context is an arrangement reflecting the permission of the patent holder to the licensee allowing the latter to do something, such as using a patented tax planning method, that would otherwise be infringing).

194. *Id.* § 284. This type of patent infringement liability may have carryover effects in triggering other types of liability. For example, some clients may seek to have their tax advisors indemnify them for patent infringement liability arising out of implementation of the advisors’ advice. If infringement liability is imposed on the client, the client will have a contractual indemnification claim against the tax advisor. Similarly, to the extent that the presence of potential patent infringement liability was a manifest risk to the client ignored by a tax advisor in giving advice to the client, this may form the basis of a malpractice claim by the client seeking recovery of damages equal to amounts paid for infringement liability, future patent license royalties associated with carrying out the advisor’s tax planning advice, and any other losses to the client based on the client’s patent infringement.

195. *Id.*

196. *Id.* § 271(b).

197. *Id.*

198. See *TI Group Automotive Sys., Inc. v. VDO N. Am. L.L.C.*, 62 U.S.P.Q. 2d (BNA) 1599, 1601 (D. Del. 2002) (citing *Black & Decker Inc. v. Catalina Lighting, Inc.*, 953 F. Supp. 134, 138 (E.D. Va. 1997) and listing the four elements of inducement of infringement).

methods that they are helping clients to implement are patented but not licensed for use by the clients, the attorneys and accountants may incur patent infringement liability by inducing the patent infringement of their clients.

In order to establish liability for inducement of patent infringement, the following elements must be proven by a preponderance of the evidence:

(1) an inducer's knowledge of the asserted patent; (2) the presence of infringement by the third party allegedly induced; (3) an inducer's actual intent to cause the acts, which he knew or should have known would induce actual infringements; and (4) the commission of an act that constitutes infringement, not merely the power to act or the failure to act.¹⁹⁹

Where a tax attorney or accountant is aware of a tax planning method patent and instructs a client or materially assists a client in carrying out the patented tax planning method, all of these criteria would seem to be met. The standards governing inducement of infringement by tax planning attorneys and accountants specializing in tax planning matters are explored further in subsection C below.

c. Financial Institutions Managing Accounts

Financial institutions or other entities that agree to carry out a patented tax planning method (for example, by acting as the trustee for a trust that carries out the steps of the SOGRAT patent) may also complete the steps covered by a patented method and be liable as a direct patent infringer. Here, the financial institution would be acting as the agent of the taxpayer for whom the infringement was undertaken, but this will not undercut the fact that the institution has carried out the patented steps and has acted as an infringer.

C. *Criteria for Imposing Liability on Attorneys as Patent Infringers*

The notion that attorneys providing advice on how to implement patented tax planning methods may themselves face patent infringement liability is firmly supported by present patent law standards regarding the inducement of infringement.²⁰⁰ These standards are reviewed in this subsection, along with their implications when applied to tax planning patents and associated advice by tax specialists.

1. *Standards for Inducement Liability*

Section 271(b) of the Patent Act provides that “[w]hoever actively induces infringement of a patent shall be liable as an infringer.”²⁰¹ In order to prevail on an inducement claim, a patentee must establish “first that there has been direct infringement, and second that the alleged infringer knowingly

199. *Id.*

200. 35 U.S.C. § 271(b) (establishing liability for those who actively induce patent infringement).

201. *Id.*

induced infringement and possessed specific intent to encourage another's infringement."²⁰² Specific intent in this context is established through a "showing that the alleged infringer's actions induced infringing acts and that he knew or should have known his actions would induce actual infringements."²⁰³

The present provisions of the Patent Act on liability for inducement of patent infringement codify a long history of case law recognizing such liability although not always under the "inducement" label.²⁰⁴

a. Goals Served by Inducement Liability

Inducement liability is imposed to break chains of conduct that would otherwise increase the volume of direct patent infringement. One court analogized the basis for inducement liability under § 271(b) to liability imposed on "accessories before the fact" under criminal law:

In effect, this statute is analogous to a criminal statute imposing liability for one who acts as an accessory before the fact. *Sims v. Western Steel Co.*, 551 F.2d 811, 817 (10th Cir. 1977) ('This subsection contemplates that the inducer shall have been an active participant in the line of conduct of which the actual infringer was guilty. Thus he should be in the nature of an accessory before the fact.') [During the . . . trial, I analogized the differences between an accessory before the fact and one who receives stolen property. Section 271(b) only targets an active participant (effectively, the accessory) and not the passive recipient (i.e. the 'fence').] While the plaintiff need not prove that the defendant exercised *control* over the third party infringer's actions to support a finding of inducement liability, *VLT Corp. v. Unitrode Corp.*, 130 F. Supp.2d 178, 200-201 (D. Mass. 2001), he must demonstrate by either direct or circumstantial evidence that the defendant knowingly aided and abetted another's direct infringement.²⁰⁵

From the standpoint of a patent holder, suits for inducement liability may have an additional tactical goal or advantage relative to equivalent suits against direct patent infringers. Suits against inducers of infringement may give a patent holder a more practical means to foreclose direct infringement than suits against the direct infringers themselves. If there are numerous direct infringers (such as numerous taxpayers using a patented tax planning method) who are difficult to locate and sue, but fewer or more easily identifiable inducers (influencing many direct infringers), it may be desirable for a patent holder to move against the inducers through a manageable number of patent

202. *Minn. Mining & Mfg. Co. v. Chemque, Inc.*, 303 F.3d 1294, 1304-05 (Fed. Cir. 2002).

203. *DSU Med. Corp. v. JMS Co.*, 471 F.3d 1293, 1304 (Fed. Cir. 2006) (en banc in relevant part) (quoting *Manville Sales Corp. v. Paramount Sys., Inc.*, 917 F.2d 544, 554 (Fed. Cir. 1990)).

204. Earlier case law sometimes described inducement of patent infringement as a variety of contributory patent infringement. See, e.g., *Hewlett-Packard Co. v. Bausch & Lomb, Inc.*, 909 F.2d 1464, 1468-69 (Fed. Cir. 1990) (providing a detailed explanation of the background of the present statutory provisions on inducement of infringement).

205. *Trs. of Columbia Univ. v. Roche Diagnostics GMBH*, 272 F. Supp. 2d 90, 104 (D. Mass. 2002).

enforcement actions. In addition, a patent holder may prefer to enforce a patent against an inducer of infringement rather than against the direct infringers who the patent holder hopes will be later customers of either the patent holder or its licensees. Avoiding the souring of the marketplace by patent infringement suits against parties who are potential customers in the future is another tactical advantage of suing an inducer rather than suing the direct infringers being induced. These same advantages seem likely to encourage holders of patents on tax planning methods to sue inducers of infringement such as tax attorneys rather than their clients

b. Required State of Mind for Inducement

The state of mind that an inducer must have to incur patent infringement liability was addressed by the Court of Appeals for the Federal Circuit sitting en banc in *DSU Medical. Corp. v. JMS Co.*²⁰⁶ The court held that, to be held liable, an inducer must be shown to have “knowingly” induced infringement and that, to establish a “knowing” promotion of infringement in this context:

It must be established that the defendant possessed specific intent to encourage another’s infringement and not merely that the defendant had knowledge of the acts alleged to constitute inducement. The plaintiff has the burden of showing that the alleged infringer’s actions induced infringing acts *and* that he knew or should have known his actions would induce actual infringements.²⁰⁷

(1) *Knowledge of the Patent Being Infringed*

To possess a sufficient state of mind for inducement liability, an inducer of infringement needs to be aware of a patent and that his or her actions are promoting conduct covered by the patent.²⁰⁸ No matter how much a party’s activities promote infringement by another party, the first party will probably not be liable absent some awareness that the conduct being promoted is covered by a patent.²⁰⁹ This need for knowledge of the relevant patent was addressed by the Federal Circuit in *Ferguson Beauregard/Logic Controls v. Mega Systems, LLC.*²¹⁰ *Ferguson* involved claims that a president and majority owner of a corporate infringer was liable for inducement of patent infringement by the corporation.²¹¹ The district court in this case noted:

[T]o be found liable under § 271(b), “a patentee must show that the

206. 471 F.3d at 1304-06.

207. *Id.* at 1306 (quoting *Manville Sales Corp. v. Paramount Sys., Inc.*, 917 F.2d 544, 553 (Fed.Cir. 1990)).

208. *Water Tech. Corp. v. Calco, Ltd.*, 850 F.2d 660, 668 (Fed. Cir. 1988) (“[A] person infringes by actively and knowingly aiding and abetting another’s direct infringement.”).

209. *Golden Blout, Inc. v. Robert H. Peterson Co.*, 365 F.3d 1054, 1060 (Fed. Cir. 2004) (noting that a patent owner must show that the alleged infringer “knew that the combination for which its components were especially made was both patented and infringing”).

210. *Ferguson Beauregard/Logic Controls v. Mega Systems, L.L.C.*, 350 F.3d 1327,1330 (Fed. Cir. 2003).

211. *Id.*

individual charged with inducement took actions that actually induced infringement and that such individual knew or should have known that such actions would induce direct infringement,” [and t]he district court . . . concluded that the evidence proffered by [the patent owner] did not show that [the corporation’s president] “knew or should have known his actions would induce infringement,” regardless of how actively [he] was involved with the development and/or marketing of the [infringing] device.²¹²

The Federal Circuit found that the district court applied the correct standard and that the defendant was appropriately held not to have had the state of mind needed for liability for inducement of patent infringement.²¹³

The patent holder in *Ferguson* argued that a less demanding state of mind test should apply to liability for inducement of patent infringement.²¹⁴ The patent “owner asserted that the district court should have required the defendant corporate officer be aware only of his activities, not necessarily aware that his activities amounted to infringement.”²¹⁵ The Federal Circuit disagreed with this argument, pointing out that:

In support of this less stringent test, [the patent owner] cites a number of district court cases that are not binding on this court. Not only are the cases cited by [the patent owner] not binding on this court, they are contradicted by our precedent. *See, e.g., Micro Chem.*, 194 F.3d at 1261 (“Officers of an allegedly infringing corporation can be held personally liable for actively inducing infringement under 35 U.S.C. ‘271(b) only if they ‘knew or should have known [their] actions would induce actual infringements.’” (quoting *Manville Sales*, 917 F.2d at 553)). [The patent owner’s] position is untenable based on *Manville Sales*, which makes clear that ‘it must be established that the defendant possessed specific intent to encourage another’s infringement and not merely that the defendant had knowledge of the acts alleged to constitute infringement.’²¹⁶

(2) Knowledge of Conduct Constituting Infringement

A party must also intend to facilitate the activities constituting patent infringement in order for the facilitating actions to constitute inducement of patent infringement. The Federal Circuit considered this issue in *Moba, B.V. v. Diamond Automation, Inc.*²¹⁷ In reviewing the type of knowledge of infringing activities that is needed to support liability for inducement of patent infringement, the Federal Circuit observed that:

Although § 271(b) does not use the word ‘knowingly,’ this court has

212. *Id.* at 1342 (citing *Micro Chem. Inc. v. Great Plains Chem. Co.*, 194 F.3d 1250 (Fed. Cir. 1999)).

213. *Id.*

214. *Id.* at 1330.

215. *Id.* at 1342.

216. *Id.*

217. 325 F.3d 1306, 1318 (Fed. Cir. 2003).

uniformly imposed a knowledge requirement. *Water Tech. Corp. v. Calco, Ltd.*, 850 F.2d 660, 7 USPQ2d 1097 (Fed. Cir. 1988); *C.R. Bard, Inc. v. Advanced Card. Sys., Inc.*, 911 F.2d 670, 15 USPQ2d 1540 (Fed. Cir. 1990). This court defined the generally applicable intent standard in *Hewlett-Packard*. . . . In *Hewlett-Packard*, this court held that ‘proof of actual intent to cause the acts which constitute the infringement is a necessary prerequisite to finding active inducement’ under ‘ 271(b). . . . Hewlett-Packard Co. (HP), was the assignee of the LaBarre patent on aspects of X-Y plotter technology. Bausch & Lomb, Inc. (B & L), manufactured and sold X-Y plotters and a variety of other electronic equipment through a division that it sold to Ametek, Inc. HP alleged that B & L induced infringement of the LaBarre patent by its sale to Ametek. This court found, however, that the sale did not evince an intent to induce infringement but, rather, merely an intent to sell at the highest price. This court particularly noted that B & L had no interest in, nor control over, Ametek’s use of the purchased division. Implicit in this court’s determination was that Ametek could have employed the purchased division in a wide range of non-infringing activity. Moreover, this court noted that the agreement to develop a non-infringing plotter established, if anything, B & L’s intent to avoid any inducement of infringement.²¹⁸

c. Types of Activities Previously Seen as Supporting Liability for Inducement of Patent Infringement

Diverse types of activities comparable to the actions of tax attorneys and accountants in advising clients on tax minimization methods have been seen as constituting inducement of patent infringement. Inducement of patent infringement has connotations of active steps knowingly taken—knowingly at least in the sense of purposeful, intentional, as distinguished from accidental or inadvertent. But with that qualifying approach, [such inducement] is as broad as the range of actions by which one in fact causes, or urges, or encourages, or aids another to infringe a patent.²¹⁹

Mere inaction or omission of an action on the part of an asserted inducer will seldom if ever constitute a basis for liability.²²⁰ Rather, some affirmative step to promote infringement is needed to provide the basis for liability for inducement of patent infringement.²²¹

218. *Id.*

219. *Fromberg, Inc. v. Thornhill*, 315 F.2d 407, 411 (5th Cir. 1963).

220. *See id.* (requiring “active steps” by alleged inducer).

221. *See Beverly Hills Fan Co. v. Royal Sovereign Corp.*, 21 F.3d 1558, 1569 (Fed. Cir. 1994) (concluding that a claim of inducement cannot be premised on an omission because “active inducement of infringement requires the *commission* of an affirmative act”).

(1) *Providing Instructions*

Defendants in a number of contexts have been found to be inducers of patent infringement based on their actions in providing instructions to others on how to undertake a patented process or implement a patented design.²²²

In some instances, instructions leading to inducement liability have been provided by a licensor of one patent who has supplied licensees with information on how to implement a process or device design that infringes a second patent.²²³ Under these circumstances, the holder of the second patent can recover from the licensor of the first patent on the grounds that the instructions provided in connection with the licensing of the first patent furthered the infringing activities of the licensees, making the party providing the instructions an inducer of infringement.²²⁴ For example, this type of liability was considered in *Toppa v. Tiffany Refrigerator Car Co.*²²⁵ In that case, the defendant “furnished its licensees . . . with working plans and drawings . . . showing and requiring [the patentee’s] device, and . . . this was done with no thought or expectation that the [patent] owner’s consent would be obtained for such use.”²²⁶ Under these circumstances, the defendant was seen as an inducer of its licensees’ patent infringement.²²⁷

Another context in which instructions have been seen as a vehicle for inducement of patent infringement is where instructions on how to implement a patented process or device are circulated in advertisements or product packaging associated with sales of non-patented components or materials to be used in the patented process or device.²²⁸ Instructions provided to customers in these circumstances have commonly been seen as involving inducement liability because the party engaging in the advertising or product sales is clearly encouraging instances of infringement to promote sales of related non-patented items. For example, in *Chiuminatta Concrete Concepts, Inc. v. Cardinal Industries, Inc.*, the Federal Circuit upheld the liability on inducement of infringement grounds of a party that advertised and sold a rotary saw for cutting concrete.²²⁹ The saw was capable of being used in a manner that infringed a patent that described a means for cutting concrete at a specified stage of hardening.²³⁰ The advertisements for the saw in question suggested cutting concrete at a stage earlier than the stage required by the patented method, but the advertisements also encouraged use at later stages that fell within the patent.²³¹ Whereas at least one mode of use of the saw that was

222. *E.g.*, *Toppa v. Tiffany Refrigerator Car Co.*, 39 F. 420, 421 (C.C.N.D. Ill. 1889).

223. *Id.*

224. *Id.*

225. *Id.*

226. *Id.*

227. *Id.*

228. *Lifescan Inc. v. Can-Am Care Corp.*, 859 F. Supp. 392, 396 (N.D. Cal. 1994); *Rohm & Haas Co. v. Roberts Chems., Inc.*, 118 U.S.P.Q. (BNA) 503, 504 (S.D. W.Va. 1958).

229. *Chiuminatta Concrete Concepts, Inc. v. Cardinal Indus., Inc.*, 145 F.3d 1303, 1311-12 (Fed. Cir. 1998).

230. *Id.*

231. *Id.*

recommended and instructed by the advertising was infringing, the party selling the saw was seen as having intentionally induced its customers' infringement as facilitated by the instructions in the advertising.²³²

(2) *Designing Infringing Items*

Inducement of infringement has also been found where a party has designed an item for another knowing that the resulting item, when assembled, would infringe a patent.²³³ For example, in *Baut v. Pethick Construction Co.*, a general contractor, a subcontractor, and an architect were all liable for infringement of a patent covering the functional features of a particular type of stained glass window.²³⁴ All these parties actively participated in the decisions concerning the design of a window for an addition to a church.²³⁵ The window produced in accordance with their design was infringing and the designers were liable for inducing this infringement.²³⁶

2. *Consequences of Inducement of Patent Infringement*

Inducers of patent infringement are liable for the same scope of damages as the direct infringers whose improper activities are furthered.²³⁷ In addition, because an inducer of patent infringement will typically be aware of the patent involved in order to incur liability for such inducement, the inducer may often be seen as a willful infringer and face liability for punitive damages of up to three times the patent holder's actual damages. Actual damages in settings—such as the licensing of a patented tax planning method—where a patent holder normally seeks to make his or her profit from a patent through licensing will probably be determined by estimating the reasonable royalty that the patent holder would have charged a party for the activities constituting the direct infringement following an arm's length negotiation of the royalty.²³⁸ Where a patent holder has an established royalty schedule or formula for the type of activity found to be infringing in a given case, this schedule will typically be used to determine the reasonable royalty and the corresponding patent infringement damages.²³⁹

In addition to damages, a patent infringer (including an inducer of

232. *Id.* at 1312.

233. *E.g.*, *Water Techs. Corp. v. Calco, Ltd.*, 850 F.2d 660, 668 (Fed. Cir. 1988); *Fehr v. Activated Sludge Inc.*, 84 F.2d 948, 957 (7th Cir. 1936); *Oak Indus. Inc. v. Zenith Elecs. Corp.*, 726 F. Supp. 1525, 1542-43 (N.D. Ill. 1989); *see also Nat'l Tractor Pullers Ass'n, Inc. v. Watkins*, 205 U.S.P.Q. (BNA) 892, 913 (N.D. Ill. 1980) (finding that a national association overseeing tractor pulling contests engaged in inducement of infringement by adopting contest rules requiring the use of a patented invention in contest events).

234. *Baut v. Pethick Constr. Co.*, 262 F. Supp. 350, 364 (M.D. Pa. 1966).

235. *Id.* at 362-63.

236. *Id.* at 362, 364.

237. *See, e.g.*, *Chiuminatta Concrete Concepts, Inc. v. Cardinal Indus., Inc.*, 1 Fed. App'x 879, 883-84 (Fed. Cir. 2001) (stating that relief against one inducing infringement may be the same as relief against a direct infringer).

238. *E.g.*, *Hanson v. Alpine Valley Ski Area, Inc.*, 718 F.2d 1075, 1077-78 (Fed. Cir. 1983).

239. *Id.* at 1078.

infringement) or a party whose probable future actions threaten infringement may be enjoined from future infringement.²⁴⁰ Although recent Supreme Court case law indicates that these sorts of injunctions should be granted under the same standards that are applied to injunctions generally,²⁴¹ the criteria for injunctive relief will often be met in connection with patent infringement litigation²⁴² and these sorts of injunctions may be common in the case of threatened or actual inducement of direct infringement of tax planning patents.

D. Prior User Defense for Long Term Users of Tax Planning Methods

One potentially important enforcement question related to tax planning patents is the impact on the enforcement of these patents of the patent law's special defense for "prior users" of patented business methods. The prior user defense is designed to deal with the possibility that a party may have developed and used a business method in secret for a long period, only to find that another party has independently developed and patented the same method.²⁴³ The prior secret user of the patented method would be unable to invalidate the patent at issue because the prior use was conducted in secret and would not be considered in determining if the second developer's discovery of the patented process involved a new and non-obvious invention.²⁴⁴ Worse yet, absent a special defense, the prior, secret user would be an infringer of the patent with respect to any continued use of the patented process after the patent issues.²⁴⁵ Hence, the earlier user would need to either cease its long-established use of the procedure or pay a royalty to the patent holder to continue using this procedure.²⁴⁶

In order to avoid this type of interruption of a prior practice adopted in good faith by the first user, Congress enacted provisions in the Patent Act establishing a special prior user defense to protect long term users of business methods from patent infringement liability.²⁴⁷ The Patent Act specifies that, for business methods only, there shall be no infringement liability for:

[A]ny subject matter that would otherwise infringe one or more claims for a method in the patent being asserted against a person, if such person had, acting in good faith, actually reduced the subject matter to practice at least 1 year before the effective filing date of such patent,

240. 35 U.S.C. § 283 (2000).

241. *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 390-91 (2006) (holding that the issuance of injunctions in patent cases should turn on the same four factors that govern the issuance of injunctions generally, namely a showing by the plaintiff seeking relief that (1) it has suffered irreparable injury; (2) remedies available at law are inadequate to compensate for that injury; (3) "considering balance of hardships between plaintiff and defendant, remedy in equity is warranted;" and (4) public interest would not be disserved by an injunction).

242. *See generally id.* at 395 (Roberts, C.J., concurring) (stating that since the early nineteenth century, courts have granted injunctive relief in the vast majority of patent cases).

243. 35 U.S.C. § 273(b)(1).

244. *Id.* § 273(b)(9).

245. *Id.* § 273(b)(8).

246. *See id.* (discussing the consequences for unsuccessfully asserting the defense).

247. *Id.*

and commercially used the subject matter before the effective filing date of such patent.²⁴⁸

This provision may protect some long term users of a tax planning method who have implemented the method more than one year prior to the effective filing date for a patent application covering the method.²⁴⁹ For example, this defense might shield a taxpayer who is a long term user of the SOGRAT method against liability for carrying out the method and achieving a related tax advantage. However, there are a number of limitations on the prior user defense that may make it a largely illusory protection against liability for infringement of tax planning patents.

1. Tax Planning Methods May Not Be Business Methods

The prior user defense is carefully limited by the Patent Act to infringement involving the use of patented business methods.²⁵⁰ For this purpose, “business methods” are defined as “method[s] of doing or conducting business.”²⁵¹ Tax planning methods may not be considered business methods, in which case the prior user defense will be completely inapplicable to asserted infringement of tax planning patents. There are several reasons why the actions or methods covered by tax planning patents may not be business methods for purposes of the prior user defense.

First, patented tax planning methods may not be undertaken by businesses and, hence, not in any sense an action related to “doing or conducting business.” Many of these methods relate to the personal affairs of affluent individuals—in most cases, individuals seeking a means of avoiding estate or transfer taxes. It seems to stretch the meaning of “business methods” to argue that these means for planning individual affairs, often related to the eventual transference of assets to family members, are instances of business activity.

Second, even with respect to tax planning methods undertaken by businesses, the steps that businesses undertake to reduce their taxes may not be

248. *Id.* § 273(b)(1). The definitional provisions of this subsection limit the application of this defense to “a method of doing or conducting business.” *Id.* § 273(a)(3).

249. The prior user defense only applies to a party who begins use of a patented business method more than one year before the patent on that method issues. In addition, uses protected under the prior user defense are limited by the following additional provisions:

The defense asserted by a person under this section is not a general license under all claims of the patent at issue, but extends only to the specific subject matter claimed in the patent with respect to which the person can assert a defense under this chapter, except that the defense shall also extend to variations in the quantity or volume of use of the claimed subject matter, and to improvements in the claimed subject matter that do not infringe additional specifically claimed subject matter of the patent.

Id. § 273(b)(3)(C).

Thus, a prior user is given some latitude to change his or her volume of established use of the patented method and to augment that method with some additional improvements not independently infringing the patent at issue. This latitude regarding changes in the volume of use of an established user of a patented method might give a long term user of a tax planning method the ability to reimplement a patented method in additional tax planning vehicles and arrangements without engaging in infringement, so long as at least one such use by the same party met the timing requirements for the prior user defense.

250. *Id.* § 273(b)(3)(A).

251. *Id.* § 273(a)(3).

methods of “doing or conducting business” because these tax-related activities are not aimed at enhancing traditional sources of business profits. Business methods for purposes of the prior user defense in patent law may be limited to methods for increasing operating revenues or reducing operating costs of business activities. These may not include the further steps that businesses take to comply with the law and to manage their relationship to governmental authorities like the IRS. In this framework, tax planning strategies may not be business methods because they derive value not from business activities but from minimizing costs of complying with government requirements.²⁵²

In sum, though corporations and other businesses may be able to claim that tax reduction methods are “business methods” within the meaning of the patent laws, it seems doubtful that means of managing one’s personal finances—including managing an individual’s personal tax affairs to reduce tax liabilities—involve “business methods” for patent law purposes. These personal activities, though financially important, seem divorced from the sorts of commerce management and associated administrative practices normally associated with businesses and “business methods.” Hence, individual taxpayers who undertake patented tax planning methods to reduce their individual taxes may not be able to raise the prior user defense to infringement liability specified in the patent laws for long time users of business methods.

2. *Limitations on Protections for New Uses*

Even if tax planning methods are “business methods” for purposes of the prior user defense, the defense will not apply to new uses of a patented method initiated after the issuance of an applicable patent.²⁵³ This means that tax planning professionals will not be able to extend a patented technique to new clients after the issuance of a patent and that clients that were not long-standing users of the patented technique will not be able to freely adopt the technique once it gains public disclosure and notoriety through the issuance of a patent. It also means that long-time users of the patented technique will not be able to initiate new types of uses of patented techniques beyond the use embedded in the prior users’ long time practices.

3. *Absence of Protections for Inducers Such as Tax Attorneys*

Furthermore, even if the prior user defense applies to protect a long-term user of a tax planning method—perhaps because the user is a taxpayer who has had the planning method implemented for a substantial period—this defense will probably not apply to parties such as tax attorneys who are held liable as

252. Some critics of tax planning patents argue that these patents are not justified under present patent law standards supporting patents for innovative business methods because tax planning methods are not just business methods involving the types of business management procedures that have previously been patented, but that they are instead means of complying with legal requirements and, hence, distinct from normal business methods. AICPA ANALYSIS, *supra* note 10, at 1-2; JOINT COMM. ON TAXATION, *supra* note 3, at 21.

253. See 35 U.S.C. § 273(b)(1) (discussing that the defense only applies when the method was “actually reduced . . . to practice at least 1 year before the effective filing date of such patent”).

inducers of the infringement of other parties. The statutory provisions defining the prior user defense clearly indicate that the defense is limited to those parties who undertake the steps of a patented business method.²⁵⁴ In the case of tax planning methods, these parties will be the taxpayers who implement tax planning methods (and perhaps financial institutions or trustees who, as agents of taxpayers, carry out the steps of patented tax planning methods). This suggests that the protected parties would probably not include tax professionals who recommend but do not execute the steps of a patented tax planning method.

VI. POTENTIAL IMPACTS OF PATENTS ON FUTURE TAX PLANNING INNOVATION

A. The Consequences of Protecting Intangible Advances: Lessons Learned from Financial Services Patents

Tax planning patents are arguably a subset of financial services patents because patented tax planning processes achieve financial benefits through tax savings that are comparable in value to increased profits and income achieved through earlier types of patented financial services.²⁵⁵ Whether one views financial services patents as a superset of tax planning patents or as a set of close cousins to tax planning patents, the recent history of patents in the financial services field can provide insights into how the pursuit and impact of tax planning patents may influence tax planning activities.

Financial services patents have been issued in substantial volumes and enforced vigorously because the Federal Circuit court confirmed the validity of such patents in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*²⁵⁶ Financial services specialists have already recognized several trends in this field stemming from the availability of financial services patents.²⁵⁷ These trends include changes in the ways that financial services methods are developed, marketed, and used.²⁵⁸ This subsection summarizes these changes by way of foreshadowing the similar developments that may lie ahead for the tax planning field as tax planning patents become more common and influential.

1. Intellectual Property-Based Service Providers

The ability of financial services companies to accumulate intellectual property interests—by either obtaining patents for their own innovations or acquiring patent rights from other innovators—and to define restricted ranges

254. *Id.* § 273(b)(6).

255. *Cf.* Godici Statement, *supra* note 9, at 37 (describing tax planning innovations and financial service innovations as two types of business method innovations falling with the range of potentially patentable subject matter).

256. 149 F.3d 1368, 1373 (Fed. Cir. 1998).

257. See James F. Bauerle, “Beam Me Up Scotty”: *Business Method Patents as a Transformational Device in Financial Services*, 119 BANKING L.J. 376, 379-82 (2002) (discussing trends in the field).

258. *Id.*

of activities based on their patent rights are changing the characteristics of financial services firms and how they operate.²⁵⁹ Financial capital tends to follow intellectual capital and the financial services firms with substantial intellectual property interests have an advantage over firms with weak intellectual property portfolios.²⁶⁰ Intellectual property interests are figuring in the valuation of financial services firms, just as such interests have affected the valuation of high tech companies for some years.²⁶¹ Future mergers and acquisitions in this area are likely to focus on intellectual property interests as companies use these sorts of transactions to expand their intellectual property portfolios or to eliminate intellectual property enforcement threats from other parties.²⁶²

2. *High-Tech Products*

The development of financial services products is becoming increasingly technical and computer-based as firms devote large amounts of resources to innovation efforts with the reassurance that resulting financial services and management methods can be protected under intellectual property controls.²⁶³ The impact of computers here is bidirectional. Computers are the sources of innovations because computer-based studies lead to new insights that can be implemented in innovative financial services. However, computers are also the objects of design efforts as older types of financial services are implemented with new accuracy, detail, and success through computer-based processes.

3. *Strengthening of Patentable over Unpatentable Lines of Business*

The availability of patents and related licensing rewards for certain types of innovations within the financial services field may tend to skew the efforts of larger companies towards innovations that have the potential for patents

259. Lauria Hunter, *Intellectual Capital: Accumulation and Appropriation* 51-53 (Melbourne Inst. Working Paper No. 22/02).

260. See Bauerle, *supra* note 257, at 383 (“The competitive advantage and profit to be gained by market participants that hold the rights to these instruments makes them compelling product initiatives no less than advances in the design of steelmaking equipment a century ago.”).

261. See *id.* at 382-83 (relating how capital follows intellectual property in high tech firms and how this would logically expand to financial services companies creating intellectual property).

262. Intellectual property interests of target companies in mergers and acquisitions and threats of intellectual property liability that may carry over after mergers and acquisitions are both increasing concerns in these types of corporate transactions. The unexpected invalidity of an intellectual property interest or an undetected source of infringement liability may easily turn an apparently attractive merger or acquisition transaction into a losing proposition. Hence, there has been an increasing effort to evaluate and analyze these features of corporate mergers and acquisitions prior to the completion of these sorts of transactions. See generally RICHARD S. GRUNER, SHUBHA GHOSH & JAY P. KESAN, *INTELLECTUAL PROPERTY IN BUSINESS ORGANIZATIONS* 607-76 (2006) (describing the role and issues created by intellectual property in mergers and acquisitions).

263. See Bauerle, *supra* note 257, at 379-82 (“The last 20 years’ transition to an economy that depends on computer software that is legally protected as the proprietary property of its developers and licensors holds profound implications for our culture and society.”).

over other types of business activities that cannot be similarly protected.²⁶⁴ This may tend to encourage more innovation in service types, particular along significantly new lines of development that are likely to produce the sorts of new and non-obvious designs that are capable of qualifying for a patent. The attraction of patenting opportunities may turn companies increasingly towards these high-risk projects that are capable of producing patentable results and away from non-innovative activities such as increased marketing campaigns for old financial service products.

4. *Disclosed Paths of Innovation*

Trends towards patenting and disclosing financial services innovations are expanding the understanding of financial services and management methods among innovators, regulators, and investors.²⁶⁵ Innovators can use the efforts of patent holders as the basis for improvements on the patented methods (which will require licenses from the patent holders to implement) or as guidance for redirecting future innovation efforts away from the design features protected by existing patents (which can produce substantially different designs of benefit to the public and falling outside the original patents). Once the relevant patents expire, innovators can use the formerly patented methods freely in producing additional designs. Regulators can use information from published patent applications and issued patents to anticipate new practices in the financial services field and to target abuse monitoring and regulatory enforcement efforts accordingly. Investors can use patent disclosures to identify types of investment strategies potentially in use in various markets and thereby detect associated risks of rapid market changes or other responses that depend on the investment and financial management strategies of other investors.

B. *Other Potential Impacts of Tax Planning Patents*

Though a number of commentators and tax specialists have focused on what they perceive to be the potential problems with tax planning patents (many of which were discussed in Part IV of this Article),²⁶⁶ relatively little attention has been given to the positive influences that the availability and issuance of patents may have on future innovation in tax planning methods.²⁶⁷ This section looks at some of the potential benefits of these patents in shaping future tax planning advances and modes of innovation. The potential changes

264. See *supra* note 256 and accompanying text.

265. See *id.* at 384 (relating the theory of how patents create disclosure and thus expand the public knowledge to the financial services markets).

266. See *supra* Part IV.

267. E.g., Brant J. Hellwig, *Questioning the Wisdom of Patent Protection for Tax Planning*, 26 VA. TAX REV. 1005, 1007 (2007); Cover Letter from AICPA, *supra* note 160; Patented Tax Strategies: New Developments, http://ataximgmatter.blogs.com/tax/tax_patents/index.html (Sept. 28, 2007); Posting of Mike Masnick to The Techdirt Blog, <http://www.techdirt.com/articles/20061020/120330.shtml> (Oct. 20, 2006, 16:36 EST).

discussed here are the natural consequences of specially encouraging the sorts of non-obvious “outlier” innovations in tax planning methods that can qualify for patent rewards.

1. New Design Signaling

One potentially valuable impact of patents obtained for particular tax planning methods will be to focus attention on the new work of the developers of the patented methods. The issuance of a patent will act as a confirmation or signal by the USPTO that the patented tax planning method is a distinctive departure from the prior knowledge in the field. The approval of the patent by the USPTO will tend to indicate that its neutral patent examiners have compared the claimed invention to the prior knowledge in the field and found the invention to be a non-obvious addition to that knowledge.²⁶⁸ The patent, as a symbol of the underlying analysis by the USPTO, therefore becomes credible evidence of both the newness of the patented invention and of the analytic skill of the invention developer in being able to produce a non-obvious extension of prior designs.

This is a reflection of the “signaling” role of patents regarding technological developments generally.²⁶⁹ As described by Clarisa Long, patents provide:

[A] means of credibly publicizing information. Patents can reduce informational asymmetries between patentees and observers. Under some circumstances, the informational function of patents may be more valuable to the rights holder than the substance of the rights. . . . If an easily measurable firm attribute such as patent counts is positively correlated with other less readily measurable firm attributes such as knowledge capital, then patent counts can be used as a means of conveying information about these other attributes. Knowing this, firms may choose to obtain and use a portfolio of patent rights to signal information about themselves that would be more expensive to do through other means. Alternatively, firms can use the patent document itself to convey information that would not be as credible when revealed in other contexts.²⁷⁰

Notice that, as described by Long, the signals provided by a patent relate to both the invention at hand and the broader skill and knowledge of the inventor and (if relevant) the firm associated with the patented invention. The implication of a patent is that the invention involved is the product of skills and knowledge that may be applied again in the future to produce similar non-obvious advances. Hence, the issuance of a patent can have a spillover effect of enhancing the reputation of the person or company involved in areas other than just sales of the patented product or services.

268. See 35 U.S.C. § 103 (2000) (listing the requirement that an invention must be non-obvious to receive a patent.).

269. Clarisa Long, *Patent Signals*, 69 U. CHI. L. REV. 625, 641 (2002).

270. *Id.* at 625.

Although the issuance of a patent will sometimes add valuable information to the public's insights into the skills and background knowledge of the patent holder, there are several reasons that the signals provided by patents may be misinterpreted. For one thing, the USPTO may just get it wrong, mistakenly issuing a patent when the invention involved is not new or, if new, is no more than an obvious extension of prior designs. This type of error is particularly likely in fields like tax planning methods or financial services where the history of patenting is short, the record of past advances is not well-documented in patent records, and there are few other sources where past advances have been carefully documented. The USPTO may consequently reach erroneous conclusions about what is a new advance and about what constitutes an obvious extension of prior knowledge using average skills in the field.

Another reason why patent signals may be misinterpreted is that the issuance of a patent provides little evidence itself that a patented invention will be translated into useful products or services or that such products or services will be commercially successful.²⁷¹ A large number of issued patents are not transformed into commercially significant products and are instead allowed to lapse by the patent holders, apparently due to the conclusion by these parties that the inventions involved are not worth further protection and development into commercial products.²⁷² Hence, the signals provided by the issuance of a patent must be interpreted in the context of the product development and marketing abilities of the party or firm in control of the patent, as well as in light of consumers' needs for the types of products that the patented invention will support.

2. *Product Differentiation*

Another impact of issued patents in tax planning area may be the increased differentiation of products of patent holders from those of competitors. A company marketing a particular tax planning service incorporating patented features can assure its customers that this same service, and whatever advantages it provides, cannot be obtained from other vendors because the patent involved will preclude adoption of the patented feature in other parties' products and services. Through this type of product differentiation, a firm can establish a pattern of "sustainable differentiation" from its competition built on a foundation provided by the firm's patents or the patents that it licenses from others.²⁷³

271. One reason why a patented invention may not result in a commercially successful product is that, although an invention must have some small amount of practical benefit or "utility" to users in order to qualify for a patent, utility need not trump or be greater than the utility of earlier designs in order for a patent to issue. All that is needed is some utility, not superior utility. See 35 U.S.C. § 101 (discussing the requirements for a patentable invention).

272. Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 NW. U. L. REV. 1495, 1503-04 (2001).

273. See John C. Spaccarotella, *Patents Continue to Gain Visibility, Value in the Lucrative Derivatives, Hedge Fund, and Allied Financial Services Market*, 25 FUTURES & DERIVATIVES L. REP., Oct. 2005, at 3 (noting the potential of financial services patents to enhance the marketing of an "allegedly-proprietary

This type of sustainable product differentiation has been seen as highly valuable in other fields. For example, in a detailed study of patenting and investment practices in the computer software field, Ronald J. Mann found that venture capitalists are particularly interested in patents and associate them with company value because the patents provide a vehicle for sustainable differentiation of software developers from their competitors.²⁷⁴ Mann described the linkage between patent holdings and perceived company value in the eyes of venture capitalists as follows:

[F]or firms that have a credible product idea and the expertise to implement it, venture capitalists plainly accept the idea that their goal is to identify firms that will have sufficient market power to earn extraordinary profits. IP protection is important only indirectly, as a tool that might provide that market power. The key is “sustainable differentiation”: something special about the particular firm that will enable it to do something that its competitors will not be able to do for the immediate future. . . . [I]t is clear that the key to a desirable investment opportunity is in the expectation of market power, and all other attributes of the company are indirect predictors of that ultimate goal.²⁷⁵

3. *Channeling Competitors' Actions*

The issuance of a patent, coupled with substantial publicity regarding the scope of the patent and its probable enforcement, can be a means to direct competitors' activities away from a particular domain of product development. Competitors of the patent holder will have considerable motivations to “design around” the patented innovation by creating products or services that compete successfully with the patented innovation, but which do not include the patented feature. Even if the patented feature is so fundamentally important that parties must seek a license and adopt the feature in order to remain competitive in their field, parties will still have motivations to produce their own innovations in their special domains of expertise, seek related patents, and use the resulting patents as “bargaining chips” in seeking licenses to use the fundamental breakthrough.

By channeling innovation among competitors and encouraging parties to move into new innovative domains in these ways, patents on tax planning methods may both avoid duplication of similar innovative efforts conducted in secret and spur competitors into exploring new innovative domains. The result may be far more diverse patterns of overall innovation than would be present absent such patents.

product and technology to current and potential clients”).

274. See Ronald J. Mann, *Do Patents Facilitate Financing in the Software Industry?*, 83 TEX. L. REV. 961, 980 (2005) (noting the relation between venture-backed software startups having patents and their success).

275. *Id.* at 976.

4. *Signaling Future Innovation Strengths*

Patents concerning a particular type of product or service can also signal future business strategies to customers and competitors. The investment of large research expenditures in developing new financial products or services in a particular area, coupled with the revelation of those expenditures through the publication of patent applications or patents describing inventions resulting from the innovative efforts, can provide business intelligence information to customers and competitors.

For customers, the message is that the firm involved is serious about being a technology and product leader in the domain of the innovation being patented, with the possibility of more similar advances to come. Such a message can establish a degree of trust in the future products of an innovative patent holder that encourages customers to establish long term business relationships with the innovator.

For competitors of a patent holder, the implications of a valid patent may be that the competitors will find it difficult to pursue innovation in the same direction as the innovation covered by the patent (because they will need to license rights under that patent in order to pursue such innovation) and that the patent holder may be a significant force in producing future similar innovations outside the scope of the present patent (because the expert personnel and resources used to produce the patented innovation will be available to produce additional similar advances).

5. *Increasing Innovation Specialization*

As a tax planning patent holder and its competitors pursue different innovative paths in reaction to an issued patent, each has incentives to develop specialized expertise and knowledge that will aid it in producing further innovations and, perhaps, additional patents that will reserve to each party a particular product niche. By staying out ahead in expertise in at least one subcomponent of the tax planning field, a firm maintains the opportunity to produce a string of “non-obvious” advances in that domain that will result in a corresponding string of patents. This type of innovation partitioning strategy will tend to strengthen the specialization and firm differentiation effects in the tax planning field.²⁷⁶

As this process goes forward, specialized innovators may need to cross-license patents to and from their competitors so that each can gain the specialized advances of the other to produce viable, competitive products. The patents that each firm has on their specialized advances in the narrow slice of the field where they have particularly strong innovative capabilities will become the “currency” with which they can bargain for rights to use the advances of their competitors.

The impacts of tax planning patents on specialization may operate at both

276. Burk & McDonald, *supra* note 7, at 13.

the firm and individual employee levels. As parties within firms focus on innovative activities leading to patentable inventions, such work will establish its own specialized career path and associated set of employees whose work options and abilities to transfer their skills from firm to firm will be valued in direct relation to their abilities to produce valuable intellectual property rather than just their skills in serving their present employers.²⁷⁷

6. *Rewarding Innovators over Non-Innovators*

The winners in this sort of innovation-valuing arrangement will be those tax planning firms that have innovations and patents that enable them to be highly successful competitors in the field. The losers will be parties with no innovations and no patents to bargain with. In effect, this sort of process should help to filter out less innovative firms, leaving only ongoing innovators that can bargain with their own patents for access to the latest designs in their fields and thereby stay competitive in consumer markets.

VII. NEW LEGISLATION: A CURE WORSE THAN THE DISEASE?

A. *The Background of the Proposed Bill*

In an effort to solve a variety of perceived problems with tax planning patents, tax specialists as well as Congress proposed laws that would have either eliminated tax planning methods from patentable subject matter or that would restrict the enforcement of patents for such methods.²⁷⁸ Representative Rick Boucher of Virginia sponsored an amendment to the Patent Act based on the former model and this amendment was attached to a larger patent reform bill that was pending in 2007.²⁷⁹ The legislation excluding tax planning patents from patentable subject matter gained strong support from AICPA and the approval of the Chair of the Courts, the Internet and Intellectual Property Subcommittee of the House Judiciary Committee, Representative Howard Berman of California.²⁸⁰ The patent reform bill, including the amendment to the patent act regarding tax planning patents, was approved by the House Judiciary Committee on July 18, 2007,²⁸¹ and by the full House on September 7, 2007.²⁸² Similar support for tax planning patent legislation on the Senate side was uncertain as of that point.²⁸³ Also unclear was the degree to which tax planning patent reform would receive separate attention amidst the

277. *Id.* at 5.

278. AICPA ANALYSIS, *supra* note 10, at 12-13; Drennan, *supra* note 10, at 313.

279. *E.g.*, Tax Patents: Breaking News, <http://ataxingmatter.blogs.com/tax/2007/07/tax-patents-bre.html> (July 18, 2007).

280. *E.g.*, AICPA Supports Bill that Would Ban Patents on Tax Strategies (Nov. 19, 2007), <http://www.macpa.org/Content/23816.aspx>.

281. Tax Patents: Breaking News, *supra* note 279.

282. AICPA, Tax Strategy Patents, Legislation Addressing Tax Strategy Patents, <http://tax.aicpa.org/Resources/Tax+Patents> (last visited July 8, 2008).

283. *See* S. 1145, 110th Cong. (2007) (lacking any provision that would exclude tax planning methods from patenting).

consideration of many more significant issues related to the overall patent reform bill.

B. Provisions of the Proposed Bill

The provisions of the proposed bill to eliminate tax planning patents is short in text but long in problems. The legislation would amend the patentable subject matter provisions of present patent laws to provide that:

(b) TAX PLANNING METHODS. –

(1) UNPATENTABLE SUBJECT MATTER. – A patent may not be obtained for a tax planning method.

(2) DEFINITIONS. – For purposes of paragraph (1) –

(A) the term “tax planning method” means a plan, strategy, technique, or scheme that is designed to reduce, minimize, or defer, or has, when implemented, the effect of reducing, minimizing or deferring a taxpayer’s tax liability, but does not include the use of tax preparation software or other tools used solely to perform or model mathematical calculations or prepare tax or information returns;

(B) the term “taxpayer” means an individual, entity, or other person (as defined in section 7701 of the Internal Revenue Code of 1986) that is subject to taxation directly, is required to prepare a tax return or information statement to enable one or more other persons to determine their tax liability, or is otherwise subject to a tax law; and

(C) the terms “tax”, “tax laws”, “tax liability”, and “taxation” refer to any Federal, State (as defined in subsection (c)(2)(G)), county city, municipality, or other governmental levy, assessment, or imposition, whether measured by income, value, or otherwise²⁸⁴

Further provisions of the bill specify that it will take effect upon enactment and will apply to any application for a patent or application for a reissue patent that is either (1) filed on or after the date of enactment, or (2) filed before that date if a patent or reissue patent has not been issued pursuant to the application as of the enactment date.²⁸⁵

C. Problems Left Unresolved by the Proposed Legislation

Though the proposed bill purports to resolve some of the tax planning patent issues addressed in this Article and to simplify patent law by creating a specific exclusion of tax planning methods from all potential patenting, the bill may simply substitute another set of problems for the tax patent problems that it avoids.²⁸⁶ The new problems raised by the proposed legislation relate to the following implications of the bill.

284. Patent Reform Act of 2007, H.R. 1908, 110th Cong. § 10 (2007).

285. *Id.*

286. *Id.*

1. *Determining the Design Objectives of a Method*

The bill will preclude patenting for a method if it is “designed to reduce, minimize, or defer” a taxpayer’s tax liability.²⁸⁷ How this design goal should be measured is left unclear. Also unaddressed is whether the involvement of this as one of many design goals means that a method is unpatentable. For example, suppose a new financial method is aimed at both increasing a party’s income and at ensuring that the income is realized as long term capital gains. The latter would suggest that one of the design goals of the method is tax reduction. However, the first goal would be a more traditional income enhancement goal typical of patentable business methods, generally. Which design objective will control? What evidence should be considered in determining if tax reduction is a design objective of a business or financial method? How should the multiple objectives that may underlie a given method be reconciled or ranked to determine if tax reduction is a design goal deserving recognition under the proposed legislation?

2. *Excluding Patentability Based on Method Results*

Even more troubling, the proposed bill excludes from patenting any method that has, when implemented, “the effect of reducing, minimizing or deferring a taxpayer’s tax liability.”²⁸⁸ This provision will apply even if a given method was not designed to reduce taxes. Hence, the unintended result of a financial or business method (or any other practice) in reducing taxes will apparently be enough to prevent patenting of the method.

There are several clear problems with this provision. First, designers of new business and financial methods will have no means to plan to avoid the exclusion from patenting that this provision creates, because the results that might be achieved by a new method are not fully predictable and there would always be a chance that a new method would have some beneficial tax consequences. A highly unpredictable range of business practices—even things as simple as the timing of purchases of supplies in the present year rather than waiting until after January 1—may “have the effect of reducing . . . a taxpayer’s tax liability” and be affected by this legislation.

Second, by focusing on the results achieved by a business or financial method, this provision has the potential to exclude a broad range of new business and financial methods from patenting. For example, any financial method that is aimed at producing new income but that sometimes fails and produces losses is, with respect to the latter result, a method that has the effect of reducing the user’s tax liability (because the loss from the method, if incurred in a business setting, will probably reduce the taxpayer’s net income and tax liability). Was this type of new financial or business method with a chance of creating business losses intended to be excluded from patenting?

287. *Id.*

288. *Id.*

Third, by emphasizing that the results achieved by a method may be a ground for excluding the method from patenting,²⁸⁹ the proposed legislation creates a difficult timing problem regarding when the patentability of a method should be determined. If the method does not achieve a tax reduction result when first used by its inventor, does this mean that this provision is not applicable and that the method can still be patented without concern over the future results that the method may achieve? Or are the results that the method actually achieves in use always a potential ground for invalidating the patent, in which case patents on methods with the potential for some desirable tax impacts will take on a significant infirmity over the life of the patents?

3. *Applying the Special Rule for Tax Preparation and Calculation Tools*

The exception from patentability for tax planning methods under the new bill is subject to its own counter-exception for the use of “tax preparation software” and “other tools used solely to perform or model mathematical calculations or prepare tax or information returns.”²⁹⁰ This counter-exception to the general exclusion of tax planning methods from patenting means that methods involving the use of tax preparation software and the other tools mentioned in this provision will still be patentable.

Assuming that methods of use of “tax preparation software” are sufficiently new and non-obvious to ever qualify for patenting, it is unclear why these methods are more meritorious and should be privileged under the patent laws over other types of tax reduction methods. The gains to taxpayers from tax preparation software and from tax reduction strategies may be highly similar in that both are ultimately aimed at retaining more financial resources for taxpayers’ use. Better software may, for example, aid taxpayers in identifying and using tax deductions that are applicable to their affairs, thereby resulting in tax savings. Tax reduction methods may reduce tax payments by restructuring taxpayers’ affairs to trigger lesser tax liabilities than would otherwise be the case. Why patents for the former should be allowed but not patents for the latter is a mystery.

The preservation of patents for methods involving the use of “tools used solely to perform or model mathematical calculations” is even more problematic.²⁹¹ If this provision really means what it says, the bill seems to provide positive support for patents on methods of mathematical calculations that would, under prior patent laws, have been unpatentable as abstract, unapplied ideas.²⁹²

However, what the bill’s authors may have been trying to say is that methods involving the use of tools for calculations or mathematical modeling related to tax analyses and tax reductions remain patentable. Though this

289. *Id.*

290. *Id.*

291. *Id.*

292. *See* Gottschalk v. Benson, 409 U.S. 63, 71-72 (1972) (discussing the patentability of mathematical formulas as ideas in digital computers).

would make more sense, it would also establish an exception that could swallow the rest of the proposed legislation. For example, the essence of the SOGRAT patent described earlier in this Article is a means for analyzing certain investments and developments in investment value to trigger particular asset sales and distributions in patterns that reduce taxes.²⁹³ Assuming that a method like this involves some new set of calculations or sequences of calculations leading to advice on how to take actions to reduce taxes, a party who held a patent and controlled the use of the new sequence of calculation steps would also control the new tax reduction method for practical purposes. Hence, the type of “calculation” patents allowed under the proposed legislation may be precisely the type that tax specialists have protested so much.

4. *The Broad Range of “Taxpayers” Covered*

The proposed legislation specifies that, for purposes of determining whether a procedure reduces, minimizes or defers the tax liability of a “taxpayer” and is thereby unpatentable, the range of parties considered to be “taxpayers” should not be limited to those persons with direct tax liabilities, but should also include other parties with obligations to prepare and file informational tax returns addressing the tax liabilities of other parties.²⁹⁴ Although these sorts of persons obligated to file informational returns are doubtless affected by tax laws, it is unclear how an innovative method of assisting these parties in preparing a return would have the design goal or result of “reducing, minimizing or deferring” the preparer’s tax liability. Hence, this expansive definition of a taxpayer within the bill seems to envision a circumstance that could never have fallen within the bill anyway. It is at least very mysterious as to what this very broad definition of “taxpayer” was intended to accomplish.

5. *The Nature of “Taxes” Reduced*

The proposed legislation also adopts a remarkably broad definition of the types of “tax” reductions that cause a method to fall within the range of unpatentable innovations addressed by the legislation.²⁹⁵ Not only will a procedure that reduces traditional forms of taxes suffice, a procedure for the reduction of any “governmental levy, assessment, or imposition, whether measured by income, value, or otherwise” will also fall within the proposed legislation.²⁹⁶

The remarkable—and probably unintended—breadth of this language is apparent when one realizes that a broad range of user fees or license fees will be treated as “taxes” under this language. For example, the fee one pays to obtain a driver’s license is a “governmental . . . imposition . . . measured . . .

293. U.S. Patent No. 6,567,790 (filed Dec. 1, 1999).

294. Patent Reform Act of 2007, H.R. 1908, § 10.

295. *Id.*

296. *See id.* (providing definitions for “tax,” “tax laws,” “tax liability,” and “taxation”).

otherwise [than by income or value].”²⁹⁷ This means that an innovative method for reducing the fees that drivers’ should pay to obtain drivers’ licenses would be treated as a “tax” reduction method under this bill and excluded from patenting. Though there may be a case to be stated for eliminating all methods of law compliance or for reducing payments to the government from the patent laws, to do so under the guise of defining them as means for reducing “tax” payments seems likely to produce little analysis of the consequences and some unintended results.

VIII. CONCLUSION: THE BRAVE NEW WORLD OF TAX PLANNING PATENTS

The emergence of tax planning patents reflects the confluence of three important trends in patent law. First, patentable subject matter standards have been steadily expanding in coverage. Federal court standards have, over the past two decades, recognized that our patent system should encourage and reward advances in fields as divorced from traditional physical engineering and chemistry as bioengineering, computer software, communication information processing, accounting record keeping, financial investment strategies, and business methods. In this march towards ever broader patent system scope, it is a small step to extend patents to advantageous tax planning methods that produce important financial results for taxpayers.

Second, the impacts of computers and computer-based analyses have expanded the range of sophisticated tax planning strategies that are appreciated by tax specialists and implementable on behalf of taxpayers. Computer analyses of potential asset and income management strategies and associated tax results have expanded our understanding of what types of tax planning methods are desirable, leading to types of potentially patentable tax planning methods that would not have been understood a few years ago. On the implementation side, computer management and tracking processes allow for the implementation of tax planning strategies that would not have been possible in an earlier era. These developments in computer technologies applied to tax planning methods have expanded the range of computer-related tax planning patents just as the presence of computers has expanded the number of patents in so many fields.²⁹⁸

Third, reassured in part by the availability of patents in the financial and tax planning services fields, tax specialists, accounting firms, and financial services concerns are devoting more resources towards the development of highly sophisticated methods for tax planning, with the amount of those resources augmented by expectations of large rewards achieved through patent control of the resulting innovations. If a given advance can only be marketed by the firm making it to that firm’s particular client set and may become available for marketing by competitors through public disclosures of the

²⁹⁷. *Id.*

²⁹⁸. *See generally* Gruner, *Better Living*, *supra* note 34, at 1065 (mentioning that changes in the industry suggest that there is an increasing need for software patent incentives to promote future software development).

method, a firm pursuing the development of a method will only be encouraged to devote such resources to the development process as will be paid back in extra payments from their own clients in later transactions. However, if a firm can count on patent protections for a new and highly innovative tax planning strategy, the firm will be able to afford to devote greater resources to the development of the method knowing that all taxpayers who wish the benefit of using the method will need to pay a royalty to gain this advantage. Under this latter type of system, the full range of taxpayer advantages from a given new technique will define the extent of development expenditures that are justified in producing it. It will also encourage firms to focus on the types of highly innovative, non-obvious extensions of prior designs that are capable of qualifying for patents.²⁹⁹

This last analysis suggests why patents on tax planning methods, though highly foreign and seemingly dysfunctional to tax planners at present, may ultimately be beneficial to this field. If the future of tax planning methods lies in highly sophisticated, computer-intensive means of asset and income management, then substantial development rewards and protections may be needed to encourage the invention of these methods. Patents on such methods will encourage the very best designers of such methods to devote their time to these sorts of resource-intensive development processes. Patents will also encourage the devotion of expensive combinations of computer and financial accounting resources to the development of fundamentally new types of computer-based tax planning approaches and methods with the knowledge that successful results can lead to valuable patents. This type of development pattern has prevailed in a number of other fields where patents serve to allow smaller, highly innovative concerns to focus on innovations, with the assurance that other, less innovative firms will need to pay for use of the resulting innovations.

In short, a patent-mediated world of tax planning may be one in which greater efforts are devoted to the types of innovative tax planning methods that are non-obvious advances over prior methods and that can qualify for patents. It may also lead to a restructuring of the field where innovators are significantly advantaged in competition with non-innovators and in which specialists in innovation can be sure that their useful results will be paid for by the numerous clients and tax specialists who use and benefit from the innovative tax planning methods that emerge.

299. See generally Gruner, *Everything Old*, *supra* note 127, at 211 (discussing the patentability of “new advances that are merely obvious extensions or modifications of prior design”).