

NO METHOD TO THE MADNESS: THE FAILURE OF SECTION 14 OF THE PATENT REFORM ACT OF 2011 TO MAKE ANY OBVIOUS CHANGES FOR THE BETTER

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A few years ago, tax and accounting professionals raised eyebrows over the perceived threat of the “tax patent.”¹ A veritable parade of horrors were voiced, stoking fears to an Orwellian level amidst the masses.² There were few outward supporters of the burgeoning field probably because those who routinely toiled in the financial arena

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1. *Tax Patents: cert is filed in Bilski business method patent case*, ATAXINGMATTER (Jan. 30, 2009), <http://ataxingmatter.blogs.com/tax/2009/01/tax-patents-cert-is-filed-in-bilski-business-method-patent-case.html>; Evelyn McDowell, *Tax Strategy Patents: Truth and Consequences Can Patents Encourage Invention Without Complicating Tax Preparation and Compliance?*, THE CPA J. ONLINE (Feb. 2008), <http://www.nyssepa.org/cpajournal/2008/208/essentials/p46.htm>; Ellen P. Aprill, *Responding to Tax Strategy Patents*, LOYOLA-LA LEGAL STUDIES PAPER NO. 2007-26 (April 2007); Dennis I. Belcher & Dana G. Fitzsimons, *Tax Planners—Beware of Patented Estate Planning Techniques*, PROB. & PROP. J. (Nov./Dec. 2006); Andrew A. Schwartz, *Tax Strategies Are Not Patentable Inventions*, 25 IPL NEWSLETTER 35 (Fall 2006).

2. These include claims that granting patent protection to tax strategies limited the use of the patented approach for others simply trying to comply with the law; that tax preparers will be burdened with due diligence searches just for trying to file tax returns; tax patents will violate rules of ethical practice for attorneys, accountants, and tax planners; and that tax patents will set the stage for patenting any efforts to comply with the law and in fact allow patents on legal practice. Others in the patent field pointed out that the advent of tax patents might in fact benefit members of the tax profession by leading to increased labor mobility and greater entrepreneurial opportunities. Dan L. Burk & Brett H. McDonnell, *Patents, Tax Shelters, and the Firm*, Legal Studies Research Paper Series, No. 07-05, <http://ssrn.com/abstract=961749>.

seemed bent on wiping out the newfangled viral menace before it spread too far. Now patent reform has attempted to accomplish that goal by way of Section 14 of the Patent Reform Act of 2011, also commonly referred to as the new American Invents Act.³ Or has it? One may question whether the new law effectively terminates tax patent efforts or is merely a façade perhaps only temporarily pacifying the concerns of various constituencies who complained of problems that in practice were never proven to exist.

This article briefly examines the short history of openly expressed concerns regarding tax patents and the legislative response crafted to address them. The goal here is not so much to argue in favor of tax patents, although there is nothing wrong with them in terms of basic legal principles, as it is to criticize the weak language of the bill, which in attempting to satisfy so many, or perhaps based on the substantive lack of understanding of the bill sponsors, led to the poor draftsmanship of an unnecessary part of the new patent act.

I. THE ARGUMENTS AGAINST TAX PATENTS

The arguments against tax patents were generally divided into three broad categories. The public ownership category included hyperbolic assertions loosely based on the notion that select groups of private individuals would, by virtue of patent protection, be granted mercenary ownership with respect to a body of law applicable to every single person within the United States jurisdiction.⁴ As such, those private individuals might “capture” the tax law-making process, reduce or eliminate their own taxes without public benefit, and charge a toll for the distribution of those same presumptively illegitimate tax reduction benefits solely to other taxpayers able to afford that toll.

The due process/equal protection category included assertions that the non-patent holder taxpayers, who could not afford the toll, would be unable to comply with a law that is otherwise mandatory or be forced to pay more government tribute than similarly situated taxpayers. Additionally, the grant of the patent would result in a perceived

3. America Invents Act, Pub. L. No. 112-29, sec. 14, 125 Stat. 284, 327-28 (2011).

4. See Linda M. Beale, *Tax Patents: At the Crossroad of Tax and Patent Law*, 2008 U. ILL. J.L. TECH. & POL'Y 107 (2008) (arguing that tax patents should be prohibited); Charles F. Wieland, III & E. Daniel Leightman, *Patents on Tax Strategies: Protecting Innovation or Inhibiting Advice?*, 8 HOUS. BUS. & TAX L. J. 225, 249-64 (2008) (arguing against the need to prohibit tax patents).

guarantee regarding the resulting tax benefit that the government may later disregard.⁵

The insurmountable administrative burden category included assertions that tax professionals would be precluded by patent law from rendering their best advice to those seeking to comply with the law and that patent examiners might too easily grant patents for tax strategies as a result of their lack of tax expertise (increasing the likelihood of the former insurmountable administrative burden).⁶ The latter point is essentially an assertion that tax strategies for which patents are granted would normally be novel only to the unschooled, and thus not deserving of patent protection in the first instance.⁷

The last objection—that patent examiners lack qualifications to determine the non-obviousness of tax patents—is answerable in two different ways. As noted earlier, patents are granted for useful, novel, and non-obvious inventions. Implicit in the assertion regarding the ability of patent examiners to determine whether a tax strategy meets these criteria is the notion that, if patent examiners were well-versed in tax law, most tax strategies would fail the non-obviousness requirement and not gain patent protection.⁸ The basic examination standard

5. The due process/equal protection arguments are often stated in the tax language of “horizontal equity”:

A patented tax loophole may leave similarly situated taxpayers in three different situations. The taxpayer who invents the tax loophole and obtains the patent will be able to reduce her taxes without paying any license fees. All other taxpayers that could use the loophole are faced with a choice that will have economic consequences. Some taxpayers may choose to use the loophole and pay license fees to the patent holder to avoid being sued for patent infringement. Other taxpayers will choose not to license the loophole and, out of fear of being sued for patent infringement, will not use the loophole and will pay higher taxes. Thus, similarly situated taxpayers will wind up in three different economic situations as a result of patents on loopholes.

William A. Drennen, *The Patented Loophole: How Should Congress Respond to this Judicial Invention*, 59 FLA. TAX REV. 229, 281 (2007).

6. Beale, *supra* note 4, at 143 (regarding the professional concerns raised by tax patents, including the burdens that might require tax planners to limit the scope of the advice they provide to clients).

7. See Christopher R. Leslie, *The Anticompetitive Effects of Unenforced Invalid Patents*, 91 MINN L. REV. 101 (2006) (arguing that even invalid patents can result in serious anti-competitive effects in the marketplace).

8. It is well documented that patent examiners are qualitatively and quantitatively overwhelmed by their assigned tasks and, as a result, improvidently grant too many patents, but this is not an assertion unique to the examination of tax strategies. The understaffing and insufficient training within the patent office has been a known fact for years:

Here’s how bad it is at the U.S. Patent and Trademark Office. If the agency could shut its doors to catch up on its work, its 5,500 patent examiners would take at least two years to clear the backlog of pending applications. When the agency reopened, there would be more than 1 million new applications piled up on the doorstep. In the global economy,

essentially requires that the invention involve a strategy a well-versed tax professional would not easily recognize.⁹ A person having ordinary skill in the art (PHOSITA) for determining obviousness of the claimed invention is a reasonableness standard as opposed to a standard requiring the level of knowledge possessed by the most knowledgeable expert in any given field.¹⁰ The obvious is illusive and perhaps even nonexistent, however, to even the most well-versed tax professional.¹¹

innovation, technological progress and the protection of intellectual property rights are keys to U.S. competitiveness. Keeping up with the demand for patents is critical to the nation's health. But the patent office is suffering from troublesome turnover. One patent examiner leaves for nearly every two the agency hires, according to a report from the Government Accountability Office, an arm of Congress. About two-thirds of patent examiners surveyed by the GAO said the patent office's production quotas are one of the biggest reasons for quitting. To meet their quotas, 70 percent of examiners surveyed by the GAO said they had to work substantial unpaid overtime in the previous 12 months. Others said they caught up with their work while on vacation. The production quotas are based on the number of applications that examiners must review and complete biweekly and have not been adjusted since 1976. Since then, patent applications have become more complex, which means it takes longer to review them.

Stephen Barr, *Backlog, Quotas Overwhelm Patent Examiners*, WASHINGTONPOST.COM (Oct. 8, 2007), <http://www.washingtonpost.com/wp-dyn/content/article/2007/10/07/AR2007100701199.html>. See generally U.S. PATENT AND TRADEMARK OFFICE HIRING EFFORTS ARE NOT SUFFICIENT TO REDUCE THE PATENT APPLICATION BACKLOG, United States Government Accounting Office (Sept. 2007), <http://www.gao.gov/new.items/d071102.pdf>. Another commentator notes, without regard to tax patents in particular:

The United States Patent and Trademark Office (Patent Office or USPTO) has recently come under increasing scrutiny for the quality of the examinations to which patent applications are subjected. It has been argued that U.S. patent examination is deficient as compared to other national patent offices. The common criticism from all sides is that the Patent Office grants patent claims that are broader than what is merited by the invention and the prior art, resulting in so-called "bad" or improvidently granted patents. This problem is exacerbated with respect to new technologies such as Internet and computer software, where it can be difficult to identify prior art information. The existence of these types of errors has important economic consequences, including inefficient resource allocation and significant harm to economic growth.

Jay P. Kesan & Andreas A. Gallo, *Why Bad Patents Survive in the Market and How We Should Change: The Private and Social Costs of Patents*, 55 EMORY L.J. 61 (2006).

9. 35 U.S.C. § 103 (2006). For a thorough discussion of the history and meaning of Mr. Phosita, see Joseph P. Omeara, *Just Who is The Person Having Ordinary Skill in the Art? Patent Law's Mysterious Personage*, 77 WASH. L. REV. 267 (2002).

10. "Patent law's 'person having ordinary skill in the art' (Phosita) has been likened to the reasonable person of tort law." *Id.* at 267 (citing *Panduit Corp. v. Dennison Mfg.*, 810 F.2d 1561, 1566 (Fed. Cir. 1987)).

11. One reason why tax reduction strategies are rarely obvious is that they typically make no economic sense and, absent tax considerations, would be against common sense. One of the more famous descriptions of a tax shelter, for example, is "a deal done by very smart people that, absent tax considerations, would be very stupid." *Tax Report*, WALL ST. J., Feb. 10, 1999, at A1 (quoting Professor Michael Graetz). By contrast, another observer describes a tax shelter transaction as "a deal done by very smart people who are pretending to be rather stupid themselves for financial gain." David P. Hariton, *Response to "Old 'Brine' in New Bottles" (New Brine in Old Bottles)*, 55

One may confidently assert that a tax strategy for which a taxpayer will pay a cost involves the application and interrelationship of and between several disparate tax statutes, regulations, administrative interpretations, and judicial opinions; rarely will that interrelationship be accurately described as obvious, if only because tax professionals tend to specialize in coherent, self-contained portions of the tax code. In short, there is nothing that can be easily described as “obvious” with respect to a tax strategy even for well-versed tax professionals whose expertise is never as expansive as the entire tax code. Even if the patent office were staffed with persons having years of professional tax training and experience, it would not likely reject more tax patent applications than under present circumstances.

Indeed, every “new” tax strategy invariably involves the discovery of an otherwise unanticipated consequence of two or more legal tax doctrines, oftentimes from disparate sections of the tax code.

On July 13, 2006, the House Committee on Ways and Means received testimony before the Subcommittee on Select Revenue Measures.¹² Those testifying included Dennis I. Belcher, an experienced tax attorney who was also an officer in the American College of Trust and Estate Counsel (ACTEC). Mr. Belcher was specifically concerned with the implications of a patent issued in 2003, which had become commonly known as the SOGRAT patent.¹³ The SOGRAT patent involved the use of Stock Options to fund a Grantor Retained Annuity Trust, hence the name. Grantor retained annuity trust funding was a commonly used estate planning technique; thus, according to Mr. Belcher’s testimony, the estate planning community was shocked

TAX L. REV. 397, 398 (2002). The point relevant to the present discussion is that typically, complex tax reduction strategies are hardly ever “obvious” in the PHOSITA sense, in large part because they are counter-intuitive.

12. *Issues Relating to the Patenting of Tax Advice Before the Subcomm. On Select Revenue Measures of the House Comm. On Ways and Means*, 109th Cong. (2006), available at <http://waysandmeans.house.gov/media/transcript/10219.html>.

13. *Id.* (statement of Dennis I. Belcher, Partner, McGuire Woods LLP). The SOGRAT patent was not the first tax patent issued but it did illustrate the breadth of the controversy. “Tax patent” is really a broad misnomer that fails to do anything more than indicate that a patent issued may impact the area of tax liability for some person or entity at some time in the future. It is akin to saying someone has an electrical patent and, because everyone needs electricity, no one should be able to get such a patent. Prior to SOGRAT, many patents affecting taxes in some fashion had issued and some even included the disputed patent in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998), as the first tax patent. See *Method And Apparatus That Processes Financial Data Relating To Wealth Accumulation Plans*, U.S. Patent No. 5,991,744 (filed Oct. 31, 1997) (issued Nov. 23, 1999) and *System For Performing Tax Computations*, U. S. Patent No. 6,064,983 (filed Mar. 21, 1997) (issued May 16, 2000).

to learn that a patent of this type was issued.¹⁴ Mr. Belcher testified that the existence of the SOGRAT patent prevented taxpayers from using a government authorized estate and gift tax reduction technique when attempting to plan their financial affairs.¹⁵

Mr. Belcher alluded to the high cost of defending a patent infringement lawsuit or alternatively instigating a suit to declare a patent invalid.¹⁶ Cost factors are a matter of significant consideration throughout the legal system, and this is especially true regarding patent litigation.¹⁷ While some patent infringement suits have cost the parties involved millions of dollars in litigation expenses and remedies, those figures are atypical in relation to the average patent granted. Mr. Belcher failed to mention the high costs of bringing an action for infringement, something patent holders must constantly evaluate in determining the degree to which they are willing to police their intellectual property.¹⁸ Many individuals receive implicit satisfaction from the government's recognition of their invention as evidenced by their patent, and most patented subject matter does not end up as part of market transactions.¹⁹

All patents raise the costs associated with the patented subject matter because the patent holder obtains certain exclusive rights that others must pay for in order to use the patented subject matter.²⁰ These

14. *Issues Relating to the Patenting of Tax Advice Before the Subcomm. On Select Revenue Measures of the House Comm. On Ways and Means*, 109th Cong. (2006) (statement of Dennis I. Belcher, Partner, McGuire Woods LLP).

15. *Id.* See also George G. Jones & Mark A. Luscombe, *Patenting Tax Strategies: A Troubling Storm Develops*, ACCOUNTING TODAY (Aug. 21, 2006), <http://www.webcpa.com/article.cfm?articleid=21538>.

16. *Issues Relating to the Patenting of Tax Advice Before the Subcomm. On Select Revenue Measures of the House Comm. On Ways and Means*, 109th Cong. (2006) (statement of Dennis I. Belcher, Partner, McGuire Woods LLP).

17. Michael K. Kirk, Executive Director of the American Intellectual Property Law Association (AIPPLA) testified in 2004, that AIPPLA's annual economic survey indicated that practitioners reported average costs of \$500,000 to \$3,995,000 in patent infringement suits. *Hearing on Issues Relating to Patent Quality Improvement: Post Grant Opposition Before the Subcomm. On Courts, The Internet and Intellectual Property of the House Comm. On Ways and Means*, 108th Cong. (2004), available at <http://www.gpo.gov/fdsys/pkg/CHRG-108hrg94459/html/CHRG-108hrg94459.htm>.

18. *Id.*

19. See Mark A. Lemley & Carl Shapiro, *Probabilistic Patents*, 19 J. ECON. PERSPECTIVES 75 (Spring 2005) (noting that while nearly 200,000 patents are issued by the USPTO annually, most have little or no commercial value, and only 1.5% of patents are ever litigated to trial. Those facts are juxtaposed against the fact that inventors file more than 350,000 patent applications a year with the USPTO and spend over \$5 billion a year on just the process of obtaining patents).

20. 35 U.S.C. § 271(a) (2006) provides "whoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States or imports into the United States any

costs are temporary and are offset to some degree by the fact that patented subject matter must be disclosed to the general public.²¹ Furthermore, the general public is usually unaware of the patent status of the things they use on a daily basis.²² Taxpayers usually seek to secure the best advice possible and are unlikely to be affected by the fact that a tax saving method is touted as patented or not. Goods and services are rarely if ever marketed based on their IP status.²³

Mr. Belcher and others' testimony insisted that the Internal Revenue Service ("IRS") or USPTO curtail the use of tax planning patents or that Congress provide a solution by denying tax patents

patented invention during the term of the patent therefor, infringes the patent." These rights are often characterized as the patent holder's monopoly, which has in turn given rise to debates over the antitrust implications of a patent. A patent does not give one an absolute right to practice the invention, and while the right to exclude others from selling, using, and making the patented res, even that right has limitations. Thus, monopoly is used quite differently in patent law than in the normal legal parlance in which one finds the term monopoly used such as in the area of antitrust law. There, the term connotes a singular entity having a market advantage over all others that disrupts the vital need for competition to the financial disadvantage of consumers. There is no such corollary in the patent use of the term. See Aaron B. Rabinowitz, *When does a Patent Right Become an Antitrust Wrong? Antitrust Liability for Refusals to Deal in Patented Goods*, 11 RICH. J.L. & TECH. 7 (Winter 2005); Andrea Figler Ventura, *Mourning the Consumer Demand Test: Restoring the Proper Analysis to Antitrust Monopoly Leveraging Claims Against Patent Holders*, 36 SW. U. L. REV. 107 (2007).

21. When a patent is issued by the patent office, it is disclosed to the public. Before 1999, a patent application was not disclosed before the patent issued; however, the law was changed in 1999, to require that patent applications generally be disclosed 18 months after filing. See *Publication of Patent Applications*, USPTO.GOV, http://www.uspto.gov/patents/resources/general_info_concerning_patents.jsp#heading-13 (last visited Feb. 23, 2012); see also Donald R. Palladino, *The Publication Bar: How Disclosing an Invention to Others Can Jeopardize Potential Patent Rights*, 37 DUQ. L. REV. 353 (1999).

22. Patented subject matter or those hoping to secure a patent may indicate there is a patent by labeling the subject matter with the words "Patented" or "U.S. Patent" followed by the patent registration number or by the words "patent pending" or "patent applied for." Improper use of the terms can subject the user to a fine for public deception. See *Frequently Asked Questions About Patents*, USPTO. GOV, <http://www.uspto.gov/web/offices/pac/doc/general/faq.htm> (last visited Oct. 24, 2011).

23. Not having a patent does not preclude one from financially benefitting from their invention and securing a patent does not indicate there will be financial success. In fact, most patented items do not make money. The American Inventors Protection Act was signed into law in 1999 (P.L. 106-113) in order to help inventors avoid the multi-million dollar scam network that is rampant throughout the country where con artists prey on the hopes of inventors that their inventions will be profitable. Many of these entities have been shut down in recent years by various efforts of the Federal Trade Commission including their cleverly named "Project Mousetrap." See *FTC/State "Project Mousetrap" snares Invention Promotion Industry*, FED. TRADE COMM'N, <http://www.ftc.gov/opa/1997/07/mouse.shtm> (last visited Oct. 24, 2011).

protection.²⁴ Similar options were presented by other groups such as the National Conference of CPA Practitioners (“NCCPA”) and the American Institute of Certified Public Accountants (“AICPA”).²⁵

The NCCPA identified a potential costly need for tax practitioners to educate themselves about patent law in order to avoid problems such as the prospect of providing advice that resulted in unintended infringement.²⁶ These actions were deemed especially necessary because patent law, unlike some other areas of IP law, makes no exception for “innocent infringement.”²⁷ The NCCPA also recognized that patents are only as strong as the owner’s ability to enforce them but viewed tax patents as being susceptible to sell to well-financed “patent mills.”²⁸ Those entities would supposedly seek nuisance value damages or bogus royalties from thousands of tax practitioners.²⁹ That fear was also unjustified from a tax patent standpoint. The total body of patent law indicates this concern is also unrealistic. Nuisance damages and improperly extorted royalty payments are in fact very rare in patent law.³⁰

24. *Issues Relating to the Patenting of Tax Advice Before the Subcomm. On Select Revenue Measures of the House Comm. On Ways and Means*, 109th Cong. (2006) (statement of Dennis I. Belcher, Partner, McGuire Woods LLP).

25. Walter M. Primoff, *Tax Strategies Patents*, SUMNEWS, Summer II 2007, at 10. Similar options were presented by other groups such as the American Institute of Certified Public Accountants (AICPA). *Id.*

26. *Id.*

27. Even in copyright law where “innocent infringement” is viable, it is not a defense to infringement but instead a mitigating factor limiting the remedial exposure of a defendant when the protected work failed to give notice of its protection. Failure to designate a patented product does not give the infringer any such protection. But recent decisions have made it more difficult for a plaintiff to prove that infringement is willful and thereby worthy of receiving an enhanced award. *See In re Seagate Tech., LLC*, 497 F.3d 1360 (Fed. Cir. 2007).

28. Primoff, *supra* note 25.

29. *Id.*

30. The closest thing to improperly extorted royalties in the patent field arises from patent trolls, submarine patents and patent misuses based on alleged illegal tying arrangements from an antitrust perspective. *See* Daniel J. McFeely, *An Argument for Restricting the Patent Rights of Those Who Misuse the U.S. Patent System to Earn Money Through Litigation*, 40 ARIZ. ST. L.J. 289 (2008); *see also* Blair Silver, *Controlling Patent Trolling with Civil RICO*, 11 YALE J. L. & TECH. 70 (2009).

II. TAX PRACTICE REALITIES

Detractors of tax patents (and often times supporters as well) generally provided arguments that were almost entirely divorced from contemporary or even historical actual practice.³¹

That tax strategies abounded even before the contemporary debate supports a conclusion that the existence of patent protection is neutral, at best, with regard to positive or negative incentives. A couple of contemporary and thoroughly discussed tax reduction strategies highlight these facts. The first involves the use of “blocker corporations” by offshore investment funds to avoid the unrelated business income tax.³² The second involves the “son of boss”

31. Most objections to tax patents are articulated in terms of a broad and vague set of supposed dangers: 1. The fear that tax shelter patents might increase abusive activities; 2. The fear that the patent office is not equipped to evaluate tax strategy patents; 3. The fear that owners of tax strategy patents might misrepresent the patent as a government endorsement of the underlying strategy; 4. The fear that owners of tax strategy patents could charge a fee for use of the patent; and 5. The fear that patents would provide incentives for innovation in a field where such incentives are unnecessary.

Issuing these types of patents raises multiple public policy concerns. Patents issued for aggressive tax strategies, for example, may enable unscrupulous promoters to claim the patent represents an official endorsement of the strategy and evidence that it would withstand IRS challenge. Patents could be issued for blatantly illegal tax shelters, yet remain in place for years, producing revenue for the wrongdoers while the IRS battles the promoters in court. Patents for tax shelters found to be illegal by a court would nevertheless remain in place, creating confusion among users and possibly producing illicit income for the patent holder.

Another set of policy concerns relates to the patenting of more routine tax strategies. If a single tax practitioner is the first to discover an advantage granted by the law and secures a patent for it, that person could then effectively charge a toll for all other taxpayers to use the same strategy, even though as a matter of public policy all persons ought to be able to take advantage of the law to minimize their taxes. Companies could even patent a legal method to minimize their taxes and then refuse to license that patent to their competitors in order to prevent them from lowering their operating costs. Tax patents could be used to hinder productivity and competition rather than foster it.

The primary rationale for granting patents is to encourage innovation, which is normally perceived to be a sufficient public benefit to justify granting a temporary monopoly to the patent holder. In the tax arena, however, there has historically been ample incentive for innovation in the form of the tax savings alone. The last thing we need is a further incentive for aggressive tax shelters. That’s why Section 303 would prohibit the patenting of any “invention designed to minimize, avoid, defer, or otherwise affect the liability for Federal, State, local, or foreign tax.”

153 Cong. Rec. S2206-07 (daily ed. Feb. 17, 2007) (statement of Senator Carl Levin, Introducing the Stop Tax Haven Abuse Act, S. 681, 110th Cong.).

32. The origin and uses of the “blocker corporation” invention were developed by pension funds and other nonprofit organizations to avoid the unrelated business income tax. *See* Priv. Ltr. Rul. 199952086 (Sept. 30, 1999) (describing and approving of the use of an offshore corporation—a blocker corporation—to avoid the unrelated debt financed income tax imposed by I.R.C. § 514). The blocker corporation was actually a target of later tax revision efforts aimed at offsetting the

strategy—generically described as the use of a partnership to manufacture a tax loss deduction without any real economic loss.³³ One may have also included “joint operating agreements”³⁴ and the partnership profit interest strategy³⁵ transactions to further emphasize the point, but it is sufficiently proven by the first two strategies, both of which result in fewer taxes paid by the beneficiaries or, in intellectual property terms, “owners” of the strategies. Both of these strategies were motivated by the desire to avoid taxes, yet they demonstrate opposite responses. Blocker corporations are deemed as advantageous to tax law, while the son of boss strategy is considered harmful to tax law. Both could have been protected by tax patents, yet the taxpayer, industry, and government responses to each would not have been affected. These examples highlight the necessity of evaluating tax strategies on a case-by-case basis. A rule categorically denying tax patents precludes

savings resulting from the scheme. These efforts as part of the Stop Tax Haven Abuse Act needlessly incorporated provisions seeking to ban tax patents. *See infra* note 69 and accompanying text. *See also* Samuel D. Brunson, *Stopping Tax Haven Abuse Without Stopping Tax-Exempt Investment*, available at

http://www.jrcls.org/faculty_conference/2011/Investment%20and%20the%20unrelated%20debt-financed%20income%20rules.pdf (noting that the legislation “would make investment through offshore hedge funds and other offshore blocker corporations impractical for tax-exempt organizations, while not providing for any equivalent investment option.”).

33. The “Son of Boss” strategy, formerly used by taxpayers to generate tax loss deductions without a corresponding economic loss, has since been shut down by administrative and legislative action. *See* IRS Notice 2000-44 (Aug. 11, 2000), available at http://www.irs.gov/pub/irs-utl/notice_2000-44.pdf (stating the IRS’ intent to vigorously challenge the strategy); Treas. Reg. 1.752-7 (2005), available at <http://www.irs.gov/businesses/partnerships/article/0,,id=134691,00.html> (regarding the definition of “liabilities” in a manner that prevents the effectuation of the Son of Boss tax strategy).

34. *See* Darryll K. Jones, *Creating Complex Monsters: Joint Operating Agreements and The Logical Invalidity of Treasury Regulation 1.502-1(b)*, 3 FLA. TAX REV. 563 (1997) (describing the “joint operating agreement” invention as a tool to avoid the unrelated business income tax—although the strategy allowed users to avoid a tax that seemed to otherwise apply to the joint efforts embodied in joint operating agreements, the Service nevertheless approved the invention’s effectiveness. *See* Priv. Ltr. Rul. 97-22-042 (Mar. 3, 1997); Priv. Ltr. Rul. 97-21-031 (Feb. 26, 1997); Priv. Ltr. Rul. 97-16-021 (Jan. 17, 1997); Priv. Ltr. Rul. 97-14-011 (Dec. 24, 1996); Priv. Ltr. Rul. 96-51-047 (Sept. 24, 1996); Priv. Ltr. Rul. 96-23-011 (Feb. 29, 1996); Priv. Ltr. Rul. 96-09-011 (Nov. 22, 1995).

35. *See* Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1 (2008) (describing the use of partnership profit interests to achieve deferral of income and reduction in tax rates applicable to compensation income). The partnership profit interest strategy was initially approved by the Service when it appeared the deleterious effects on tax revenues were considered insignificant. Later, when the effects were thought to be more damaging to the fairness and integrity of the tax code, legislators initiated actions to deprive the strategy of its effectiveness. *See generally* Darryll K. Jones, *The Taxation of Profits Interests and The Reverse Mancur Olson Phenomenon*, 36 CAP. L. REV. 853 (2009).

individual consideration and thus good as well as bad advancements in the law.³⁶

Taxes are mandatory, but the transactions that generate tax liability are not. The tax code is replete with provisions that encourage but do not demand certain transactions and then give certain tax benefits only to those who are successfully encouraged to act. The grant of patent protection would not prevent compliance with a transaction giving rise to tax liability because compliance is never demanded. The due process assertion—that the law punishes noncompliance when the government’s grant of a patent prevents compliance—just does not prove true. In other words, horizontal inequities in tax law or administration are hardly the result of granting patents for tax strategies. That some similarly situated taxpayers pay disparate amounts of taxes is the result of capitalism.

The developers of a patentable tax strategy might make their invention available solely to those able and willing to pay a fee and, as a result, similarly situated taxpayers may face dissimilar tax burdens. Even in the absence of patent protection, though, only those who could afford rather expensive tax advisors would have access to the strategy. Regardless of whether patent protection existed, the strategy would be available solely to those who could afford to navigate the volume and complexity of the tax code.³⁷ This is simply the reflection of the business of law, not a result of patent protection or the lack thereof.

The strategies discussed above are done so in only enough detail to demonstrate the effectiveness of the strategies for tax reduction purposes and allow one to intuitively make the following conclusions:

First, tax patents will not add appreciably to existing incentives to reduce or avoid taxes. The search for tax reduction strategies is, instead, positively correlated with the amount of taxes to be saved and the economic profit from the activity pursued.

Second, even if tax patents add to the body of knowledge devoted exclusively to *illegitimate* tax avoidance that is not necessarily a bad thing. In most instances viewed as abusive, Congress, the IRS, or the

36. Many tax provisions are enacted to encourage or discourage government endorsed consumption or spending and to that extent are entirely optional; indeed, the tax code never demands the undertaking of any given economic transaction. For example, tax benefits for the purchase of electric powered vehicles are designed to encourage favored consumption but there is no mandate involved. See I.R.C. § 179A (2006) (providing for a deduction equal to the costs of “clean fuel burning vehicles”).

37. The blocker corporation solution, like many tax strategies, requires the services of experts trained in the intricate provisions that both make the invention necessary and ensure its effectiveness.

judiciary can and has easily, albeit sometimes belatedly, responded in a fashion that ultimately improved the articulation, efficiency, and fairness of the tax code.

Third, even assuming there really is already too much incentive for tax planning, tax patents can nevertheless only increase social utility. The assumption that encouraging inventive minds increases social utility regardless of subject and even if “bad inventions” sometimes result, is no less applicable to the application of inventive minds to the goal of tax reduction. Taxes are, like any other cost, expenses that reduce gross national product—by reducing the businessperson’s desire or ability, for example, to hire more workers or invest in more physical plants. To the extent tax patents reduce disincentives to business activity—by removing unintended tax barriers, social utility increases—and the need for government extractions decrease.

A final conclusion, necessarily implicit in each of the foregoing conclusions, is that it is incorrect to treat tax reduction strategies, whether subject to patent protection or not, as synonymous with illegitimate tax avoidance. Much of the tax literature does just that.

III. RECENT JUDICIAL AND LEGISLATIVE INFLUENCES

While the SOGRAT patent may have been responsible for the tax patent debate reaching congressional heights, the genesis of the dispute appears tied to the CAFC decision in *State Street Bank*.³⁸ Despite the USPTO’s assertions that protection of business method patents date back to the late 18th century, there was little debate about the propriety of these types of patents until *State Street Bank*.³⁹ In fact, cases had

38. *State St. Bank & Trust Co. v. Signature Fin. Grp.*, 149 F.3d 1368 (Fed. Cir. 1998). In that case, the patent at issue involved a data processing system for financial services. The court found that a machine’s transformation of data representing dollar amounts into share prices via mathematical transactions was patentable. The CAFC expressly stated that business methods were not unpatentable subject matter but instead were subject to the same evaluation as other types of subject matter. The more important question was not whether a business method was involved but instead whether a useful, concrete, and tangible result was reached through the method or process sought to be patented. Some assert that inspiration for the new provision predates *State Street Bank* instead growing out of a bill in the 104th Congress seeking to bar patentability medical procedure methods. See Hayden W. Gregory, *Patents on Tax Preparation Strategies: Is the End in Sight?*, 3 LANDSLIDE 1, March/April 2011. Congress ultimately approved medical procedure patents but eliminated enforcement remedies against infringing medical practitioners or facilities. See Pub. L. No. 104-208, § 616 (Sept. 30, 1996).

39. According to the USPTO, business method patents date back to the late eighteenth (18th) century shortly after the Constitutional Convention. The first financial patent was granted on March 19, 1799, to Jacob Perkins for an invention for “Detecting Counterfeit Notes.” *USPTO White Paper - Automated Business Methods - Section III Class 705*, <http://www.uspto.gov/patents/resources/>

expressly held that business methods were unpatentable long before software and the Internet were ever conceived of.⁴⁰ *State Street Bank* expressly rejected the so-called business methods exception in patent law and the case is routinely referred to as opening the floodgates for business method patents on the Internet.⁴¹

In 2006, the SOGRAT patent holders filed suit against Aetna alleging infringement.⁴² The alleged infringing activity was discovered during the review of the SEC filings generally required when trusts are funded with security instruments. That suit was settled although the terms of the agreement were not released.⁴³

Although the reasons for the ultimate settlement are unknown, many tax experts had ridiculed the existence of the patent; therefore, the plaintiff may have been as motivated to settle as the defendant for fear of the patent's inability to withstand a validity challenge.⁴⁴ If the patent was strong, the plaintiff would certainly want everyone to know of the damages it was able to secure. Perhaps the defendant did not want to

methods/afindpm/class705.jsp (last visited Feb. 23, 2012). See also John M. Carson & Eric M. Nelson, *Legal Victory for Electronic Commerce Companies: State Street Bank & Trust v. Signature Financial Group Signals Fall of Last Barrier to Internet Software Patents*, 21 T. JEFFERSON. L. REV. 193 (1999) (noting that *State Street Bank* was seen as a government affirmation that not only were software patents easily available for protection based on the standards enunciated in that case but also that internet patents were also easily achievable).

40. See, e.g., *Hotel Security Checking Co. v. Lorraine Co.*, 160 F. 467 (2d Cir. 1908). There, the court held that a bookkeeping system to prevent embezzlement by waiters was unpatentable. After the arrival of software and computers the courts were still reluctant to consider the instructions and operability associated with technology as patentable subject matter since in its rawest form it was really numbers at the arrangement of numbers at the core of the disputes. The Court had generally construed mathematical algorithms as abstract ideas, and thus as unpatentable subject matter under § 101 of the patent act. See *Gottschalk v. Benson*, 409 U.S. 63 (1972); *Parker v. Flook*, 437 U.S. 584 (1978). In *Diamond v. Diehr*, 450 U.S. 175, 185 (1981), the Court relaxed this algorithm unpatentability doctrine by concluding that the incorporation of a computer algorithm to improve an industrial process did not automatically make the process unpatentable subject matter. The Court did not overrule the *Benson-Flook* algorithm unpatentability doctrine but nevertheless stated, "an application of a law of nature or mathematical formula to a known structure or process may well be deserving of patent protection." *Id.* at 187.

41. Kevin M. Baird, *Business Method Patents: Chaos at the USPTO or business as Usual?*, 2001 U. ILL. J.L. TECH. & POL'Y 347, 348 (Fall 2001) (noting that as a result of *State Street Bank* and its progeny that by 2001 more than 40,000 business method patents had been issued with thousands more in line leading to ineffective patent searches and bad patents due to the USPTO being ill equipped to handle those types of applications).

42. GREGORY A. STOBBS, *BUSINESS METHOD PATENTS* 13-14 (Aspen Pub. 2002).

43. CAROL CANTRELL, *STOCK OPTIONS: ESTATE, TAX AND FINANCIAL PLANNING* 6-36-6-37 (CCH 2008).

44. Although few patents are litigated, a high number of those challenges are successful. See Lenley, *supra* note 19, at 76 (noting that roughly half of all litigated patents are found to be invalid).

challenge the patent, deciding it was cheaper to settle than litigate.⁴⁵ None of these scenarios are particular to tax patents, inasmuch as they are normal business decisions that must be made regularly due to the intersection of IP law with nearly all commercial concerns.

The Supreme Court of the United States' ("SCOTUS") decision in *KSR International Co. v. Teleflex Inc.* significantly reduced the potential for patent protection by making it easier to find patent claims obvious under the law.⁴⁶ The District Court granted KSR summary judgment, but the CAFC reversed based on the lower court's failure to properly apply the applicable "teaching, suggestion, motivation" test ("TSM").⁴⁷ The SCOTUS reversed, finding that the CAFC approach to obviousness was too narrow and rigid and therefore inconsistent with the dictates of Section 103 of the Patent Act.⁴⁸

While the KSR decision indicated that patents generally would be both harder to obtain and sustain, the SCOTUS sent a very different message with its decision in *In re Bilski*.⁴⁹ On April 10, 1997, Bernard L. Bilski and Rand A. Warsaw ("Bilski") filed a patent application entitled "Energy Risk Management Method."⁵⁰ The parties claimed to have invented a method or process for managing the consumption risk costs involved in certain commodity transactions.⁵¹ The examiner rejected the application under Section 101 of the Patent Act, finding that

45. The owner of the SOGRAT patent had issued at least one license regarding its patent. *See* Cantrell, *supra* note 42.

46. *KSR Int'l Co. v. Teleflex Inc.*, 550 U.S. 398 (2007). Also in 2007, the Court of Appeals for the Federal Circuit (CAFC), the principle court for reviewing patent disputes, issued a significant ruling in *In re Comiskey*, 499 F.3d 1365 (Fed. Cir. 2007). There, the court found that certain types of business systems were unpatentable. Specifically, the claimants application to patent an arbitration method related to certain legal documents was deemed to be a set of mental processes that were abstract ideas and thus unpatentable despite the fact that certain claims expressly required the use of a computer or other means of electronic communication to accomplish the claimed tasks. The court held that processes involving human thinking standing alone were not patentable regardless of the practical application. The original decision in *Comiskey* was later revised in 2009 in an apparent effort to clarify the earlier opinion's efforts to define the line of patentable subject matter where business methods and machines intersected. *See Federal Circuit Revises (Muzzles) Comiskey*, PATENTLYO (Jan. 13, 2009), <http://www.patentlyo.com/patent/2009/01/federal-circu-3.html>.

47. *KSR*, 550 U.S. at 412-13.

48. *Id.* at 415. ("We begin by rejecting the rigid approach of the Court of Appeals. Throughout this Court's engagement with the question of obviousness, our cases have set forth an expansive and flexible approach inconsistent with the way the Court of Appeals applied its TSM test here.")

49. *Bilski v. Kappos*, 130 S. Ct. 3218 (2010).

50. *Ex Parte Bilski & Warsaw*, No. 2002-2257 (B.P.A.I. Mar. 8, 2006).

51. *Bilski*, 130 S. Ct. at 3232.

the claims were directed to nonstatutory subject matter.⁵² The applicants appealed and the USPTO Board of Patent Appeals and Interferences (“BPAI”) affirmed the rejection of all the claims.⁵³ The applicants appealed to the Court of Appeals for the Federal Circuit, which took the unusual step of determining that an en banc panel was necessary to render a proper decision.⁵⁴ The CAFC heard oral arguments and received approximately thirty (30) amicus briefs from interested parties on the general issue of defining patentable subject matter as applied to methods or processes.⁵⁵ The CAFC affirmed the decision of the BPAI concluding that Bilski’s claims were not directed to patent-eligible subject matter.⁵⁶ Bilski then appealed to the SCOTUS.⁵⁷

The SCOTUS unanimously rejected the patent application agreeing that the machine or transformation test was not the sole basis or even necessary for determining if a process described patentable subject matter.⁵⁸ However, the Court rejected the idea that business methods should be categorically excluded.⁵⁹ Four of the Justices took the contrary view, arguing that the intent of the framers of the Constitution and established precedent supported the removal of business methods from patentable subject matter.⁶⁰ The majority stated that modern technologies posed a challenge for patent law to find the optimum balance between protecting inventors and avoiding inappropriate

52. *Id.* at 3233.

53. *Id.* at 3220.

54. *Id.*

55. For an excellent summary of the main points on each brief, see *Ex Parte Bilski: On the Briefs*, PATENTLYO (Apr. 10, 2008), <http://www.patentlyo.com/patent/2008/04/ex-parte-bilski.html>. The briefs and arguments could basically be categorized as those disfavoring a rigid interpretation of Section 101 as opposed to those favoring the recognition of Section 101 as a threshold and setting forth some type of test language to that end. Amongst the amicus filers was the American Institute of Certified Public Accountants (“AICPA”), whose brief specifically argued against the validity of tax patents.

56. *In re Bilski*, 545 F.3d 943 (Fed. Cir. 2008). The B.P.A.I. decision thoroughly reviewed the judicial precedent interpreting Section 101 in its effort to answer the question of what test(s) should be applied in determining statutory subject matter. The BPAI decision noted that the claims in question were so broad that they amounted to an abstract idea ineligible for patent protection. The BPAI noted that the claims failed to involve patent-eligible transformation and that the process as claimed failed to produce the requisite “useful, concrete and tangible result”.

57. *Bilski*, 130 S. Ct. at 3218.

58. *Id.*

59. *Id.* at 3221.

60. *Id.* at 3232 (Justice Stevens concurring in the Court’s holding, joined by Justices Ginsburg, Breyer and Sotomayor, but stating that “although a process is not patent-ineligible simply because it is useful for conducting business, a claim that merely describes a method of doing business does not qualify as a “process” under §101 of the Patent Act”).

monopolies but that “Nothing in this opinion should be read to take a position on where that balance should be struck.”⁶¹

Several recent decisions have wrestled with the implications of *Bilski* as far as the SCOTUS’ unwillingness or inability to provide a test for determining when a business method patent is patentable or not.⁶² In *Ultramercial v. Hulu*, the CAFC found that a patent covering a method and system for payment of intellectual property royalties was not too abstract to be considered patentable subject matter.⁶³ In *Classen Immunotherapies v. Biogen IDEC*,⁶⁴ the CAFC determined that methods for evaluating and improving safety immunization schedules were also acceptable subject matter for a patent application; however, the SCOTUS vacated the judgment and remanded for further consideration in light of *Bilski*.⁶⁵ Yet in *Cybersource Corp. v. Retail Decisions, Inc.*, the court found an application for a patent comparing data such as IP information and email addresses to detect fraud in credit card transactions did not contain patentable subject matter but instead was too abstract although, as in the other cases, computers played some role in the claims of the inventions.⁶⁶

These cases reflect the current whimsical state of the law in regards to business methods and the systems they seek to cover regardless of whether a computer or other machinery is employed. The degree of uncertainty cuts across all commercial boundaries when it comes to patents in the financial realm. The situation makes it even more ironic that tax patents, a minor subsection of the patentable subject matter section identified by the USPTO as Class 705, “Data Processing: Financial, Business Practice, Management, or Cost/Price Determination” should be singled out for special negative treatment.⁶⁷

61. *Id.* at 3228.

62. See Julie Samuels, *A Trio of Post-Bilski Cases Fail to Clearly Define the Meaning of “Abstract”*, ELEC. FRONTIER FOUND. (Sept. 20, 2011), <https://www.eff.org/deeplinks/2011/09/trio-post-bilski-cases-fail-clearly-define>.

63. *Id.*

64. *Classen Immunotherapies, Inc. v. Biogen IDEC*, 304 Fed. App’x 866 (Fed. Cir. 2008), cert. granted, judgment vacated, *Classen Immunotherapies, Inc. v. Biogen IDEC*, 130 S. Ct. 3541 (2010).

65. *Classen Immunotherapies, Inc. v. Biogen IDEC*, 130 S. Ct. 3541 (2010).

66. *CyberSource Corp. v. Retail Decisions, Inc.*, 654 F.3d 1366 (Fed. Cir. 2011).

67. See, for example, an exemplary list of patents and pending applications in Class 705/36T, *US Patent Classification 705/36T*, http://www.uspto.gov/patents/resources/classification/numeric/class705_sub36t.jsp (last visited Feb. 23, 2012).

It appears that as a result of Congressional hearings in 2004⁶⁸ on bridging the tax gap, at which the Commissioner of Patents testified, and follow up hearings in 2006,⁶⁹ that tax patents suddenly were designated as some type of dangerous threat to be gotten rid of by any legislative means necessary. The targeting of tax patents occurred despite the fact that a very small number had ever been issued and of those many had been in existence for years.⁷⁰ Perhaps it was the effort of a few of the patent holders to enforce their patents that aroused more suspicion than respect, but regardless of the impetus, tax patents were lumped in with the evils of off shore tax havens and their impending doom, at least on their face, was set in motion.

The Stop Tax Haven Abuse Act (“STHAA”) was introduced in 2007, following an investigation into alleged abusive offshore tax shelters that purportedly cost the U.S. Treasury an average of forty to

68. See *Bridging the Tax Gap Before the S. Comm. on Finance*, 108th Cong. 10 (2004) (statement of Nick Godici, Commissioner of Patents).

The Commissioner’s testimony broadly addressed business method patents as potential contributors to the country’s tax gap but avoided singling out tax patents as a particularly dangerous subclass and simply pledged that the Patent Office would monitor the situation as far as the concerns raised by the other speakers that day. The other witnesses providing testimony were primarily members of the tax community.

69. *Issues Relating to the Patenting of Tax Advice Before the Subcomm. On Select Revenue Measures of the House Comm. On Ways and Means*, 109th Cong. (2006), available at <http://waysandmeans.house.gov/media/transcript/10219.html>.

70. For example, Patent No. 6,058,376, Process for Evaluating the Financial Consequences of Converting a Standard Form I.R.A. to a Roth Form I.R.A., issued May 2, 2000, available at <http://patft.uspto.gov/netacgi/nph-Parser?Sect1=PTO1&Sect2=HITOFF&d=PALL&p=1&u=%2Fmetahtml%2FPTO%2Fsrchnum.htm&r=1&f=G&l=50&s1=6058376.PN.&OS=PN/6058376&RS=PN/6058376>, cites as references several other finance related patents dating back to 1987. The invention claims a computer-implemented process for evaluating the financial consequences of converting a standard format IRA to a new Roth form IRA. The process includes computing and disclosing the substantial federal income tax consequences involved in converting the standard form IRA to the Roth form. It further includes multiple options how a given IRA holder can cope with the substantial tax consequences, including without limitation how he or she will fare if he or she obtains term insurance on the federal tax liability of early withdrawal by reason of premature death, or if he or she deducts the federal taxes and insurance premium from the rollover amount, or, in the alternative, how he or she will fare by financing the federal tax consequences and insurance premium in order to preserve intact the entire IRA amount for rollover. See also Michael Bowman, *U.S. Patent Reform in 2011—Implications for the Insurance & Financial Industries*, CORONADO GROUP, LTD., http://www.coronadogroup.com/images/Patent_Reform_2011_Business_Methods.pdf (noting that as of March 11, 2011, the USPTO had issued 136 tax strategy patents and published 161 patent [class 705] applications and that of the 136 patents issued only 32 indicate that a tax strategy is their most comprehensive claim. Of the 32, half deal chiefly with software. Also, 16 of the 136 are considered by the USPTO to be mainly insurance patents).

seventy billion dollars annually from individual tax evasion.⁷¹ The Senate version of the legislation was sponsored by Senators Norm Coleman and Carl Levin in addition to then Senator and now President Barack Obama.⁷² The primary aim of the legislation was to combat the secrecy and increase the transparency of transactions that involved offshore financial operations.⁷³ One of the many provisions for the proposed legislation was formerly titled “Prohibition on Tax Shelter Patents” and later “Tax Planning Inventions Not Patentable.”⁷⁴ The Section proposed to amend § 101 of the Patent Act by adding provisions dealing specifically with the unpatentability of tax planning devices.⁷⁵

71. See *infra* notes 79, 83 and accompanying text. See also Maria Tihin, *The Trouble with Tax Havens: The Need for New Legislation in Combating the Use of Offshore Trusts in Abusive Tax Shelters*, 41 COLUM. J.L. & SOC. PROBS. 417 (2008).

72. *Id.*

73. *Id.*

74.

Issuing these types of patents raises multiple public policy concerns. Patents issued for aggressive tax strategies, for example, may enable unscrupulous promoters to claim the patent represents an official endorsement of the strategy and evidence that it would withstand IRS challenge. Patents could be issued for blatantly illegal tax shelters, yet remain in place for years, producing revenue for the wrongdoers while the IRS battles the promoters in court. Patents for tax shelters found to be illegal by a court would nevertheless remain in place, creating confusion among users and possibly producing illicit income for the patent holder. Another set of policy concerns relates to the patenting of more routine tax strategies. If a single tax practitioner is the first to discover an advantage granted by the law and secures a patent for it, that person could then effectively charge a toll for all other taxpayers to use the same strategy, even though as a matter of public policy all persons ought to be able to take advantage of the law to minimize their taxes. Companies could even patent a legal method to minimize their taxes and then refuse to license that patent to their competitors in order to prevent them from lowering their operating costs. Tax patents could be used to hinder productivity and competition rather than foster it. The primary rationale for granting patents is to encourage innovation, which is normally perceived to be a sufficient public benefit to justify granting a temporary monopoly to the patent holder. In the tax arena, however, there has historically been ample incentive for innovation in the form of the tax savings alone. The last thing we need is a further incentive for aggressive tax shelters. That’s why Section 303 would prohibit the patenting of any “invention designed to minimize, avoid, defer, or otherwise affect the liability for Federal, State, local, or foreign tax.”

153 Cong. Rec. S2206-07 (daily ed. Feb. 17, 2007) (statement of Senator Carl Levin, Introducing the Stop Tax Haven Abuse Act, S. 681, 110th Cong.).

75. SEC. 303. TAX PLANNING INVENTIONS NOT PATENTABLE.

(a) In General- Section 101 of title 35, United States Code, is amended

(1) by striking ‘Whoever’ and inserting ‘(a) Patentable Inventions- Whoever’, and

(2) by adding at the end the following:

‘(b) Tax Planning Inventions-

‘(1) UNPATENTABLE SUBJECT MATTER- A patent may not be obtained for a tax planning invention.

‘(2) DEFINITIONS- For purposes of paragraph (1)--

‘(A) the term ‘tax planning invention’ means a plan, strategy, technique,

Senator Levin's comments regarding the section indicated that it was not addressed solely to offshore tax shelters but instead was a part of the wide-ranging effort to prohibit all patents that involved tax saving processes.⁷⁶ It is possible that intense lobbying caused the Senator and others to cast such a wide net, but tax patents were certainly not the focus of the bill.⁷⁷ Indeed, commentary on the Act by various organizations neglected to mention the section dealing with the unpatentability of tax planning inventions altogether.⁷⁸ The original STHAA failed to pass as have other versions since that time and while a

scheme, process, or system that is designed to reduce, minimize, determine, avoid, or defer, or has, when implemented, the effect of reducing, minimizing, determining, avoiding, or deferring, a taxpayer's tax liability or is designed to facilitate compliance with tax laws, but does not include tax preparation software and other tools or systems used solely to 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),

(C) the terms 'tax', 'tax laws', 'tax liability', and 'taxation' refer to any Federal, State, county, city, municipality, foreign, or other governmental levy, assessment, or imposition, whether measured by income, value, or otherwise, and

(D) the term 'State' means each of the several States, the District of Columbia, and any commonwealth, territory, or possession of the United States.'

(b) Applicability- The amendments made by this section--

(1) shall take effect on the date of the enactment of this Act,

(2) shall apply to any application for patent or application for a reissue patent that is-

(A) filed on or after the date of the enactment of this Act, or

(B) filed before that date if a patent or reissue patent has not been issued pursuant to the application as of that date, and

(3) shall not be construed as validating any patent issued before the date of the enactment of this Act for an invention described in section 101(b) of title 35, United States Code, as added by this section.

S. 506, 111th Cong. § 303 (2009).

76. Senator Levin specifically mentioned that it was necessary that all such patents be banned in order to address a wide range of policy concerns. 153 Cong. Rec. S2206-07 (daily ed. Feb. 17, 2007) (statement of Senator Carl Levin, Introducing the Stop Tax Haven Abuse Act, S. 681, 110th Cong.). These concerns put many in the mindset of the chicken and egg conundrum since the most prominent points made mimicked much of the testimony presented during the hearings surrounding the SOGRAT patent. *Id.* Specifically, Senator Levin noted (improperly) that patents could be issued for "blatantly illegal tax shelters" and that even if patent shelters were found to be illegal by a court they would remain in place under patent law continuing to wrongfully benefit those unaware of the court decision. *Id.*

77. See, e.g., *Tax Strategy Patents: Looking Back*, CPA CAFE (Sept. 16, 2011), <http://cpacafe.blogspot.com/2011/09/tax-strategy-patents-looking-back.html> (wherein the Virginia CPA Association heralds Section 14 of the AIA eliminating tax patents as the triumph of five years of legislative activity) (last visited Feb. 23, 2012).

78. See, e.g., *Citizens for Tax Justice, The Stop Tax Haven Abuse Act; Bill Targets Tax Havens and Tax Dodging*, CTJ CITIZENS FOR TAX JUSTICE (July 25, 2011), <http://www.ctj.org/pdf/stopact.pdf> (where despite a summarization of the bill and an extraction of bill highlights, no mention is made of Section 303 of the proposed legislation).

version of the bill is still pending Section 303 of the bill making tax patent strategies unpatentable has been eliminated.⁷⁹

The Leahy-Smith America Invents Act of 2011 (“AIA”) became law on September 16, 2011.⁸⁰ The law, touted as the most comprehensive overhaul to the nation’s patent system since the 19th century, has many significant sections that change much of the way patent law is practiced in this country.⁸¹ Amongst the many provisions in the Act is Section 14, which deals with tax strategies in light of obviousness and the prior art.⁸²

Section 14 of the AIA is generally construed as eliminating the prospect of patents being issued for tax strategies.⁸³ It was drafted to prevent alleged profiteering by innovative tax dodgers and declares

79. A version of the STHAA was still in session as of the summer of 2011, however, the latest version has deleted the original Section 303. See H.R. 2669, 112th Cong. (2011), available at <http://www.govtrack.us/congress/billtext.xpd?bill=h112-2669>. See also Edward Tanenbaum, *The Annual Stop Tax Haven Abuse Act Show*, BLOOMBERG BNA (Sept. 12, 2011), <http://www.bna.com/annual-stop-tax-n12884903413/>. *Tax Strategy Patent Legislation in Prior Congressional Sessions*, AICPA (Apr. 4, 2011), <http://www.aicpa.org/interestareas/tax/resources/taxpatents/pages/legislationinpriorcongresses.aspx>.

80. Leahy-Smith America Invents Act (AIA), Pub. L. No. 112-29, 125 Stat. 284 (2011); see also *President Obama Signs America Invents Act, Overhauling the Patent System to Stimulate Economic Growth, and Announces New Steps to Help Entrepreneurs Create Jobs*, OFFICE OF THE PRESS SEC’Y, THE WHITE HOUSE, (Sept. 16, 2011), <http://www.whitehouse.gov/the-press-office/2011/09/16/president-obama-signs-america-invents-act-overhauling-patent-system-stim>.

81. *Id.* See also *Leahy-Smith America Invents Act Implementation*, USPTO.GOV, http://www.uspto.gov/aia_implementation/index.jsp (last visited Feb. 23, 2012).

82. Specifically Section 14:

SEC. 14. TAX STRATEGIES DEEMED WITHIN THE PRIOR ART.

(a) IN GENERAL.—For purposes of evaluating an invention under section 102 or 103 of title 35, United States Code, any strategy for reducing, avoiding, or deferring tax liability, whether known or unknown at the time of the invention or application for patent, shall be deemed insufficient to differentiate a claimed invention from the prior art.

(b) DEFINITION.—For purposes of this section, the term “tax liability” refers to any liability for a tax under any Federal, State, or local law, or the law of any foreign jurisdiction, including any statute, rule, regulation, or ordinance that levies, imposes, or assesses such tax liability.

(c) EXCLUSIONS.—This section does not apply to that part of an invention that—

(1) is a method, apparatus, technology, computer program product, or system, that is used solely for preparing a tax or information return or other tax filing, including one that records, transmits, transfers, or organizes data related to such filing; or

(2) is a method, apparatus, technology, computer program product, or system used solely for financial management, to the extent that it is severable from any tax strategy or does not limit the use of any tax strategy by any taxpayer or tax advisor.

(d) RULE OF CONSTRUCTION.—Nothing in this section shall be construed to imply that other business methods are patentable or that other business method patents are valid.

(e) EFFECTIVE DATE; APPLICABILITY.—This section shall take effect on the date of the enactment of this Act and shall apply to any patent application that is pending on, or filed on or after, that date, and to any patent that is issued on or after that date.

Leahy-Smith America Invents Act, Pub. L. No. 112-29, sec. 14, 125 Stat. 284, 327-28 (2011).

certain types of tax strategies to now be part of the prior art.⁸⁴ The section appears to be a facially weak response that addresses a questionable past “problem” while deflecting attention from the much bigger issue of business methods patents of which tax strategies are a minor subpart.⁸⁵

Although much of the concern voiced before the section was finalized centered on individuals, the real culprit underlying much of the debate was the potential for corporate tax abuse. Section 14 is a softer version of comparable sections (Section 303) of the STHAA. Instead of addressing Section 101 patentable subject matter, Section 14 speaks to the evaluation of tax patents in light of the novelty and obviousness provisions of Sections 102 and 103 of the Patent Act.⁸⁶ Thus, taking a cue from the SCOTUS, patents related to taxes may be Section 101 patentable subject matter because *Bilski* failed to delineate any boundaries for the same as related to business methods. Instead, because *Teleflex* made it more difficult for claims eligible subject matter in light of a broader approach to obviousness, Section 14 unceremoniously makes tax strategy subject matter obvious. There is a caveat, however, if the tax strategy subject matter is linked in a proper way to computers, but unfortunately no guidance on just what type of software interactivity is necessary. Thus, one is presently only able to let “Turbo Tax” be the guide.⁸⁷

Section 14 does not apply to patents covering preparation of tax returns or financial management systems nor does it apply to methods or apparatus involving computers that assist in achieving either of those functions.⁸⁸ It also expressly states that it shall not be construed as passing on the validity of business method patents in general.⁸⁹ Some

84. *Id.*

85. Section 14 also implies that a weakness existed in the functioning of the first inventor defense. The First Inventor Defense Act of 1999 provided that one who independently reduced the patented method to practice and then commercially used that method at least one year prior to effective filing date of the patented method had a defense for conduct that would otherwise be deemed infringement. The relatively new defense was established in direct response to confirmation of business methods as patentable subject matter in the *State Street Bank* case. See First Inventor Defense Act, Pub. L. No. 106-113, 113 Stat. 1536 (1999), *codified at* 35 U.S.C. § 273(b).

86. Sec. 14, 125 Stat. at 327-28.

87. See U.S. Patent No. 6,697,787 (filed Feb. 6, 2001), System For Collecting Tax Data (describing the invention as “an electronic intermediary electronically connects with a tax data provider and collects electronically tax data from the tax data provider. The electronic intermediary processes the tax data collected electronically, and prepares an electronic tax return using the processed tax data.”).

88. Sec. 14(c), 125 Stat. at 327-28.

89. Sec. 14(d), 125 Stat. at 328.

have already attacked the language as being too broad or too narrow to achieve its purported goal. Too narrow because patentability may possibly still be achieved by a combination of the strategy with a device or software that achieves the desired outcome in some new manner. And too broad because the statute may be read to encompass business methods or technical inventions that may act to reduce tax liability although that is an unintended consequence of their actual purpose.⁹⁰

The legislative history of the bill recounted many of the early concerns from past congressional hearings, proposed legislation, and general alarmists.⁹¹

The legislation probably will forever retard if not effectively kill the seedlings of what was being foreseen as a prospective cottage industry. While relatively few tax strategy patents had issued over the years there was an undeniable recent spike, which did portend of good tidings for the finances of patent lawyers who would be employed to draft, examine, prosecute, license, and litigate tax strategy matters.⁹² Contrarily, some tax practitioners saw the potential growth as undesired costs tied in to education, investigation, and unwarranted adjudication over the myriad of concerns that threatened to further ensnare the already complex area of tax planning.

90. See Mark A. Lemley, *Things You Should Care About in the New Patent Statute*, Stanford Public Law Working Paper No. 1929044, Sept. 16, 2011.

91. H.R. REP. NO. 112-098, pt. 1, at 51-52 (2011).

Tax preparers, lawyers, and planners have a long history of sharing their knowledge regarding how to file returns, plan estates, and advise clients. The ability to interpret the tax law and implement such interpretations should remain in the public domain, available to all taxpayers and their advisors. The Act mandates that tax strategies are deemed “insufficient to differentiate a claimed invention from the prior art.” In other words, any future tax strategy will be considered indistinguishable from all other publicly available information that is relevant to a patent's claim of originality. Under the Act, however, protection (an exclusion) is made available for software that enables individuals to file their income tax returns or that assists them with managing their finances. The exclusion does not apply to that part of the software related to a tax strategy.

Id.

92. Bowman, *supra* note 68 (noting that as of March 11, 2011, the USPTO had issued 136 tax strategy patents and published 161 patent [class 705] applications and that of the 136 patents issued only 32 indicate that a tax strategy is their most comprehensive claim. Of the 32, half deal chiefly with software. Also 16 of the 136 are considered by the USPTO to be mainly insurance patents).

Prior to Section 14's implementation, the USPTO had issued 136 tax strategy patents and published 161 tax related patent applications. Less than a quarter of the 136 (32) issued with a primary 705/36T classification. The number 705 is the business methods class, and 36T is the particular subset designated for tax strategy matters. Of the 32, half dealt mainly with software, and 16 of the 136 were considered as insurance related patents that also contained a tax strategy element.

While the ban on patenting tax strategies is easily measurable in simplistic, immediate terms, i.e. no applications will any longer expressly identify tax-planning strategy as the primary claimed invention, deeper questions remain. One wonders whether a net negative effect will arise from the chill on innovation in an area that was just beginning to brim with creativity.⁹³

Though the immediate devaluation of existing tax strategy patents is harmful, various avenues remain for the continued origination and proliferation of tax strategy subject matter as long as it is claimed in a different manner. Only time will tell whether the current legislation will be enough to appease those who identified tax strategy patents as strange low hanging fruit that required immediate obliteration. Surely, those testifying for the elimination of tax strategy patents were more concerned with certain kinds of tax strategies than getting rid of the category as a whole. Automation and technology are an integral part of the finance industry thus inventions with tax implications which have previously been acceptable will continue to arise in the future, despite the uncertainty that recent case law casts over their protectability.

Inventive minds may just reroute their activities to include computers to carry out the strategies that were previously offered without the necessity of a software accomplice for purposes of patenting. Of course, this approach does not guarantee success as *Bilski* and its progeny aptly illustrate.⁹⁴ Some may also decide to rely on the longer, but limited, protection of copyright to a greater extent.⁹⁵ Trade secret protection is also available for these strategies and it costs nothing at all.⁹⁶

93. Bowman, *supra* note 68.

94. Samuels, *supra* note 61 and accompanying text.

95. Copyright law has long been preferred as the protection for software because the costs involved in procuring it is a minor fraction of the costs associated with patents. Software also has a relatively short lifespan, thus, writers of protectable software risk losing out on potential commercial exploitation by seeking patent protection which typically takes a couple of years to secure as opposed to copyright which may be secured in as little as a couple of months. Once granted, copyrights last for the life of the author plus seventy years as opposed to the comparatively pedestrian term of twenty years available for Patent protection. See Pamela Samuelson, *Frontiers of Intellectual Property: Why Copyright Law Excludes Systems and Processes from the Scope of Its Protection*, 85 TEX. L. REV. 1921, 1924 (2007) (tracing the history of copyright protection as it relates to systems and eventually software).

96. See J. Jonas Anderson, *Secret Inventions*, 26 BERKLEY TECH. L.J. 917, 978 (Spring 2011) (comparing patent protection with the mutually exclusive availability of trade secret protection and noting the many underappreciated benefits of the latter). See also Joshua I. Miller, *Unknown Futures and the Known Past: What Can Patent Learn From copyright in the New technological age?*, 21 ALB. L.J. SCI. & TECH. 1, 9 (2011) (noting the ability of Copyright law to more flexibly

Perhaps, the area will be revisited and positive experiential data used to support a limited allowance of openly identified tax strategy patents without the need to intertwine computer assistance as was done to some extent with medical procedures in the past.⁹⁷ Of course, ingenuity may prove that no further actions need be implemented as tax strategists take advantage of the poorly drafted, loose language of Section 14 to accomplish the very protections that the statute purports to limit.

respond to changes in technology in a manner more certain patent law as reflected by the *In re Bilski* decision).

97. The American Medical Association lobbied in support of the Medical Procedures Innovation and Affordability Act which prevented patents from issuing on surgical and medical procedures, therapies, diagnosis unless done so through the accompaniment of a patentable machine, manufacture, or composition of matter. See Silvy A. Miller, *Should Patenting of Surgical Procedures and Other Medical Techniques By Physicians Be Banned?*, 36 IDEA 255 (1996). Patent law ultimately amended to provide for exceptions for infringement liability in medical situations as opposed to banning all medical patents as unpatentable subject matter or declaring them obvious. See also Fei Hu & Aaron Mallin, *Medical Method Patents: Treating "the Physicians' Immunity Statute"*, 23 SYRACUSE SCI. & TECH. L. REP. 63, 64 (2010) (noting that patents on medical processes date back to 1952 but that as a result of patent enforcement activities the Medical Procedures Act was established, which led to the elimination of certain medical methods patents and limited the liability of medical practitioners for the infringement of valid medical patents).